

CHAPTER 1

GLOBAL OUTLOOK

After growing 3.1 percent last year, the global economy is set to slow substantially in 2023, to 2.1 percent, amid continued monetary policy tightening to rein in high inflation, before a tepid recovery in 2024, to 2.4 percent. Tight global financial conditions and subdued external demand are expected to weigh on growth across emerging market and developing economies (EMDEs). Projections for many countries have been revised down over the forecast horizon, with upgrades primarily due to stronger-than-expected data at the beginning of 2023 more than offset by downgrades thereafter. Inflation has been persistent but is projected to decline gradually as demand weakens and commodity prices moderate, provided longer-term inflation expectations remain anchored. Global growth could be weaker than anticipated in the event of more widespread banking sector stress or if more persistent inflation pressures prompt tighter-than-expected monetary policy. Weak growth prospects and heightened risks in the near term compound a long-term slowdown in potential growth, which has been exacerbated by the overlapping shocks of the pandemic, the Russian Federation's invasion of Ukraine, and the sharp tightening of global financial conditions. This difficult context highlights a multitude of policy challenges. Recent bank failures call for a renewed focus on global financial regulatory reform. Global cooperation is also necessary to accelerate the clean energy transition, mitigate climate change, and provide debt relief for the rising number of countries experiencing debt distress. At the national level, it is imperative to implement credible policies to contain inflation and ensure macroeconomic and financial stability, as well as undertake reforms to set the foundations for a robust, sustainable, and inclusive development path.

Summary

The global economy remains in a precarious state amid the protracted effects of the overlapping negative shocks of the pandemic, the Russian Federation's invasion of Ukraine, and the sharp tightening of monetary policy to contain high inflation. The resilience that global economic activity exhibited earlier this year is expected to fade. Growth in several major economies was stronger than envisaged at the beginning of the year, with faster-than-expected economic reopening in China and resilient consumption in the United States. Nonetheless, for 2023 as a whole, global activity is projected to slow, with a pronounced deceleration in advanced economies and a sizable pickup in China (figure 1.1.A). Inflation pressures persist, and the drag on growth from the ongoing monetary tightening to restore price stability is expected to peak in 2023 in many major economies. Recent banking sector stress will further tighten credit conditions. This will result in a substantial growth deceleration in the second half of this year. This slowdown will compound a period of already-subdued growth—over the first half of the 2020s (2020-2024), growth in EMDEs

is expected to average just 3.4 percent, one of the weakest half-decades of the past 30 years (figure 1.1.B). This slowdown reflects both cyclical dynamics and the current trend of declining global potential output growth (figure 1.1.C).

Global financial conditions have tightened as a result of policy rate hikes and, to a lesser extent, recent bouts of financial instability. Many banks experienced substantial unrealized losses due to the sharp rise in policy interest rates. Concerns about the viability of balance sheets of some banks led to depositor flight and market volatility in the United States and Europe earlier in the year, which were stemmed by a swift and extensive policy response. Financial markets remain highly sensitive to evolving expectations about the future path of interest rates of major central banks. Spillovers from banking turmoil in advanced economies to EMDEs have so far been limited. However, countries with more pronounced macroeconomic policy vulnerabilities, as reflected by lower credit ratings, have experienced slower growth and greater financial stress, including large currency depreciations and a sharp widening of sovereign spreads. Projections for 2023 growth in these economies have fallen by more than half over the past year (figure 1.1.D).

Inflation pressures persist. Although global headline inflation has been decelerating as a result of base effects, abating supply chain pressures, and

Note: This chapter was prepared by Carlos Arteta, Phil Kenworthy, Patrick Kirby, Nikita Perevalov, Dominik Peschel, and Garima Vasishtha, with contributions from John Baffes, Samuel Hill, Osamu Inami, Sergiy Kasyanenko, Jeetendra Khadan, and Naotaka Sugawara.

TABLE 1.1 Real GDP¹

(Percent change from previous year unless indicated otherwise)

							Percentage point differences from January 2023 projections	
	2020	2021	2022e	2023f	2024f	2025f	2023f	2024f
World	-3.1	6.0	3.1	2.1	2.4	3.0	0.4	-0.3
Advanced economies	-4.3	5.4	2.6	0.7	1.2	2.2	0.2	-0.4
United States	-2.8	5.9	2.1	1.1	0.8	2.3	0.6	-0.8
Euro area	-6.1	5.4	3.5	0.4	1.3	2.3	0.4	-0.3
Japan	-4.3	2.2	1.0	0.8	0.7	0.6	-0.2	0.0
Emerging market and developing economies	-1.5	6.9	3.7	4.0	3.9	4.0	0.6	-0.2
East Asia and Pacific	1.2	7.5	3.5	5.5	4.6	4.5	1.2	-0.3
China	2.2	8.4	3.0	5.6	4.6	4.4	1.3	-0.4
Indonesia	-2.1	3.7	5.3	4.9	4.9	5.0	0.1	0.0
Thailand	-6.1	1.5	2.6	3.9	3.6	3.4	0.3	-0.1
Europe and Central Asia	-1.7	7.1	1.2	1.4	2.7	2.7	1.3	-0.1
Russian Federation	-2.7	5.6	-2.1	-0.2	1.2	0.8	3.1	-0.4
Türkiye	1.9	11.4	5.6	3.2	4.3	4.1	0.5	0.3
Poland	-2.0	6.9	5.1	0.7	2.6	3.2	0.0	0.4
Latin America and the Caribbean	-6.2	6.9	3.7	1.5	2.0	2.6	0.2	-0.4
Brazil	-3.3	5.0	2.9	1.2	1.4	2.4	0.4	-0.6
Mexico	-8.0	4.7	3.0	2.5	1.9	2.0	1.6	-0.4
Argentina	-9.9	10.4	5.2	-2.0	2.3	2.0	-4.0	0.3
Middle East and North Africa	-3.8	3.8	5.9	2.2	3.3	3.0	-1.3	0.6
Saudi Arabia	-4.3	3.9	8.7	2.2	3.3	2.5	-1.5	1.0
Iran, Islamic Rep. ²	1.9	4.7	2.9	2.2	2.0	1.9	0.0	0.1
Egypt, Arab Rep. ²	3.6	3.3	6.6	4.0	4.0	4.7	-0.5	-0.8
South Asia	-4.1	8.3	6.0	5.9	5.1	6.4	0.4	-0.7
India ²	-5.8	9.1	7.2	6.3	6.4	6.5	-0.3	0.3
Pakistan ²	-0.9	5.8	6.1	0.4	2.0	3.0	-1.6	-1.2
Bangladesh ²	3.4	6.9	7.1	5.2	6.2	6.4	0.0	0.0
Sub-Saharan Africa	-2.0	4.4	3.7	3.2	3.9	4.0	-0.4	0.0
Nigeria	-1.8	3.6	3.3	2.8	3.0	3.1	-0.1	0.1
South Africa	-6.3	4.9	2.0	0.3	1.5	1.6	-1.1	-0.3
Angola	-5.6	1.1	3.5	2.6	3.3	3.1	-0.2	0.4
Memorandum items:								
Real GDP¹								
High-income countries	-4.3	5.4	2.8	0.8	1.3	2.3	0.2	-0.3
Middle-income countries	-1.2	7.1	3.4	4.2	4.0	4.1	0.8	-0.3
Low-income countries	1.4	4.2	4.8	5.1	5.9	5.9	0.1	0.3
EMDEs excluding China	-3.8	5.9	4.1	2.9	3.4	3.8	0.2	-0.2
Commodity-exporting EMDEs	-3.7	5.1	3.2	1.9	2.8	2.9	0.0	0.0
Commodity-importing EMDEs	-0.3	7.9	3.9	5.0	4.4	4.5	0.9	-0.4
Commodity-importing EMDEs excluding China	-4.0	7.0	5.3	4.2	4.2	4.8	0.4	-0.3
EM7	-0.4	7.7	3.3	4.7	4.1	4.2	1.2	-0.4
World (PPP weights) ³	-2.8	6.3	3.3	2.7	2.9	3.4	0.5	-0.3
World trade volume⁴	-7.8	11.0	6.0	1.7	2.8	3.0	0.1	-0.6
Commodity prices⁵							Level differences from January 2023 projections	
WBG commodity price index	63.1	101.0	143.3	110.1	109.2	110.5	-14.9	-7.3
Energy index	52.7	95.4	152.6	108.9	109.1	111.0	-21.6	-9.2
Oil (US\$ per barrel)	42.3	70.4	99.8	80.0	82.0	84.4	-8.0	2.0
Non-energy index	84.1	112.5	124.4	112.5	109.5	109.5	-1.2	-3.5

Source: World Bank.

Note: e = estimate (actual data for commodity prices); f = forecast. WBG = World Bank Group. World Bank forecasts are frequently updated based on new information. Consequently, projections presented here may differ from those contained in other World Bank documents, even if basic assessments of countries' prospects do not differ at any given date. For the definition of EMDEs, developing countries, commodity exporters, and commodity importers, please refer to table 1.2. EM7 includes Brazil, China, India, Indonesia, Mexico, the Russian Federation, and Türkiye. The World Bank is currently not publishing economic output, income, or growth data for Turkmenistan and República Bolivariana de Venezuela owing to lack of reliable data of adequate quality. Turkmenistan and República Bolivariana de Venezuela are excluded from cross-country macroeconomic aggregates.

1. Headline aggregate growth rates are calculated using GDP weights at average 2010-19 prices and market exchange rates.

2. GDP growth rates are on a fiscal year basis. Aggregates that include these countries are calculated using data compiled on a calendar year basis. For India and the Islamic Republic of Iran, the column labeled 2022 refers to FY2022/23. For Bangladesh, the Arab Republic of Egypt, and Pakistan, the column labeled 2022 refers to FY2021/22. Pakistan's growth rates are based on GDP at factor cost.

3. World growth rates are calculated using average 2010-19 purchasing power parity (PPP) weights, which attribute a greater share of global GDP to emerging market and developing economies (EMDEs) than market exchange rates.

4. World trade volume of goods and nonfactor services.

5. Indexes are expressed in nominal U.S. dollars (2010 = 100). Oil refers to the Brent crude oil benchmark. For weights and composition of indexes, see <https://worldbank.org/commodities>.

falling commodity prices, core inflation in many countries remains elevated, and inflation is above target in almost all inflation-targeting economies. Inflation is expected to continue to be above its pre-pandemic level beyond 2024 (figure 1.1.E). That said, inflation expectations in most inflation-targeting countries have so far not undergone a major shift and appear to remain anchored.

Energy prices have eased considerably since their peak in 2022 on account of weaker global growth prospects and a warmer-than-expected Northern winter, which reduced natural gas and electricity consumption. Metal prices increased in early 2023, reflecting signs of a stronger-than-anticipated recovery in China, but subsequently retraced those gains. Agricultural prices have been easing on the back of good production prospects for most crops.

In all, global growth is forecast to slow from 3.1 percent in 2022 to 2.1 percent in 2023, before edging up to 2.4 percent in 2024. Relative to the January projections, this is 0.4 percentage point stronger in 2023 and 0.3 percentage point weaker in 2024. Greater-than-expected resilience of major economies at the end of 2022 and early in 2023 led to the overall upgrade to growth in 2023.

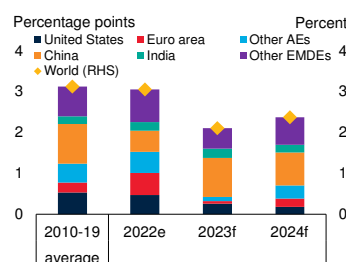
However, the drag on activity from tighter monetary policy is increasingly apparent, particularly in more interest-rate-sensitive activities such as business and residential investment, including construction. Growth over the rest of 2023 is set to slow substantially as it is weighed down by the lagged and ongoing effects of monetary tightening, and more restrictive credit conditions. These factors are envisaged to continue to affect activity heading into next year, leaving global growth below previous projections. Notwithstanding a continued recovery in tourism, global trade growth is likewise expected to slow in view of the ongoing rotation of consumption toward services, which tend to be less trade-intensive. Fiscal policy is expected to have little net impact on global growth over the forecast horizon, with modest tightening in EMDEs generally offsetting support in advanced economies.

Growth in advanced economies is set to decelerate substantially for 2023 as a whole, to 0.7 percent, and to remain feeble in 2024, due to monetary

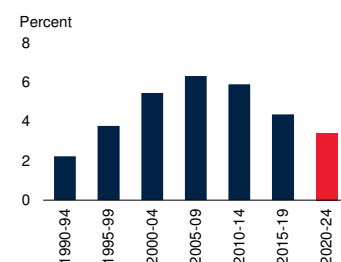
FIGURE 1.1 Global prospects

The global economy is projected to slow substantially this year, with a pronounced deceleration in advanced economies. The first half of the 2020s is expected to be one of the weakest half-decades of the past 30 years for emerging market and developing economies (EMDEs), as a result of both cyclical dynamics and slowing potential growth. EMDEs with lower credit ratings are set to experience a particularly sharp slowdown this year. Inflation remains elevated in many countries and is envisaged to remain above pre-pandemic levels beyond 2024. Excluding China, EMDEs are expected to make next to no progress at closing the gap in per capita incomes with advanced economies over the forecast horizon.

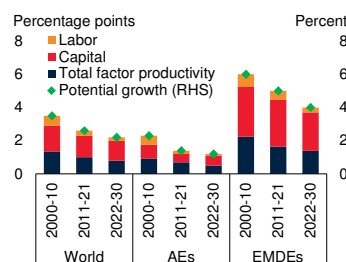
A. Contributions to global growth



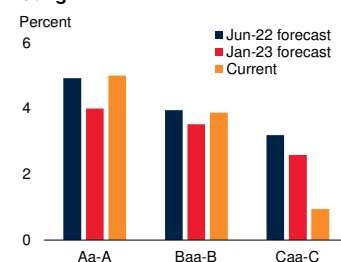
B. Growth in EMDEs



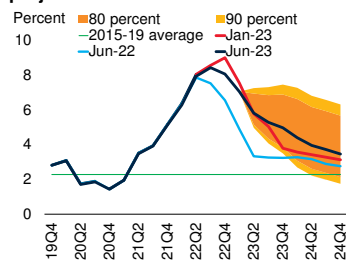
C. Contributions to potential growth



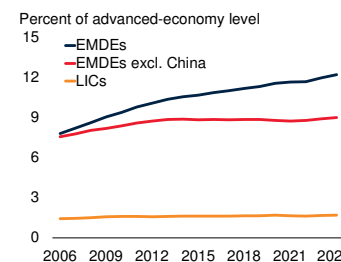
D. EMDE growth in 2023, by credit rating



E. Model-based global CPI inflation projections



F. EMDE GDP per capita



Sources: Consensus Economics; Haver Analytics; Kose and Ohnsorge (2023a); Moody's Analytics; Oxford Economics; Penn World Tables; World Bank.

Note: AEs = advanced economies; CPI = consumer price index; EMDEs = emerging market and developing economies; LICs = low-income countries.

A.B.F. Aggregate growth rates and GDP per capita calculated using real U.S. dollar GDP weights at average 2010-19 prices and market exchange rates. Data for 2023-24 are forecasts.

B. Figure shows the non-overlapping 5-year average growth in EMDEs.

C. Figure shows GDP-weighted averages of production function-based potential growth estimates for 29 advanced economies and 53 EMDEs, as in Kose and Ohnsorge (2023a). Data for 2022-30 are forecasts.

D. Comparison of GDP-weighted growth across editions of the Global Economic Prospects report, by credit ratings. Sample includes 9 Aa-A, 62 Baa-B, and 25 Caa-C EMDEs.

E. Model-based GDP-weighted projections of year-on-year country-level CPI inflation using Oxford Economics' Global Economic Model, using global oil price forecasts presented in table 1.1.

Uncertainty bands constructed from the distribution of forecast errors for total CPI from Consensus Economics for an unbalanced panel of 18 economies.

F. GDP per capita aggregates calculated as aggregated GDP divided by the aggregate population.

tightening, less favorable credit conditions, softening labor markets, and still-high energy prices. In EMDEs, aggregate growth is projected to edge up to 4 percent in 2023, almost entirely due to a rebound in China following the removal of strict pandemic-related mobility restrictions. Excluding China, growth in EMDEs is set to slow substantially to 2.9 percent this year. This projection is predicated on the assumption of a protracted period of tight global monetary policy, fiscal consolidation in most EMDEs, and weak external demand. The slowdown is expected to be even more severe for EMDEs with elevated fiscal vulnerabilities and external financing needs. Persistent weak growth means that, excluding China, EMDEs are expected to continue making next to no progress at closing the differential in per capita incomes relative to advanced economies (figure 1.1.F). By 2024, economic activity in EMDEs will still be about 5 percent below levels projected on the eve of the pandemic.

Global inflation is projected to gradually edge down as growth decelerates, labor demand in many economies softens, and commodity prices remain stable. The slow pace of improvement means that core inflation is expected to remain above central bank targets in many countries throughout 2024.

Risks to the outlook remain tilted to the downside. Recent advanced-economy bank turmoil highlights the possibility of more disorderly failures, which could lead to systemic banking crises and protracted economic downturns, with spillovers to sovereigns and across borders. These failures could be triggered by mounting concerns about balance sheet quality, continued losses in the heavily leveraged commercial real estate sector, or by the ongoing decline in house prices in many countries.

In a scenario where banking stress results in a severe credit crunch and broader financial stress in advanced economies, global growth in 2024 would only be 1.3 percent, about half the pace in the baseline forecast (figure 1.2.A). In another scenario where financial stress propagates globally to a far greater degree, the world economy would fall into recession in 2024, as global growth of only 0.3 percent would imply a contraction in global per capita GDP.

Another risk to the forecast pertains to the possibility of higher-than-expected global inflation. This would result in additional monetary policy tightening, which could trigger financial stress. This would be particularly important in the case of the United States, given the scale of international spillovers from hawkish policy reaction by the Federal Reserve to rein in inflation—such spillovers could include a substantial further rise in borrowing costs in EMDEs, especially in those with underlying vulnerabilities (figure 1.2.B). In the longer term, the decades-long slowdown of the fundamental drivers of potential growth—labor supply, capital accumulation, and total factor productivity—may be exacerbated by trade fragmentation and climate-related natural disasters.

Debt distress in various EMDEs, including low-income countries (LICs), highlights the need for globally coordinated debt relief that overcomes the challenges posed by the increasing diversity of lenders (figure 1.2.C). Sustained international cooperation is needed to accelerate the clean energy transition, help countries improve both energy security and affordability, and incentivize the investments needed to pursue a path toward resilient, low-carbon growth (figure 1.2.D). The global community also has a vital role to play in mitigating humanitarian crises stemming from food shortages and conflict.

At the national level, central banks in some EMDEs face persistent inflation and heightened risks due to the impact of their policies on fiscal positions and the financial sector. The increase in central bank credibility in many EMDEs in recent decades is an important policy accomplishment. Any erosion of credibility at this critical juncture would make the job of inflation control much more difficult and could trigger destabilizing capital outflows. Policy makers can also reduce financial market volatility by maintaining adequate foreign reserve buffers, promoting rigorous financial supervision, and strengthening bank resolution frameworks. Proper monitoring of financial system exposure to an increase in defaults and other dislocations can ensure that prompt corrective action can be taken, as needed.

Tighter financing conditions, slowing growth, and elevated debt levels create significant fiscal chal-

lenges for EMDEs. The rising cost of servicing debt is increasing the risk of debt distress among EMDEs, particularly LICs (figure 1.2.E). Countries need to pursue a carefully calibrated policy mix that avoids inflationary fiscal stimulus and ensures that government support is appropriately targeted to vulnerable groups. Measures to improve fiscal space without unduly damaging activity need to be prioritized. Across many EMDEs, especially LICs, strengthened institutions and improvements to domestic governance are needed to boost the efficiency of spending and taxation.

Many of the current challenges reflect underlying longer-run trends. Potential growth in EMDEs has been on a decades-long declining path because of slowing growth rates of labor force, investment, and productivity. The slowdown in these fundamental factors has been exacerbated by the overlapping shocks of the pandemic, Russia’s invasion of Ukraine, and the sharp tightening of global monetary policy in response to high inflation. Reversing the decline in potential growth will require decisive structural reforms (figure 1.2.F). These include measures to improve investment conditions, develop human capital and infrastructure, increase participation in the formal labor force, foster productivity growth in services, and promote international trade. In particular, fostering investment in green energy and climate resilience can ensure that growth is both robust and sustainable.

Global context

Global trade is being dampened by subdued global demand and the continued rotation of consumption toward services. Energy prices have eased considerably since their peak in 2022 as a result of weaker global growth prospects and a warmer-than-usual winter, which reduced demand for energy for heating. Core inflation around the world has been persistent, resulting in continued monetary tightening. EMDE financial conditions continue to be restrictive, with less creditworthy borrowers facing greater financial strains.

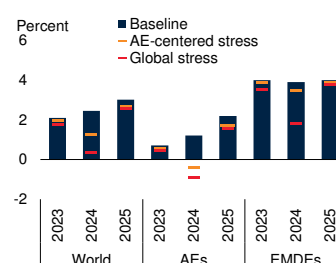
Global trade

Global goods trade growth slowed in the first half of 2023 in tandem with weakening global indus-

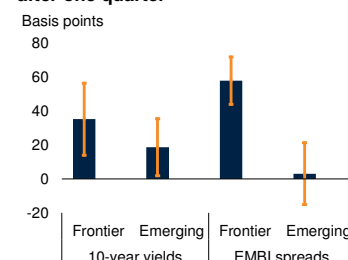
FIGURE 1.2 Global risks and policy challenges

An intensification of advanced-economy banking stress could result in a sharp slowdown in global growth in 2024, or even a global recession if it had major spillovers to emerging market and developing economies (EMDEs). A more hawkish U.S. monetary policy reaction to inflation could also further raise borrowing costs in EMDEs, especially in those with underlying vulnerabilities. There is an increasing need for debt relief for low-income countries amid a greater diversity of lenders. Substantial investments are needed to achieve resilient and low-carbon growth. Rising debt servicing costs are increasing the risk of debt distress. Reversing the decline in potential growth requires decisive structural reforms.

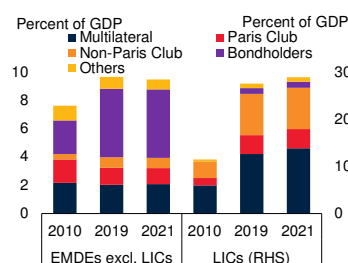
A. Global growth under different scenarios



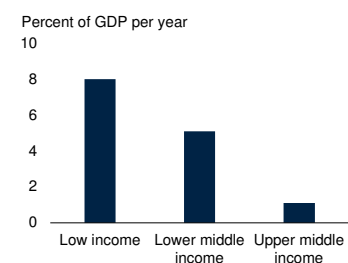
B. Impact of 25-basis-point reaction shock on EMDE financial variables after one quarter



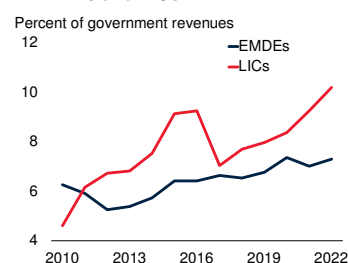
C. Composition of external debt, by creditor



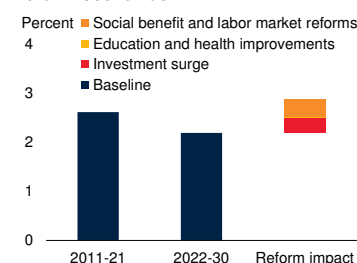
D. Additional investment for a resilient and low-carbon pathway, 2022-30



E. Government net interest payments in EMDEs and LICs



F. Global potential growth under reform scenarios



Sources: IDS (database); JP Morgan; Kose and Ohnsorge (2023a); Kose et al. (2022); MSCI; Oxford Economics; WDI (database); World Bank (2022a); World Bank.

Note: AEs = advanced economies; EMBI = emerging market bond index; EMDEs = emerging market and developing economies; LICs = low-income countries.

A. Global growth is computed by aggregating GDP at 2015 market exchange rates and prices from the Oxford Economics Model.

B. Estimated with panel non-linear local projection model with fixed effects and robust standard errors. Sample includes up to 9 frontier markets and up to 19 emerging markets, using 2022 MSCI classification. Whiskers are 90 percent confidence intervals. “EMBI spreads” based on EMBI global.

C. Figure shows U.S. dollar GDP-weighted average of public and publicly guaranteed external debt. “Others” includes multiple lenders. Sample includes 119 EMDEs, including 24 LICs.

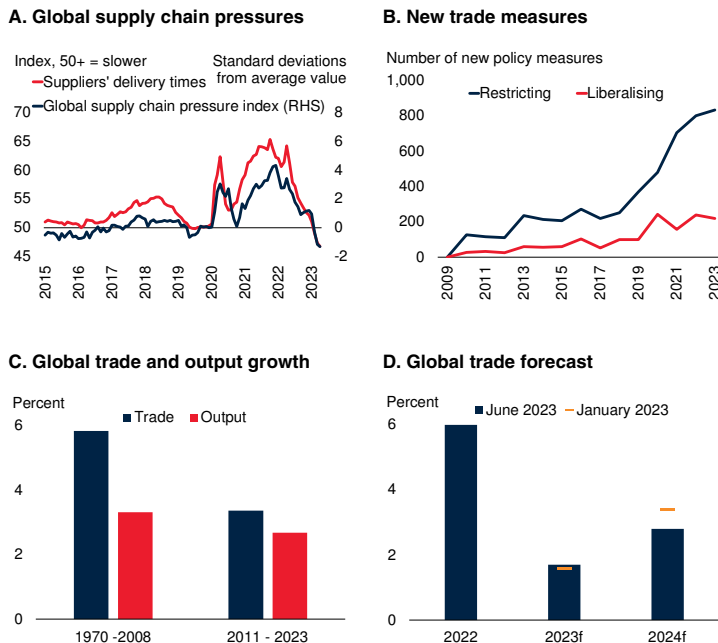
D. Bars show annual investment needs to build resilience to climate change and reduce emissions by 70 percent by 2050. Estimates include investment needs for transport, energy, water, urban adaptations, industry, and landscape. In some Country Climate and Development Reports estimates cannot be considered entirely “additional” to pre-existing financing needs.

E. Net interest payments are the difference between primary balances and overall fiscal balances. Aggregates computed with government revenues in U.S. dollars as weights, based on 150 EMDEs, including 27 LICs.

F. Figure shows annual GDP-weighted averages. Scenarios assume a repeat of each country’s best 10-year improvement as described in Kose and Ohnsorge (2023a). Data for 2022-30 are forecasts.

FIGURE 1.3 Global trade

Supply chain pressures and supplier delivery times have dropped back to pre-pandemic levels as goods demand has weakened and global shipping conditions have improved. A rising number of new trade measures have been protectionist. The ongoing shift in global consumption toward less trade-intensive goods will likely continue to lower the growth rate of trade relative to output. This shift and subdued demand are expected to dampen global trade growth substantially this year.



Sources: Federal Reserve Bank of New York; GTA (database); Haver Analytics; World Bank.

A. Figure shows manufacturing Purchasing Managers' Index (PMI) suppliers' delivery times and the Global Supply Chain Pressure Index (GSCPI). Data for delivery times are inverted by subtracting data from 100; therefore, increasing (decreasing) PMI data indicate slower (faster) delivery times. GSCPI is normalized such that zero indicates the average value for January 1998-April 2023, while positive (negative) values represent how many standard deviations the index is above (below) the average. Last observation is April 2023.

B. Figure shows the number of implemented trade policy interventions since November 2008. Restrictive (liberalizing) measures are interventions that discriminate against (benefit) foreign commercial interests. Last observation is May 24, 2023.

C. Bars indicate annual average growth. Global output growth is real GDP growth computed as a weighted average at 2010-19 average prices and exchange rates. Trade growth is the average growth of import and export volumes.

D. Trade is measured as the average of export and import volumes. "June 2023" and "January 2023" refer to the forecasts presented in the respective editions of the *Global Economic Prospects* report.

trial production. Services trade, by contrast, continued to strengthen following the easing of pandemic-induced mobility restrictions. International tourist arrivals are expected to approach 95 percent of 2019 levels in 2023, an increase from 63 percent in 2022 (UNWTO 2023).

Pressures on global supply chains have abated as goods demand has weakened and global shipping conditions have improved (figure 1.3.A). The global supply chain pressures index and suppliers'

delivery times reached their lowest levels in almost four years in the first half of 2023 and are expected to remain low.

During the pandemic, trade growth was supported by a shift in the composition of demand toward tradable goods and away from services, which are less trade-intensive. The gradual rotation of demand back to its pre-pandemic composition is now slowing trade growth—as is the fact that the recovery in China is expected to be predominantly driven by services, which will limit positive spillovers to its trading partners through demand for goods and commodities. The growing number of restrictive trade measures reflects a rising degree of geopolitical tensions and attempts by some major economies to follow more inward-looking policies (figure 1.3.B). In the longer term, this will likely reshape global supply chains and increase trade costs (EBRD 2023; Góes and Bekkers 2022).

Together, these factors are expected to further reduce the responsiveness of global trade to changes in output—responsiveness that had already declined in the 2010s relative to previous decades (figure 1.3.C; Kose and Ohnsorge 2023a). Against this backdrop, global trade growth is forecast to slow from 6 percent in 2022 to 1.7 percent in 2023 (figure 1.3.D). As global consumption returns to its pre-pandemic mix between goods and services, trade is expected to recover to 2.8 percent in 2024, only slightly stronger than GDP growth. The trade outlook is subject to various downside risks, including weaker-than-expected global demand, tighter global financial conditions, worsening trade tensions between major economies, mounting geopolitical uncertainty, and a further rise in protectionist measures (Aiyar et al. 2023; Metivier et al. 2023).

Commodity markets

Energy prices have eased considerably since their peak in the third quarter of 2022. A warmer-than-expected northern hemisphere winter reduced natural gas and electricity consumption, especially in Europe (figure 1.4.A). Oil prices have averaged \$80/bbl in 2023 to date, but they have been volatile. This volatility reflected uncertainty about

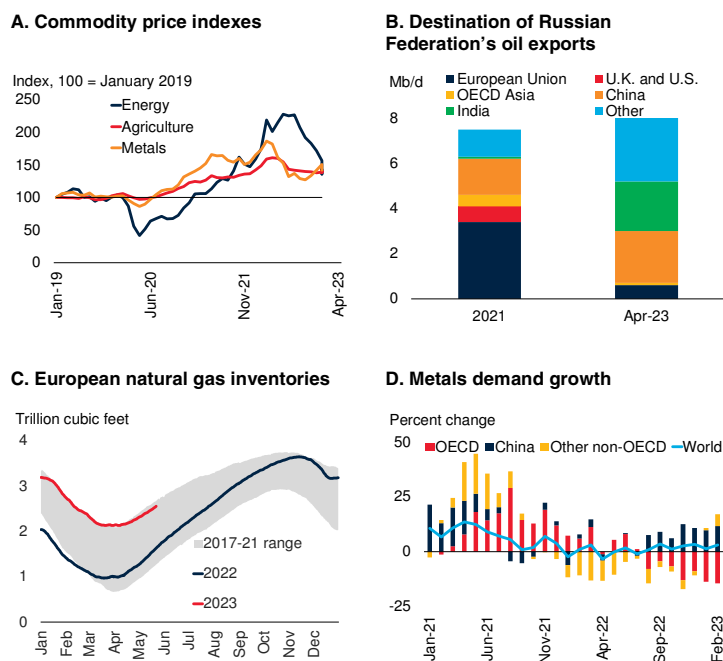
global growth prospects in the first quarter of 2023, followed by the announcement in early April by Saudi Arabia and other OPEC+ members of a cut to oil production of 1.16 mb/d. This pledge brings the total OPEC+ expected cuts over the course of 2023 to 3.6 percent of global demand. Russia has changed the destination of its oil exports without a material change in volumes (figure 1.4.B). The internationally coordinated price cap on its exports (currently set at \$60/bbl) also does not appear to be a binding constraint to exports. Metal prices increased in early 2023 on expectations of a strong recovery in China, but have subsequently retraced those gains. Most agricultural commodity prices have eased this year, reflecting good production prospects for most crops, including grains and oilseeds.

Crude oil prices are projected to average \$80/bbl in 2023, a \$8/bbl downward revision from the January forecast, and to edge up to \$82/bbl in 2024, reflecting a modest pickup in demand. Prices for natural gas and coal are expected to moderate in 2023 and decline further in 2024, as Europe has made substantial progress in improving efficiency and reducing energy demand. Natural gas prices in Europe are expected to remain well above their pre-pandemic five-year average, despite elevated inventories (figure 1.4.C). Energy prices could be lower if global demand is weaker than expected. In this respect, prospects in China play a particularly important role, as it is expected to account for more than half of the increase in global oil demand in 2023. On the upside, risks to the price forecast relate to a lack of expansion in U.S. oil production, low levels of spare capacity among OPEC members, and to the possibility that the cartel may decide to cut output further.

Metal prices are expected to decline in 2023 and 2024, albeit to levels higher than their 2015-19 average. Price declines reflect a recovery of supply following production disruptions last year, as well as subdued global demand. Metal prices may be higher if China’s real estate sector recovers faster than expected or if supply disruptions persist—the importance of developments in China is illustrated by the fact that the country has accounted for a substantial proportion of global demand growth in recent months (figure 1.4.D).

FIGURE 1.4 Commodity markets

Commodity prices have returned to their pre-invasion levels but remain historically high. Energy prices have eased considerably this year, as a warmer-than-expected winter and lower European demand reduced natural gas, coal, and electricity consumption. Russian oil export volumes have not changed materially, but their destination has shifted sharply away from Europe, which has built up substantial natural gas inventories. Metals prices have remained subdued amid a weaker-than-expected industrial recovery in China.



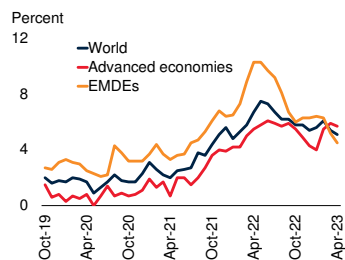
Sources: GSE (database); IEA (2023a); World Bank; World Bureau of Metal Statistics.
 Note: OECD = Organisation for Economic Co-operation and Development.
 A. Monthly data, last observation is April 2023.
 B. Figure shows the share of the Russian Federation's oil exports by destination.
 C. Sample includes 20 EU countries and the United Kingdom. Last observation is May 22, 2023.
 D. Figure shows year-on-year, percent change. Last observation is February 2023.

Agricultural prices are projected to fall 7.2 percent in 2023 and ease further in 2024, as production of grains and oilseeds is expected to increase. Nonetheless, food prices have risen significantly faster than overall inflation since the pandemic, with substantially larger increases in some countries as a result of weaker currencies and transport disruptions. Overall, the agricultural price index is expected to remain well above pre-pandemic nominal levels in 2024. The key risks to agricultural production are adverse weather patterns (including the emerging El Niño), trade policy restrictions, and higher energy costs. Food insecurity remains a critical challenge in some EMDEs, reflecting severe weather events, geopolitical conflict, and distortive trade measures.

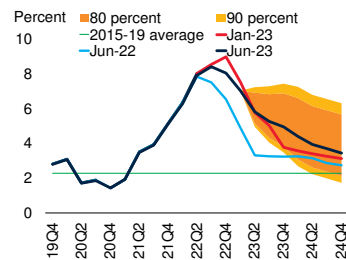
FIGURE 1.5 Global inflation

Global core inflation remains elevated. Projections suggest inflation will continue to be above its pre-pandemic level beyond 2024. Market-based measures of long-term inflation compensation in advanced economies remain above 2 percent, despite a decline in oil prices. In many emerging market and developing economies (EMDEs), inflation is either accelerating or has stabilized at high levels. One-year-ahead EMDE inflation expectations have declined only slightly. Longer-term projections point to a faster decline in inflation in countries with inflation targets.

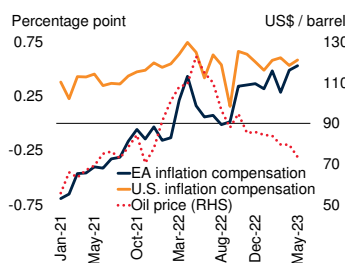
A. Core inflation



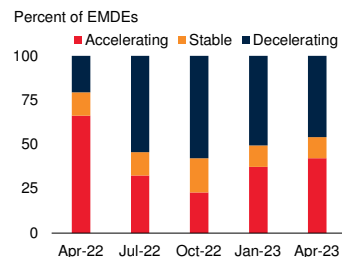
B. Model-based global CPI inflation projections



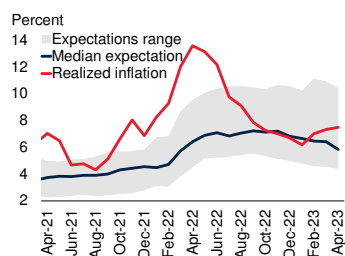
C. Deviation of long-term market inflation compensation from 2 percent



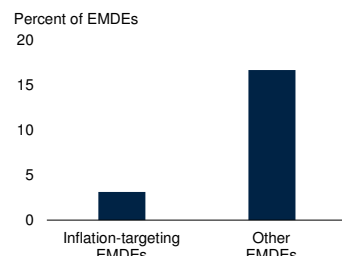
D. Inflation momentum in EMDEs



E. One-year-ahead expectations for EMDE inflation



F. Share of EMDEs with five-year-ahead inflation projections substantially above pre-pandemic inflation



Sources: Bloomberg; Consensus Economics; Haver Analytics; International Monetary Fund; Oxford Economics; World Bank.

Note: CPI = consumer price index; EA = euro area; EMDEs = emerging market and developing economies.

A. Figure shows median 3-month core inflation at an annualized rate. Sample includes 31 advanced economies and 40 EMDEs. Last observation is April 2023.

B. Model-based GDP-weighted projections of year-on-year country-level CPI inflation using Oxford Economics' Global Economic Model, using global oil price forecasts presented in table 1.1. Uncertainty bands constructed from the distribution of forecast errors for total CPI from Consensus Economics for an unbalanced panel of 18 economies.

C. Figure shows the deviation of month-end coupon on 5-year inflation swaps 5-years forward. Oil price refers to Brent crude spot price. Last observation is May 2023.

D. Accelerating (decelerating) is defined as annualized 3-month inflation 1 percentage point or more above (below) its level in the preceding quarter. Sample includes 83 EMDEs.

E. Inflation expectations calculated as a time-weighted average of consensus inflation expectations for the current and following calendar year. Expectations range is the interquartile range. Realized inflation is median 3-month inflation for a sample of up to 101 EMDEs.

F. Figure shows the proportion of EMDEs for which the 2028 inflation projection is more than 1 percentage point above average inflation in 2010-19. Sample includes 146 EMDEs.

Global inflation

Inflation remains above target in almost all inflation-targeting economies. Median headline global inflation stood at 7.2 percent year-on-year in April, down from a peak of 9.4 percent in July 2022. This deceleration largely reflects favorable base effects from commodity prices falling below their 2022 peaks, along with abating supply chain pressures. Moderating energy prices help explain global inflation being somewhat softer in the first quarter of 2023 than previously anticipated. However, recent core inflation measures suggest the disinflation that started last year has made only halting progress. Across EMDEs, three-month median core inflation has decelerated somewhat in recent months, while it has picked up in advanced economies (figure 1.5.A). Amid these developments, global inflation is envisaged to remain further above its 2015-19 average than was expected in January, and for a longer period (figure 1.5.B).

With supply chain pressures easing and energy prices declining, excess demand appears to be a key driver of continuing high inflation in advanced economies, though lingering impairments to supply capacity may also still play a role (Bernanke and Blanchard 2023). In Europe, the role of energy prices is particularly important—the pass-through of energy costs into broader prices may be adding to inflation persistence, which could be further exacerbated by the sunset of fiscal programs that have attenuated price spikes for end-users (Pill 2023). The absence of economic slack may also be increasing the ability of firms and workers to exercise pricing power, such that inflation has become more responsive to economic activity (Borio et al. 2023; Gagnon and Sarsenbayev 2022).

In some advanced economies, particularly the euro area, market-derived measures of long-term inflation compensation have moved up since last year, despite a decline in oil prices, with which they have been correlated in the past (figure 1.5.C; Elliot et al. 2015). This could signal greater risks of inflation remaining above target, but may also reflect increased inflation risk aversion among market participants (Böninghausen, Kidd, and de Vincent Humphreys 2018; Lane 2023). Consum-

er surveys indicate that medium-term inflation expectations in the United States and the euro area have been fairly stable in 2023.

In many EMDEs, inflation is either accelerating once again or has stabilized at high levels (figure 1.5.D). Some common responses to recent shocks, including (tacit or explicit) indexation of wages to inflation and increases in untargeted fossil fuel subsidies, may have added to generalized inflation pressures (IEA 2023b). A protracted period of high inflation could be especially challenging for EMDEs, where inflation expectations are generally less stable than in advanced economies and more influenced by current inflation rates (Kamber, Mohanty, and Morley 2020). Consensus-derived expectations for EMDE inflation one-year-ahead moved up substantially as inflation initially picked up, but declined more slowly as inflation decelerated last year.

The distribution of short-term inflation forecasts across EMDEs has also widened markedly, with double-digit inflation expected in more than a quarter of EMDEs (figure 1.5.E). Long-term forecasts suggest that EMDEs with inflation-targeting central banks may have an advantage in durably bringing inflation down. Five years ahead, only one-in-twenty inflation-targeting EMDEs is projected to have inflation more than 1 percentage point above 2010-19 average levels, compared with about one-in-six non-inflation-targeting EMDEs (figure 1.5.F).

The reopening of China's economy is not expected to have a material impact on global inflation. While strengthening activity will put upward pressure on domestic inflation, this will likely be limited by slack in China's economy, including in the labor market. In addition, the recovery in China is projected to be less commodity-intensive than in past episodes of growth accelerations, and therefore less likely to boost global prices.

Global financial developments

Global financial conditions have become restrictive as a result of the fastest global monetary policy tightening cycle since the 1980s, along with bouts of financial instability. For nearly a year, markets have interpreted U.S. policy rates as being well

above their long-term level. This pushed the U.S. yield curve into its steepest inversion (that is, two-year yields exceeding ten-year yields) since 1981 (figure 1.6.A). Such yield curve inversions have often preceded U.S. recessions.

Advanced-economy banks started the year with unrealized losses on bond portfolios, which increased as interest rates rose. This, combined with shortcomings in risk management, contributed to the failure of several regional banks in the United States. In Europe, Credit Suisse came under intense market pressure in March and was subject to an emergency takeover. The initial emergence of banking stress drove a surge in market volatility, including the sharpest five-day drop in two-year U.S. yields in more than two decades and a large decline in bank equity prices (figure 1.6.B). To bolster market confidence and limit contagion to the broader financial system, authorities have responded with emergency liquidity facilities. The U.S. authorities also introduced an expanded deposit guarantee for the banks that failed in March. Central banks have nonetheless reaffirmed intentions to maintain, or increase, the tightness of monetary policy until inflation shows a clear trend toward target. Even with continued signs of banking stress, broader risk appetite in advanced-economy financial markets has been notably resilient. High-yield corporate risk spreads have mostly stayed below their post-2010 average, despite bank lending standards reaching their most restrictive levels since the global financial crisis (figure 1.6.C).

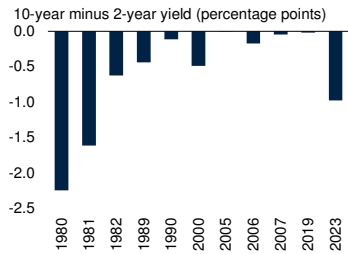
For EMDEs, higher interest rates in advanced economies often entail an extended period of costly external financing. Nonresident investors have remained cautious, which has persistently weighed on portfolio capital flows to EMDEs excluding China. Under the pressure of tight financial conditions, EMDEs have diverged into two broad subsets.¹ The first subset includes those

¹According to recent Moody's credit ratings, 73 percent of EMDEs have sovereign ratings of B or above, while 27 percent have ratings below B. This classification is similar to, but does not perfectly align with, the common practice in capital markets of dividing countries into "emerging" and "frontier" markets, which is done on the basis of a variety of characteristics such as financial market depth and liquidity.

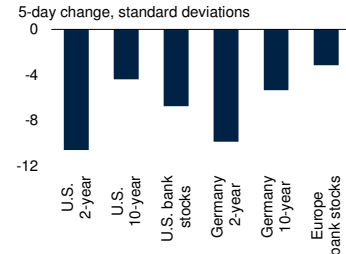
FIGURE 1.6 Global financial developments

Prior to the advanced-economy bank failures in March, the U.S. yield curve registered its deepest inversion in four decades. During the banking stress, short-term government bond yields and bank stocks fell sharply. Despite these events, and much tightened bank lending standards, advanced-economy credit spreads remain contained. As borrowing costs have risen globally, currency depreciation and credit spread widening in emerging market and developing economies have been disproportionately concentrated in the countries with the weakest credit ratings.

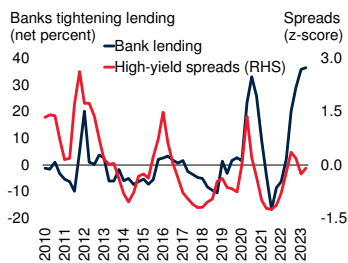
A. Yield curve inversions in the United States



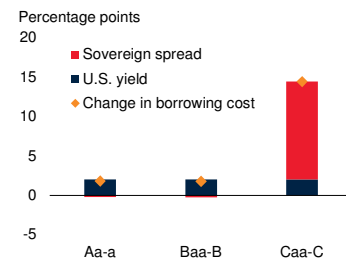
B. Advanced-economy yields and bank stocks during March 2023 banking stress



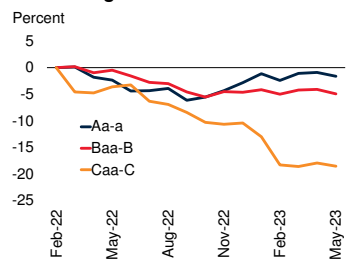
C. Bank lending standards and high-yield spreads in advanced economies



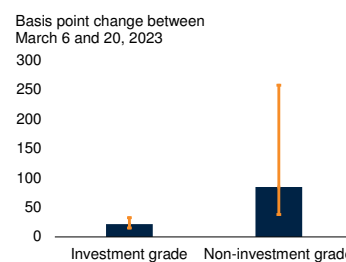
D. Change in EMDE borrowing costs since February 2022, by credit rating



E. EMDE U.S. dollar exchange rate, by credit rating



F. EMDE CDS premia around advanced-economy bank failures



Sources: Bloomberg; European Central Bank; Federal Reserve Economic Data; Haver Analytics; J.P.Morgan; Moody's Analytics; World Bank.

Note: EMDEs = emerging market and developing economies.

A. Figure shows the largest negative value for the 5-day moving average of the 10-year minus the 2-year U.S. Treasury yield during each inversion. An inversion begins when this average turns negative and ends when it turns positive.

B. Figure shows the largest 5-day changes in March 2023 as multiples of the standard deviation of 5-day changes. "2-year" and "10-year" refer to 2- and 10-year government bond yields; "bank stocks" refers to price of an index of U.S. regional bank stocks and the banks subindex of the European STOXX 600 index. Sample is January 4, 2000 to March 21, 2023 for yields and January 3, 2012 to March 21, 2023 for spreads.

C. Bank lending is a simple average of the net percentage of banks tightening lending standards to non-financial enterprises in the United States and the euro area. "High-yield spreads" is an average of z-scores of high-yield bonds spread indices for the United States and the euro area.

D. U.S. yield is the 5-year Treasury yield. Sovereign spread is the spread over U.S. yields for EMDE dollar-denominated sovereign debt. Changes are since February 2022 for 45 EMDEs.

E. Indexes constructed by compounding daily average changes in exchange rates for each group. Sample includes 76 EMDEs. Last observation is May 25, 2023.

F. Median change in 5-year U.S. dollar-denominated credit default swaps for 48 EMDEs, including 19 investment-grade and 29 non-investment-grade countries. Whiskers indicate interquartile range.

with credit ratings of B or above (the majority of EMDEs), which have so far proved able to withstand global monetary tightening without incurring substantial increases in risk premia on external debt (figure 1.6.D). In some such EMDEs where inflation has been high, central banks have helped assuage market concerns by raising policy rates earlier, and by more than, advanced-economy counterparts. Nonetheless, since the Federal Reserve started to raise its policy rate, marginal dollar-denominated borrowing costs have increased by close to 200 basis points even among the most resilient EMDEs.

The second subset includes EMDEs with the lowest credit ratings (below B), which have proved far more vulnerable. Their risk premia have increased substantially, in part because they have also experienced much greater currency depreciation than most other EMDEs (figure 1.6.E). Many of these countries have limited fiscal capacity, large unhedged foreign currency liabilities, and other economic vulnerabilities. With little or no access to commercial debt markets, they have become reliant on official creditors, or their own diminishing reserves, to meet external financing needs. Some have slipped into crises.

Spillovers from advanced-economy banking stress have so far been limited in most EMDEs, but have exhibited a similar divergence. Market perceptions of the creditworthiness of investment grade EMDEs (as measured by credit-default swap premia) were little affected in March, after the first bank failures in advanced economies; in contrast, credit default swap spreads for non-investment-grade sovereign borrowers widened notably (figure 1.6.F).

Major economies: Recent developments and outlook

Activity in advanced economies slowed less than expected in early 2023 but is set to weaken substantially later this year. Past and ongoing monetary policy rate hikes, tighter credit conditions amid banking sector stress, softening labor markets, and the lingering effects of the energy price spike of 2022 are expected to weigh on activity. In China, growth is projected to rebound more quickly than previously

expected, reflecting the economic reopening and supportive policy, before moderating toward the end of 2023.

Advanced economies

Growth in advanced economies in late 2022 and early 2023 slowed less than expected, as tight labor markets supported robust wage growth and prevented a sharper slowdown in consumption (figure 1.7.A). The tightness in labor markets is in part related to a slowdown in labor supply, with labor force participation rates falling (partly because of a rise in early retirements) and, in the United States, a decline in hours worked by those employed (Lee, Park, and Shin 2023). In the first quarter of 2023, GDP expanded by 1.1 percent in the United States on a quarterly basis, supported by broadly robust consumption. Euro area GDP grew by 0.3 percent at an annualized rate, reflecting lower energy prices, easing supply bottlenecks, and fiscal policy support for firms and households.

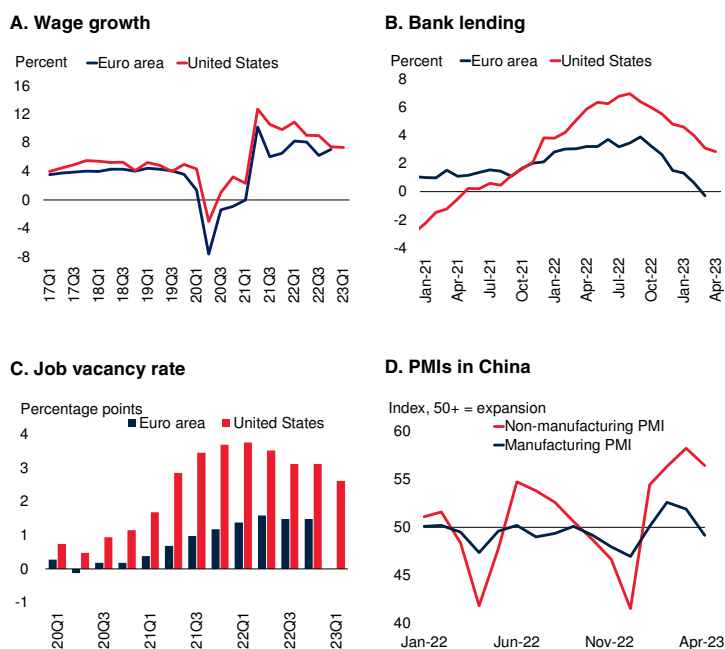
Advanced-economy growth is projected to slow to an annual average of 0.7 percent in 2023. This largely reflects the continued effect of considerable central bank policy rate hikes since early 2022. More restrictive credit conditions due to banking sector stress in advanced economies should slow domestic demand further in 2023. Past increases in energy prices and the expected softening in labor markets are also projected to weigh on activity. Growth is expected to accelerate modestly to 1.2 percent in 2024 due to a pickup in the euro area.

Stronger-than-expected activity in early 2023 is projected to push average annual growth 0.2 percentage point above the January forecast, despite an expected weakening in the second half. In contrast, the pickup in growth in 2024 is weaker than previously forecast, owing to the more delayed impact of monetary policy rate increases, as well as additional headwinds from tighter credit conditions.

In the **United States**, growth is expected to weaken significantly through 2023 and early 2024, mainly as a result of the lagged effects of the sharp rise in policy rates over the past year and a half aimed at bringing down the highest inflation

FIGURE 1.7 Major economies: Recent developments and outlook

Tight labor markets and high wage growth prevented a sharper slowdown in advanced economies in early 2023. Policy rate hikes and recent bank failures have contributed to a tightening of financial conditions and a slowdown in bank lending. Historically high job vacancy rates should decline as labor markets slow in advanced economies. The recovery in China is expected to be led by services activity, which tends to be less trade intensive.



Sources: European Central Bank; Eurostat; Federal Reserve Economic Data; Haver Analytics; National Bureau of Statistics of China; U.S. Bureau of Economic Analysis; U.S. Bureau of Labor Statistics; World Bank.

A. Figure shows the year-on-year percentage change in wages and salaries. Last observation is 2023Q1 for the United States and 2022Q4 for the euro area.

B. Figure shows six-month percentage change in the stock of credit, which is bank lending to nonfinancial private sector, monthly end of period, for the euro area and bank loans and leases from the H8 release by the Federal Reserve, monthly end of period, for the United States. Last observation is April 2023 for the United States and March 2023 for the euro area.

C. Figure shows job openings rate in the United States and the job vacancy rate in the euro area, as percentage points deviation from the average value for the period 2010-2019. Last observation is 2023Q1 for the United States and 2022Q4 for the euro area.

D. Figure shows official manufacturing and non-manufacturing Purchasing Managers' Index (PMI). PMI readings above (below) 50 indicate expansion (contraction) in economic activity. Last observation is April 2023.

rates since the early 1980s. Model-based estimates show that the peak impact on growth from this tightening is likely to take place in 2023. In addition, recent bank failures have contributed to a slowdown in credit creation (figure 1.7.B). Tighter credit will also weigh on near-term activity.

Consumption has been resilient but is expected to slow substantially. Higher borrowing costs and tighter financial conditions will weigh on house-

hold spending as the large stock of savings accumulated during the pandemic is depleted, and unusually tight labor markets begin to rebalance, gradually reducing the historically high job vacancy rates (figure 1.7.C). Decelerating consumption and residential investment will likely contribute to very feeble activity in the second half of 2023. After growing 1.1 percent in 2023, the U.S. economy is likely to remain weak in 2024, decelerating to 0.8 percent. Activity is expected to pick up toward the end of next year, as inflation eases and the effects of monetary policy tightening fade.

In the **euro area**, growth proved more resilient than expected at the turn of the year, supported by warmer weather and lower natural gas prices. Energy price pressures have been fading, but core inflation has remained elevated, reflecting the strength of the labor market, robust wage growth, lagged effects from high gas and electricity prices, and broadening price pressures. The persistence of underlying inflation pressures, as seen in the core services component which excludes shelter, suggests that monetary policy may need to be tighter than previously expected.

Growth is forecast to slow to 0.4 percent in 2023, from 3.5 percent in 2022, owing mainly to the lagged effects of monetary policy tightening. The upward revision of 0.4 percentage point to growth this year relative to January mainly reflects the better-than-expected data at the beginning of the year and the downgrade to energy price projections. After bottoming out in 2023, growth is expected to firm to 1.3 percent in 2024, supported by reforms and investments funded by the Recovery and Resilience Facility. The 0.3 percentage point downward revision to the forecast for 2024 partly reflects the effects of tight monetary policy over a longer period than previously expected.

In **Japan**, growth is expected to slow to 0.8 percent in 2023, as the lagged effects of synchronized monetary policy tightening in major advanced economies weigh on external demand. Although price pressures are expected to subside in the second half of 2023 as the pass-through from a surge in import prices runs its course, persistent weakness in real wage growth will hold back consumer demand. Growth is anticipated to edge

down further to 0.7 percent in 2024, partly as a result of the gradual unwinding of macroeconomic policy support.

China

Economic activity in China bounced back in early 2023, spurred by the earlier-than-expected economic reopening, which bolstered consumer spending, including on services-related activity (figure 1.7.D). The property sector began to emerge from a protracted slump, supported by wide-ranging policies. These included liquidity provisions to developers and measures to ensure the completion of unfinished projects. Meanwhile, goods trade remained subdued.

Growth is projected to rebound to 5.6 percent in 2023, as the economic reopening drives consumer spending, particularly on domestic services. Investment is expected to pick up only modestly as infrastructure-related stimulus fades, and high debt levels weigh on the property sector recovery. Weak external demand will also dampen growth. While the reopening will support services trade, subdued infrastructure and manufacturing sector activity will weigh on overall trade, as services activity tends to be less trade intensive. Inflation is expected to remain below target, allowing monetary policy to remain mildly accommodative. The fiscal policy stance is expected to be broadly neutral.

With the reopening boost fading in the second half of the year, growth will slow to 4.6 percent in 2024, as moderating consumption offsets a small pickup in exports. Key downside risks include continuing stress in the real estate sector, a sharper-than-anticipated slowdown in global growth and trade, and the lingering possibility of disruptive COVID-19 waves. On the upside, a more vigorous consumption recovery could support growth for longer than expected.

Emerging market and developing economies

EMDE growth is expected to pick up in 2023 almost entirely due to China's economic reopening. Excluding China, growth in EMDEs is set to slow markedly. A protracted period of tight domestic

monetary policy, fiscal consolidation, and weak external demand will curb growth in many EMDEs. Although advanced-economy banking stress has so far not translated to EMDE financial sectors, the effects of more restrictive global financial conditions will remain a headwind to growth, particularly for EMDEs with weaker credit ratings. In LICs, domestic vulnerabilities, increased fragility, and persistently high poverty rates, will continue to weigh on economic recoveries.

Recent developments

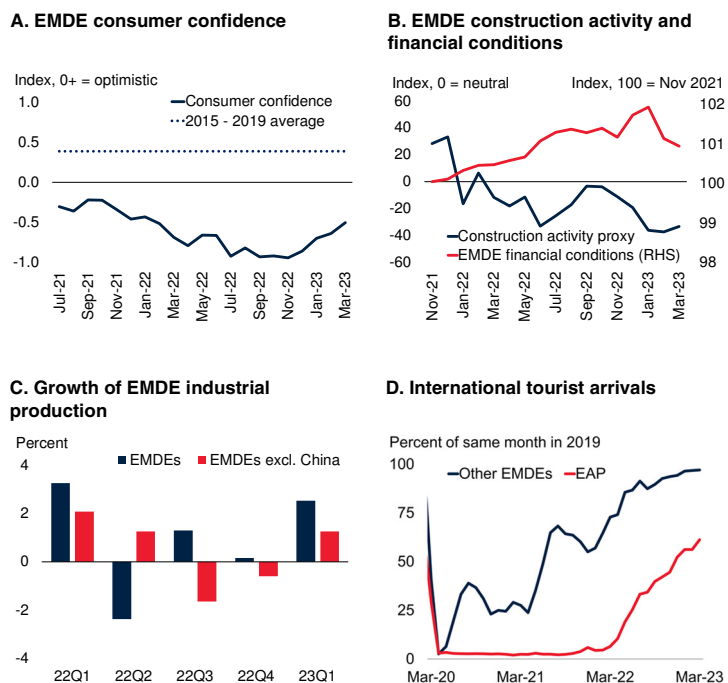
EMDE growth firmed somewhat in early 2023. External demand for many countries was supported by the pickup in growth in China and the unexpected resilience in advanced economies. Indicators of EMDE domestic demand have improved, but from a low level. Consumer confidence, for example, has improved slightly from its trough in the last quarter of 2022, but remains well below recent averages (figure 1.8.A). Services activity also picked up to start the year, with services PMIs indicating solid expansion in several large EMDEs.

Although measures of EMDE financial stress have generally declined since last year, financing costs remain elevated, reflecting both domestic and advanced-economy monetary policy tightening. This has weighed on EMDE investment and output in sectors that are more sensitive to interest rate movements, such as industrial production and construction (figure 1.8.B). Industrial production in EMDEs excluding China declined sharply in the second half of last year but rebounded somewhat in the first quarter of 2023 (figure 1.8.C). New orders in EMDE manufacturing PMIs have shown modestly increasing output, after signaling contraction for much of 2022. International tourism flows have been slow to respond to China’s reopening but have normalized substantially compared with last year (figure 1.8.D).

Activity in EMDE energy exporters remains firm, despite a decline in energy prices (especially for coal and gas), reflecting momentum from a prolonged period of elevated export earnings. In the context of decelerating advanced-economy demand, subdued metal prices will provide little support for growth in EMDE metal exporters,

FIGURE 1.8 Recent developments in emerging market and developing economies

Indicators of domestic demand in emerging market and developing economies (EMDEs), such as consumer confidence, have started to recover but remain weak. Tighter financial conditions have weighed on activity in sectors more sensitive to interest rates, such as construction and industrial production, both of which have been subdued. Tourism has recovered substantially since 2022.



Sources: Bloomberg; Goldman Sachs; Haver Analytics; World Bank.
 Note: EAP = East Asia and Pacific; EMDEs = emerging market and developing economies.
 A. Figure shows the simple average of consumer confidence indices standardized against their historical values for 12 EMDEs (Albania, Argentina, Brazil, China, Colombia, Hungary, India, Indonesia, Mexico, Pakistan, Thailand, and Türkiye). Standard deviations for constituent scores are based on the period from 2015 to the last observation, which is March 2023.
 B. Increases in the financial conditions index imply more restrictive conditions. Increases in the EMDE construction activity proxy indicate greater confidence and increasing year-on-year activity in EMDE construction sectors. The construction activity proxy is a simple average of z-scores, multiplied by 100, for variables capturing confidence and activity in construction sectors for 9 EMDEs (Argentina, Brazil, Mexico, Chile, China, Hungary, Romania, South Africa, and Thailand). EMDE financial conditions is a GDP-weighted average of the Goldman Sachs financial conditions indices for 12 EMDEs, lagged by 3 months (that is, the July 2022 value signifies conditions in April 2022).
 C. Figure shows the quarterly growth of industrial production in 31 EMDEs.
 D. Figure shows total arrivals for country groups, expressed as a percentage of the same month in 2019. Sample includes 26 EMDEs, of which 5 are EAP.

many of which are also facing headwinds from tight financing conditions. In large agricultural exporters, stable high prices have supported investment in machinery and equipment, softening the contractionary impact of increased borrowing costs. Among poorer agricultural exporters, however, prohibitive fertilizer costs are crimping output. Among EMDE commodity importers, the decline in energy import costs has partially

reversed the squeeze on consumers and industrial activity from last year's worsening terms of trade.

Across LICs, high prices for food and energy continue to weigh on consumption—especially in fragile countries and in small agricultural commodity producers, where violence, adverse weather shocks, and elevated production costs have dampened activity. Sizable financing needs, together with rising debt service costs, present a growing fiscal burden.

Outlook

EMDE outlook

Growth in EMDEs is projected to edge up to 4 percent in 2023, which almost entirely reflects the rebound in China. Excluding China, EMDE growth is set to decline to 2.9 percent this year, from 4.1 percent last year, due to the drag from high inflation and the associated monetary tightening—both domestically and via monetary policy spillovers from advanced economies—as well as from slowing external demand. From a regional perspective, growth is set to slow in all regions except EAP and ECA (box 1.1). Growth in EMDEs excluding China is expected to pick up modestly to 3.4 percent in 2024, as the effects of monetary tightening diminish and several larger EMDEs emerge from domestic strains, including natural disasters, power shortages, and political turbulence.

Substantial upgrades to projections for China and, to a lesser extent, Russia are the main drivers of the 0.6 percentage point upward revision to EMDE growth this year (figure 1.9.A). The improved near-term outlook for China reflects a greater-than-expected boost from economic reopening. In Russia, the contraction this year is envisaged to be milder than initially forecast, partially due to the continued flow of energy exports.

EMDE growth is expected to receive little support from external demand. China's recovery is envisaged to be services oriented, rather than trade-intensive. Aside from a pickup in tourism flows to Southeast Asian countries, the projections therefore entail only a muted growth impulse from

China to other EMDEs. Similarly, near-term EMDE growth will benefit only marginally from stronger-than-expected advanced-economy growth in 2023, which largely reflects positive surprises at the beginning of the year giving way to weak subsequent growth in the second half of 2023 and in 2024.

Gradual fiscal consolidation is expected in the majority of EMDEs in 2023; however, in aggregate, this is offset by a few larger EMDEs with increasing deficits. Where consolidation takes place, adjustment is foreseen to occur primarily via reduced spending, as weak growth weighs on government revenue. Spending-led retrenchment is expected to intensify in 2024. This will help rebuild fiscal buffers, but also dampen demand. Accordingly, the aggregate EMDE fiscal impulse is about neutral for growth this year and negative in 2024 (figure 1.9.B).

Many EMDE central banks have also continued to tighten monetary policies, or retained high rates for longer than previously expected. Given lags in the transmission of monetary tightening, investment growth is expected to be weak throughout the year, with labor markets and consumption also softening. Moreover, market pricing suggests that inflation-adjusted policy rates will rise further in many EMDEs, as inflation declines only gradually, taking aggregate EMDE real rates further into positive territory (figure 1.9.C). This should help to combat inflation in many countries but will entail a continued drag on EMDE activity throughout 2024.

The global tightening cycle has weighed especially on growth prospects in EMDEs with weaker sovereign credit profiles, which are expected to grow just 0.9 percent in 2023. Projections for these economies have been repeatedly downgraded as global financial conditions have tightened (figure 1.9.D). In many such countries, debt service is consuming a large proportion of limited government revenues, and non-concessional external finance has largely dried up. In the absence of fiscal capacity to buffer commodity price shocks and support populations, living standards and macroeconomic stability have deteriorated.

BOX 1.1 Regional perspectives: Outlook and risks

Growth is projected to diverge across EMDE regions this year and next. It is expected to pick up in 2023 in East Asia and Pacific (EAP) and Europe and Central Asia (ECA), as China's reopening spurs a recovery and as growth prospects in several large economies improve. In contrast, growth is forecast to moderate in all other regions, particularly in Latin America and the Caribbean (LAC) and the Middle East and North Africa (MNA). Headwinds from weak external demand, tight global financial conditions, and high inflation will drag on activity this year, especially in LAC, South Asia (SAR), and Sub-Saharan Africa (SSA). The lingering impact of the Russian Federation's invasion of Ukraine will continue to weigh on growth across regions, particularly in ECA. Next year, growth is projected to moderate in EAP and SAR but to pick up elsewhere as domestic headwinds ease and external demand strengthens. Downside risks to the outlook for all regions include possible further global financial stress and more persistent domestic inflation than projected in the baseline. Geopolitical tensions, conflict and social unrest, and natural disasters stemming from climate change also present downside risks, to varying degrees. The materialization of such risks could further weaken potential growth, leading to a prolonged period of slower growth in all EMDE regions.

Introduction

EMDE regions are contending with a mix of predominately negative global headwinds, resulting in diverging growth prospects. Amid weak growth of global demand and output, trade growth is expected to remain subdued and weigh on activity in all regions. Inflation is moderating but remains elevated, prolonging monetary policy tightening cycles in many countries. Growth is projected to strengthen in EAP and ECA in 2023 but to decline in other regions. Commodity prices, particularly for energy and food, are expected to moderate this year. This will help lower inflation and support activity in commodity-importing regions, including EAP and SAR, as well as some countries in LAC, but weigh on commodity exporters, particularly in ECA and MNA.

Against the backdrop of subdued growth, all regions face a suite of downside risks. These include financial sector stress and weaker growth stemming from tighter global financial conditions, with highly indebted regions, particularly ECA, LAC and SSA, and many oil-importing countries in MNA, especially vulnerable. In all regions persistently high inflation could lead to further domestic monetary policy tightening. Heightened geopolitical tensions could disrupt trade and damage globally integrated sectors, especially in EAP and ECA. Further risks are posed by conflicts and social instability, already severe in ECA, LAC and MNA, and natural disasters, including extreme weather events related to climate change, with SSA and small states in EAP and LAC heavily exposed.

In this context, this box considers two questions:

- What are the cross-regional differences in the growth outlook?
- What are the key risks to the outlook for each region?

Outlook

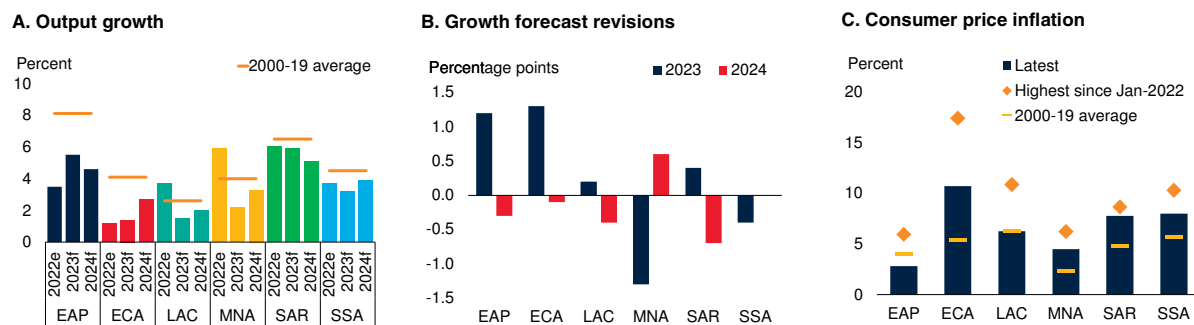
Growth is projected to diverge across EMDE regions in 2023 in the face of persistently high inflation and global headwinds—notably slower growth in the major advanced economies and tight global financial conditions (figure B1.1.1.A). In EAP and ECA, growth is forecast to strengthen in 2023, to rates higher than projected in January, mainly reflecting developments in the two regions' largest economies—China and the Russian Federation. In China, an earlier-than-expected reopening of the economy is driving a rebound in growth this year, supported by consumer spending, particularly on services. Output in Russia is projected to contract less than anticipated in January mainly due to more resilient-than-expected oil production and higher-than-expected growth momentum from 2022. Persistent contraction in export volumes, weak domestic demand, policy uncertainty, and sanctions in response to Russia's invasion of Ukraine will continue to weigh on activity.

In other EMDE regions, growth is forecast to weaken this year, and, except in LAC and SAR, more steeply than projected in January (figure B1.1.1.B). Growth in LAC and MNA is forecast to slow the most in 2023, following strong expansions in 2022 supported by economic reopening and high commodity prices. In MNA's oil exporters, cuts to oil production—with

Note: This box was prepared by Samuel Hill.

BOX 1.1 Regional perspectives: Outlook and risks (continued)**FIGURE B1.1.1 Regional outlooks**

Growth in EAP and ECA is projected to pick up, and to be faster than previously forecast, in 2023 owing to improved prospects for China and a few large economies. Growth in other EMDE regions is forecast to weaken this year, broadly in line with January projections, except in MNA, owing to lower-than-expected oil production. While headline inflation appears to have peaked in all regions, in most regions it remains elevated by recent historical standards—and a key drag on growth.



Sources: Haver Analytics; World Bank.

Note: EAP = East Asia and Pacific, ECA = Europe and Central Asia, LAC = Latin America and the Caribbean, MNA = Middle East and North Africa, SAR = South Asia, SSA = Sub-Saharan Africa.

A. Aggregate growth rates are calculated using GDP weights at average 2000-19 prices and market exchange rates. 2000-2019 refers to the simple average of growth rates for each region. Data for 2023 and 2024 are World Bank forecasts.

B. Revisions reflect differences in forecasts presented in the January 2023 edition of the Global Economic Prospects report. Data for 2023 and 2024 are forecasts.

C. Bars show regional median year-on-year consumer price inflation in April 2023 where available and otherwise March 2023. Lines show the regional median of the simple country average of year-on-year consumer price inflation between January 2000 and December 2019. Diamonds show the regional median of the highest year-on-year consumer price inflation since January 2022. Sample includes 106 EMDEs (9 in EAP, 21 in ECA, 20 in LAC, 12 in MNA, 6 in SAR, and 23 in SSA).

spillovers to broader economic activity—are expected to weigh on growth. In MNA’s oil importers, high inflation, external financing pressures, and limited access to foreign currency are expected to constrain activity. Growth is also projected to moderate in SAR—albeit only marginally—and SSA, as combinations of weak external demand, high inflation, and instability, including from debt distress and natural disasters, weigh on activity.

While headline inflation has declined from recent peaks in all EMDE regions, it remains elevated by historical standards, except in EAP and LAC, and above central bank targets in most inflation-targeting countries in most regions (figure B1.1.1.C). Inflation remains especially high in ECA and SSA, reflecting ongoing energy and food supply disruptions. While headline inflation is expected to continue moderating in the coming months, core inflation is likely to remain elevated, as higher production costs, including for labor, feed through to consumer prices. In crisis-afflicted economies, particularly in MNA and SAR, significant currency depreciations have added to inflationary

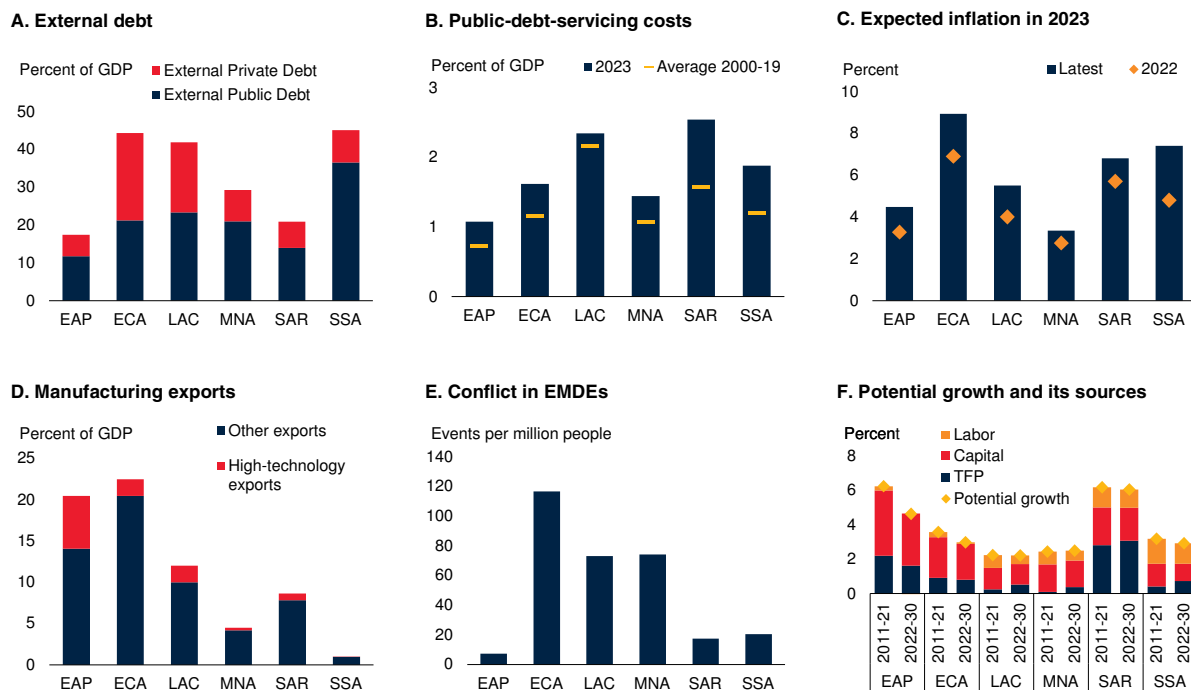
pressures. Persistently high inflation will continue to be a drag on growth this year, eroding real wages and weighing on consumption, increasing uncertainty, and holding back investment. The drag on consumption is expected to be particularly pronounced in low-income countries, predominantly in SAR and SSA, where food accounts for above-average shares of household spending.

With global trade growth projected to slow sharply this year, external demand is set to remain weak for all EMDE regions. Consumption- and services-led growth in China is expected to provide limited support to global goods trade but boost the global tourism recovery. Tepid external demand for goods, including commodities, will weigh on growth in all regions, especially EAP, ECA, and LAC. However, this will be partly offset by a pickup in international tourism, particularly in EAP and to a lesser extent in LAC. Commodity prices are projected to continue easing in 2023 from the very high levels reached last year, helping to cool inflation in all regions and supporting activity in commodity-importing regions, including EAP and SAR.

BOX 1.1 Regional perspectives: Outlook and risks (continued)

FIGURE B1.1.2 Regional risks

EMDE regions are subject to various downside risks, including from tighter global financial conditions—particularly ECA, LAC, and SSA—amid high external debt levels. Rising public-debt-servicing costs in all regions add to the risk of debt distress. Inflation has exceeded expectations in all regions and could remain stubbornly high in most regions. Intensifying geopolitical tensions could disrupt international trade and global value chains, damaging globally integrated manufacturing sectors in EAP and ECA, while further intensification of conflicts—already severe in ECA, LAC, and MNA—could cause broad economic and social damage. The materialization of downside risks, especially those harming investment, could weaken potential growth.



Sources: ACLED (Database); International Monetary Fund; Kilic Celik et al. (2023a); WDI (database); World Bank.
 Note: EAP = East Asia and Pacific, ECA = Europe and Central Asia, LAC = Latin America and the Caribbean, MNA = Middle East and North Africa, SAR = South Asia, SSA = Sub-Saharan Africa.
 A. GDP-weighted average of gross external debt as a share of GDP. Annual data as of 2022. Sample includes 60 EMDEs (8 in EAP, 14 in ECA, 18 in LAC, 6 in MNA, 5 in SAR, and 9 in SSA).
 B. Bars show the regional median of the difference between general government net lending/borrowing and general government primary net lending/borrowing. Lines show the regional median of the simple country average between 2000 and 2019. Sample includes 135 EMDEs (20 in EAP, 21 in ECA, 26 in LAC, 15 in MNA, 6 in SAR and, 47 in SSA).
 C. Bars show median inflation projections for 2023 from April 2023 World Bank projections. Diamonds show median inflation projections for 2023 from April 2022 World Bank projections. Sample includes 134 EMDEs (16 in EAP, 20 in ECA, 27 in LAC, 16 in MNA, 7 in SAR, and 48 in SSA).
 D. Bars show the GDP-weighted averages of manufacturing exports as a share of GDP in 2021. Sample includes 74 EMDEs (9 in EAP, 12 in ECA, 18 in LAC, 8 in MNA, 4 in SAR, and 23 in SSA).
 E. Bars show the number of reported conflict events in since June 2022; conflict events include battles, explosions, violence against civilians, riots and protests. Last observation is May 19, 2023. Sample includes 134 EMDEs (14 in EAP, 23 in ECA, 26 in LAC, 18 in MNA, 7 in SAR, and 46 in SSA).
 F. Figure shows GDP-weighted averages of production function-based annual average potential growth estimates. TFP growth stands for total factor productivity growth. Sample includes 53 EMDEs (6 in EAP, 9 in ECA, 16 in LAC, 5 in MNA, 3 in SAR, and 14 in SSA).

However, for commodity-exporting regions, including ECA, LAC, MNA, and SSA, this will be a drag on growth and government revenues, and will weaken their terms of trade.

Macroeconomic policies are expected to be a drag on growth in all EMDE regions in 2023. Persistently high

core inflation has prompted many EMDE central banks to delay monetary policy easing, particularly in LAC. The effects of tighter monetary policy will continue to be felt this year, with real interest rates rising as inflation moderates. Except in MNA’s oil exporters, where high oil prices have boosted government revenues, fiscal consolidation is expected to continue in 2023 in most

BOX 1.1 Regional perspectives: Outlook and risks (*continued*)

regions as governments seek to rebuild fiscal buffers, although mostly at a gradual pace. Policy uncertainty, social instability, and conflicts are also expected to weigh on activity, particularly in ECA where Russia's invasion of Ukraine continues to have a negative impact on regional output. In LAC, MNA, and SSA, political instability and protests continue to weigh on sentiment and activity in some countries.

In 2024, economic growth is expected to diverge further among the regions. In EAP, growth is projected to slow as the rebound in China fades. In SAR, growth is also forecast to slow next year, owing in part to the repercussions of economic and humanitarian crises and natural disasters, and the lagged effects of monetary and fiscal policy tightening. In the other regions, growth is projected to increase toward potential rates, as domestic headwinds from high inflation and monetary policy tightening ease. Further moderation in global food prices, together with broadly stable energy prices, is expected to help lower inflation and support consumption, particularly in commodity-importing EMDEs. In LAC and SSA, the projected pickup in growth still implies only limited reductions in poverty. In all regions, growth will be supported by stronger external demand as activity picks up in advanced economies and global trade growth firms.

Risks

The baseline projections for EMDE regions are subject to a number of downside risks. Tighter-than-expected global financial conditions could be sparked by renewed stress in the global banking sector, heightened investor risk aversion, or additional monetary policy tightening in major advanced economies in response to persistent inflation. Slower-than-expected growth in advanced economies would further weaken external demand for EMDEs. An intensification in geopolitical tensions, persistently high domestic inflation, and disruptions from domestic conflict and climate change pose further downside risks. The materialization of these risks could further weaken both actual and potential growth.

Tighter-than-expected global financial conditions would have adverse consequences for all EMDE regions, particularly where creditworthiness is lower and where some countries are already grappling with financial crises. This risk was underscored by the jump in sovereign risk premia in March across EMDE

regions—most notably in SSA—in response to bank failures in Europe and the United States. ECA, LAC, and SSA, as well as some countries in SAR, are particularly at risk, given high levels of external debt and the associated exposure to higher borrowing costs (figure B1.1.2.A). The need to finance sizable current account deficits in many countries in LAC, SAR and SSA also increases vulnerabilities to sudden increases in borrowing costs.

High levels of public debt heighten the risk of government debt crises. While fiscal deficits have generally fallen from the very high levels reached in the early phases of the pandemic, they remain above pre-pandemic levels in EAP, ECA, LAC and SAR, adding to debt and increasing the risk of a forced sharp pivot toward budgetary consolidation, which would dampen activity. As indebtedness and borrowing costs have risen, so too have public-debt-servicing costs in all regions (figure B1.1.2.B). Absent well-calibrated fiscal consolidation, further increases in borrowing costs could threaten fiscal sustainability in economies where fiscal space is limited, particularly in LAC and SSA. In MNA, and to a lesser extent LAC, government revenues—and therefore fiscal positions—are also vulnerable to sharper-than-expected declines in commodity prices.

High inflation may be more persistent than expected; indeed, expected inflation has increased in most countries in several regions, most prominently in ECA, LAC and SSA (figure B1.1.2.C). Further unexpectedly persistent high inflation would imply further erosion of household purchasing power, higher interest rates, and heightened uncertainty, leading to weaker consumption and investment. Continued high inflation also increases the risk of inflation becoming entrenched by feeding into expectations and leading to increases in wages and production costs, particularly where the outlook for demand remains robust, as in SAR. Signs that inflation expectations were becoming de-anchored could spur central banks to further tighten monetary policy.

An intensification of geopolitical tensions could further erode growth prospects in all EMDE regions by stoking uncertainty and disrupting global trade and supply chains. This applies to trade in commodities, as underscored by changes in global energy trade flows following the imposition of sanctions on Russia's energy exports in response to its invasion of Ukraine. Repercussions of

BOX 1.1 Regional perspectives: Outlook and risks (continued)

increased tensions could put renewed upward pressure on commodity prices and further stoke inflation. Geopolitical tensions could also drive a further reorientation of production lines through friend-shoring, near-shoring, or on-shoring, particularly of high-technology manufactured goods. While potentially creating opportunities for some countries, trade diversion could force a disruptive realignment or shortening of global value chains, stoking uncertainty and dampening investment, with the regions most highly integrated into global manufacturing trade, particularly EAP and ECA, at greatest risk (figure B1.1.2.D). Conflict and civil unrest—already high in many EMDEs, including in ECA, LAC, MNA, and SSA—could also escalate, increasing uncertainty and causing greater economic and social harm (figure B1.1.2.E).

As underscored by the earthquakes in the Syrian Arab Republic and Türkiye in February, natural disasters could cause severe damage and economic disruption. Extreme weather events, which are becoming more frequent and intense with climate change, could also substantially weaken growth, as highlighted by severe

droughts in LAC, MNA, and SSA, and storms in EAP. Risks are particularly large for small island states concentrated in EAP and LAC. While agricultural prices are expected to moderate this year, worsening conflicts or adverse weather-related events could reduce agricultural output, push up food prices anew, and exacerbate enduring food security challenges, especially in MNA, SAR, and SSA. This could feed further social unrest and conflict.

Growth could be weaker than projected for longer if the materialization of downside risks undermines the drivers of potential growth. Absent substantial reforms, over the remainder of this decade potential growth is already set to decline in EAP and, to a lesser extent, in ECA and to remain lackluster elsewhere (figure B1.1.2.F). In particular, investment, an important potential growth driver in all regions, could weaken if financial conditions tighten more than expected. Protracted slow global growth—or worse, recession—and trade disruptions could also depress investment. Longer-term investment growth would also suffer in the event of financial crisis.

Excluding China and Russia, growth is forecast to decline slightly more in commodity exporters than in commodity importers, and from a lower starting point (figure 1.9.E). Growth in commodity importers excluding China is set to fall to 4.2 percent in 2023, from 5.3 percent in 2022. Continued high local prices for energy and food will take a toll on private demand in most countries, while heightened macroeconomic vulnerabilities in some large commodity-importing economies are likely to weigh on business confidence. In commodity exporters excluding Russia, growth is expected to slow to 2.2 percent, from 4.2 percent last year. This largely reflects slowing growth in oil exporters, as the boom in industrial activity associated with high energy prices fades.

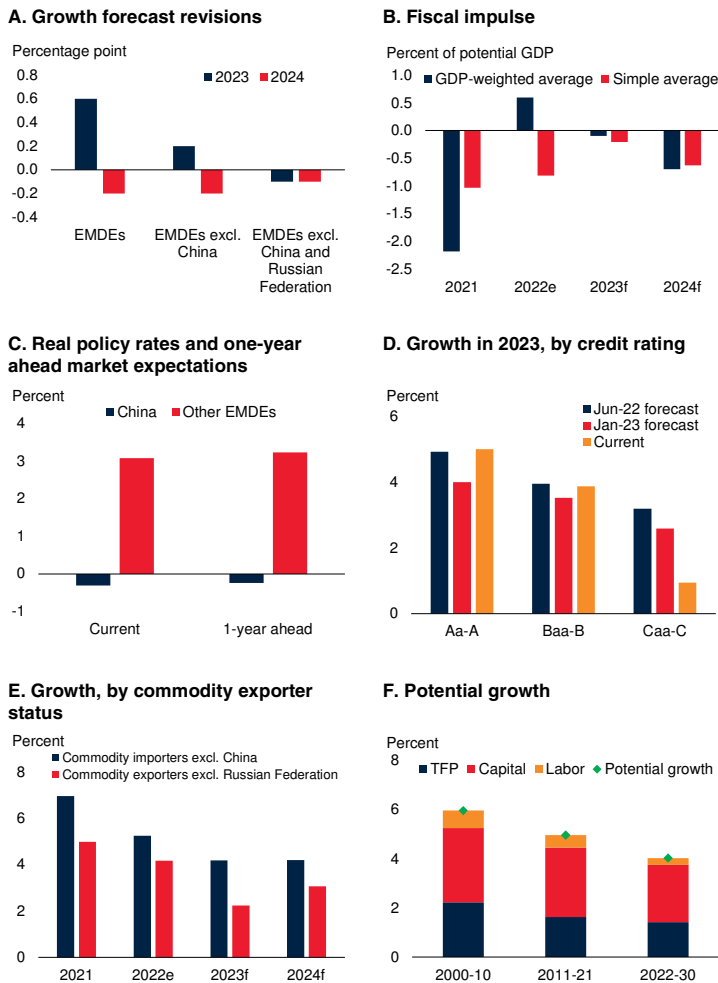
Over the first half of the 2020s (2020-2024), growth in EMDEs is expected to be unusually weak, averaging just 3.4 percent. This can be largely attributed to the overlapping adverse shocks of recent years—the COVID-19 pandemic, the repercussions from Russia's invasion of

Ukraine, and the ongoing global monetary policy tightening cycle. However, a longer-term perspective suggests that a fundamental structural slowdown is also at work, which is likely to persist throughout the remainder of the decade. This involves a reduction in the prospects for potential output, resulting from a slowing in all the major underlying drivers of growth: labor force growth (associated with aging populations); capital accumulation; and improvement in total factor productivity.

Labor force growth in EMDEs is set to decelerate as populations age in all regions except Sub-Saharan Africa. Weak investment growth, which weighed on EMDE growth for much of the past decade, is expected to continue as economies grapple with elevated debt and a long-term slowdown in trade growth. This implies a diminished contribution to growth from capital accumulation. Subdued investment is also a major driver of projections of declining total factor productivity growth, since new investment can

FIGURE 1.9 Outlook for emerging market and developing economies

Growth in emerging market and developing economies (EMDEs) excluding China is forecast to slow markedly in 2023. Upgrades to China and the Russian Federation account for most of the upward revision to growth this year. Both fiscal and monetary policy are expected to weigh on activity in 2023 and 2024. Amid high borrowing costs, growth projections for countries with weak credit profiles have on average more than halved from a year ago. Excluding China and Russia, growth is expected to slow more in commodity exporters than commodity importers, from a lower starting point. In the longer term, EMDE potential growth is weakening.



Sources: Bloomberg; Kose and Ohnsorge (2023a); WEO (database); World Bank.

Note: EMDEs = emerging market and developing economies.

A. Figure shows the difference between the latest projections and forecasts from the January 2023 *Global Economic Prospects* report.

B. Fiscal impulse is the negative annual change in the structural primary balance for up to 43 EMDEs, using data from the April 2023 WEO (database). A positive value indicates fiscal expansion, while a negative value indicates consolidation. Structural primary balance is the general government structural balance excluding net interest costs.

C. "Current" real rate is the policy rate minus a one-year ahead inflation expectation derived as a time-weighted average of 2023 and 2024 Bloomberg consensus inflation forecasts. "1-year ahead" is the market expectation derived from interest rate futures for the 1-year-ahead policy rate, minus a one-year inflation expectation for mid-2024 to mid-2025. "Other EMDEs" is the GDP-weighted average for Brazil, Chile, Colombia, Hungary, India, Malaysia, Mexico, Philippines, Poland, Romania, South Africa, and Thailand. Last observation is May 30, 2023.

D. Comparison of GDP-weighted growth between different editions of the *Global Economic Prospects* report. Sample size includes 9 Aa-A, 62 Baa-B, and 25 Caa-C economies.

E. Aggregates calculated using GDP weights at average 2010-19 prices and market exchange rates.

F. Based on the production function approach as described in Kose and Ohnsorge (2023a). Sample includes 53 EMDEs. Data for 2022-30 are forecasts.

embody efficiency improvements and technology transfer. Model-based estimates suggest that EMDE potential growth may weaken from a rate of 5 percent per year in 2011-21, to 4 percent in 2022-2030 (figure 1.9.F; Kose and Ohnsorge 2023a). This would likely further delay the attainment of poverty reduction goals.

LICs outlook

LICs are forecast to grow by 5.1 percent this year, little changed from previous projections but below the pre-pandemic average. Forecast upgrades for several large countries are offset by the sizable downgrades in many other LICs, where worsening domestic vulnerabilities and fragility are dampening growth (box 1.2). Progress with poverty alleviation is expected to remain feeble, as past increases in the cost of living continue to weigh on activity. In some countries, fiscal consolidations amid elevated debt and high borrowing costs are projected to temper growth further by dampening public spending and investment.

In a number of fragile LICs, the effects of recent cost-of-living increases were exacerbated by sharp increases in violence and insecurity and climate-change-induced adverse weather events. Humanitarian needs across some fragile LICs (Afghanistan, Somalia, South Sudan, Sudan) are severe, with substantial risks of further deterioration in extreme poverty and food security. Some smaller agricultural-commodity exporters are struggling with complex challenges, including elevated input costs for seed, fertilizer, and energy, shortages of imported raw materials, floods, pest infestations (Burkina Faso, Mali), and disruptions caused by tropical cyclones (Madagascar, Malawi, Mozambique). In some other LICs, forecasts have been revised up on the basis of supportive mining-related activity, moderating inflation, and a peace agreement in Ethiopia—the largest LIC.

Per capita income growth

In per capita terms, the baseline forecasts represent a weak recovery from the overlapping shocks of the past three years. Over the first half of the 2020s (2020-2024), about one-third of EMDEs are expected to experience negative per capita growth (figure 1.10.A).

BOX 1.2 Recent developments and outlook for low-income countries

The challenges facing low-income countries (LICs) have become more formidable. The number of people struggling with extreme poverty and food insecurity in LICs has risen significantly as sharp increases in the cost of living have, in many cases, come on top of severe droughts or floods, or intensified violence. Although the overall growth forecast for 2023 has been revised upward marginally—to 5.1 percent, mostly owing to stronger recoveries in the largest economies—forecasts have been downgraded for over 40 percent of LICs. The deterioration in the outlook for many LICs reflects persistent inflation, rising indebtedness, depleted policy space, heightened insecurity, and weather-induced disruptions to activity. Risks to the outlook are tilted to the downside, including increased debt distress, higher-than-projected inflation, more frequent or intense weather events, increased insecurity, and weaker global growth.

Introduction

Growth in low-income countries (LICs) is expected to firm this year, as several metal and energy exporters expand production, and peacebuilding in Ethiopia gradually yields dividends. Nonetheless, many LICs struggle with increased vulnerabilities and fragility stemming partly from sharp increases in the cost of living since early 2022. Despite recent declines, consumer prices remain elevated, restricting food affordability for vulnerable populations. Almost 100 million people in LICs are still experiencing severe food insecurity (WFP and FAO 2022). Policy space to support the poor has been depleted, while substantial financing needs endanger debt sustainability in many countries. High levels of violence and extreme weather events continue to displace people, disrupt food supplies, and exacerbate poverty.

The outlook for LICs is subject to substantial uncertainty and various downside risks. Volatility of global commodity prices could intensify as markets remain vulnerable to renewed supply shocks. If global inflation pressures persist, further policy tightening could not only weigh on external demand but also heighten the risk of debt crises in some LICs. A stronger-than-expected rebound in China could support activity in some commodity exporters, but it could also lead to a surge in energy and food prices. Lastly, worsening insecurity would further retard economic development and poverty reduction, especially in LICs confronting the devastating impacts of climate change.

Against this backdrop, this box addresses the following questions.

- What have been the main recent economic developments in LICs?

- What is the outlook for LICs?
- What are the risks to the outlook?

Recent developments

Growth in LICs strengthened last year to 4.8 percent, reflecting continued post-pandemic rebounds in non-resource sectors and agriculture (Ethiopia, Mozambique, Niger, Uganda), and stronger mining activity in several metal and oil producers (Chad, the Democratic Republic of Congo, Equatorial Guinea, Guinea). Nevertheless, recoveries slowed in over 60 percent of LICs as domestic vulnerabilities—including extreme poverty and food insecurity, lack of fiscal space, and large external financing needs—worsened considerably across many countries alongside sharp cost-of-living increases stemming partly from the repercussions of Russia's invasion of Ukraine (figure B1.2.1.A).

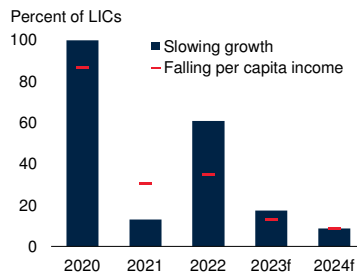
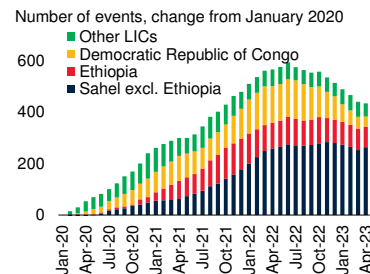
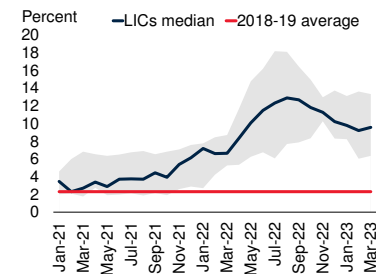
Pervasive violence, especially in the Sahel region (Burkina Faso, Mali, Somalia, South Sudan, Sudan), and adverse weather patterns overlapped with macroeconomic instability and worsened humanitarian situations across LICs last year. Although the incidence of violence has fallen from its peak in mid-2022—with improved security in several large countries—peacebuilding remains fragile in the Democratic Republic of Congo and Ethiopia, while conflict has escalated in other LICs (Burkina Faso, Sudan; figure B1.2.1.B).

Several agricultural commodity exporters, already coping with increased inter-communal violence, have been facing other challenges, including elevated costs of fertilizer and fuel, shortages of foreign exchange (Burundi, Eritrea) and imported raw materials, infestations of cotton leafhoppers (Burkina Faso, Mali), and disruptions caused by floods (Chad, Sudan) and tropical cyclones (Madagascar, Malawi, Mozambique; Engel et al. 2023). On the upside, better rainfall has

Note: This box was prepared by Sergiy Kasyanenko.

BOX 1.2 Recent developments and outlook for low-income countries (continued)**FIGURE B1.2.1 LICs: Recent developments**

Although growth in low-income countries (LICs) continued to improve in 2022, recoveries slowed in many countries because of heightened domestic vulnerabilities and increased external economic headwinds. Many LICs are still coping with worsening domestic vulnerabilities following last year's cost-of-living shocks and increased insecurity.

A. Interrupted recoveries**B. Violence and conflict****C. Consumer price inflation**

Sources: ACLED (database); Haver Analytics; World Bank.

Note: f = forecast; LICs = low-income countries.

B. Twelve-months moving average; violent events include battles, explosions, violence against civilians, riots, and protests. Last observation is April 2023.

C. Annual consumer price inflation. Sample of 9 LICs. Shaded area shows the 25-75 percentile range of inflation rates among the countries. Last observation is March 2023.

been supporting agricultural activity in a number of countries (Niger, Uganda), while improved security has put growth prospects in Ethiopia on a firmer footing.

Annual consumer price inflation in the median LIC has cooled, to below 10 percent in March 2023; however, this remains more than four times higher than before the COVID-19 pandemic and double-digit annual inflation persists in 40 percent of countries (figure B1.2.1.C; World Bank 2023a). Continued price pressures include weak currencies, elevated costs of energy and farming inputs, depleted stocks of staple foods, and adverse weather events. Furthermore, armed conflicts have been causing significant food price spikes in many local markets across LICs by disrupting major transportation and distribution routes (Alfano and Cornelissen 2022).

LICs' current account and budget deficits widened to post-pandemic highs last year because of soaring import bills and increased government spending to mitigate cost-of-living increases and improve security. Public debt in LICs remains about 70 percent of GDP on average, and in over 80 percent of LICs both the current account and the budget are in deficit. In over a quarter of LICs, these deficits both exceed 5 percent of GDP (Malawi, Rwanda, Uganda). Such considerable

financing needs, together with limited access to external borrowing, have heightened the risk of debt distress in many countries.

Outlook

Growth in LICs is projected to firm to 5.1 percent in 2023—a 0.1 percentage point upgrade from the previous forecast, but with revisions differing widely among countries. Solid activity in several commodity producers is expected to be supported by firming exports boosted by the reopening of China's economy, as well as by the continued expansion of large extractive projects (Democratic Republic of Congo, Mozambique, Zambia). Nonetheless, forecasts have been downgraded for over 40 percent of LICs by 0.7 percentage point on average. Recoveries in many of those LICs are expected to remain constrained by the legacy of past shocks, including the pandemic and the invasion of Ukraine, which worsened poverty, triggered cost-of-living surges, and undermined debt sustainability.

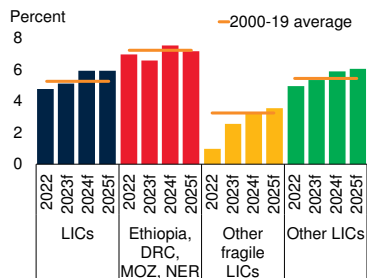
Growth in LICs is forecast to strengthen further to 5.9 percent in 2024 (table B1.2.1). The growth pickup assumes that cost-of-living pressures ease, supply disruptions caused by recent weather events gradually dissipate, and security situations improve in some

BOX 1.2 Recent developments and outlook for low-income countries (continued)

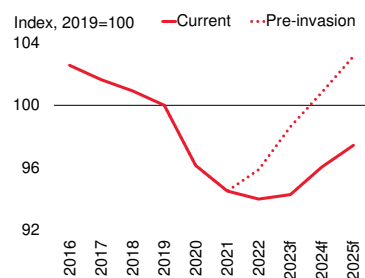
FIGURE B1.2.2 LICs: Outlook and risks

Output growth in LICs is projected to strengthen further in 2023-24 as inflation moderates and disruptions caused by recent adverse weather and insecurity gradually ease. In many fragile LICs, however, recoveries are expected to remain weak, tempered by debt distress and unfavorable terms of trade, with slowing per capita income growth. Risks to the baseline forecast are tilted firmly to the downside, especially for those LICs most vulnerable to climate change.

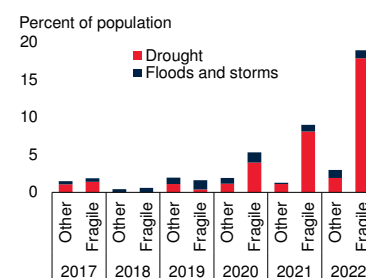
A. GDP growth



B. Real income per capita in fragile LICs



C. LIC population affected by extreme weather events



Sources: Guha Sapor, Below, and Hoyois (EM-DAT); World Bank.

Note: f = forecast; Fragile LICs = fragile and conflict-affected LICs; LICs = low-income countries.

A. DRC = Democratic Republic of Congo, MOZ = Mozambique, and NER = Niger; Ethiopia, Democratic Republic of Congo, Mozambique, and Niger are fragile LICs. Average GDP growth rates calculated using constant GDP weights at average 2010-19 prices and market exchange rates. Fragile LICs sample comprises 22 LICs, which include 13 Fragile LICs.

B. Fragile LICs exclude the Democratic Republic of Congo and Ethiopia. Pre-invasion projections are forecasts from the January 2023 *Global Economic Prospects* report.

C. Bars indicate percent of population in the affected group countries.

countries. Elevated metal prices and investment in mining and infrastructure are expected to support growth and exports of metal producers, although fiscal consolidations and political uncertainty will temper recoveries in some cases (Liberia, Sierra Leone). However, for a number of LICs, especially those in fragile and conflict-affected situations, the outlook is less favorable, with worsening humanitarian situations, high inflation, and substantial external financing needs (Burkina Faso, Malawi, South Sudan, Sudan).

In fragile LICs, growth is expected to firm to 5.6 percent a year on average in 2023-24—representing a return to past average long-term growth rates as the recovery from recent shocks accelerates. However, much of this improvement is accounted for by a few large economies where better security (Ethiopia) or expanding extractive sectors (Democratic Republic of Congo) are expected to boost growth. In Ethiopia, economic activity is projected to normalize in the Tigray region following last year’s peace agreement. In the Democratic Republic of Congo, increasing production and exports of copper and a strong pick up of growth in

nonmining sectors are expected to sustain a 7.7 average growth in 2023-24, implying continued poverty reduction. In a number of other fragile LICs, the completion of large energy projects is expected to underpin robust growth and exports (Mozambique, Niger).

The remaining fragile LICs, most of which are agricultural commodity exporters, are expected to grow more slowly—by only 2.7 percent a year on average in 2023-24, a 0.7 percentage point downgrade from the January forecast and barely faster than population growth (figure B1.2.2.A). This downgrade reflects an intensification of domestic challenges—such as resurgent violence (Sudan)—amplified by the unfavorable external environment and increased vulnerability to extreme climate events.

Recoveries in nonfragile LICs are forecast to regain momentum as the drag from last year’s shocks lessens. Growth is projected to improve in 2023-24 in several economies because of recovering tourism (Rwanda), recent funding from multilateral organizations

BOX 1.2 Recent developments and outlook for low-income countries (continued)**TABLE B1.2.1 Low-income country forecasts^a**

(Real GDP growth at market prices in percent, unless indicated otherwise)

Percentage point differences from January 2023 projections

	2020	2021	2022e	2023f	2024f	2025f	2023f	2024f
Low-Income Country, GDP^b	1.4	4.2	4.8	5.1	5.9	5.9	0.1	0.3
GDP per capita (US dollars)	-1.4	1.3	1.9	2.3	3.1	3.1	0.1	0.4
Afghanistan ^c	-2.4	-20.7
Burkina Faso	1.9	6.9	2.5	4.3	4.8	5.1	-0.7	-0.5
Burundi	0.3	3.1	1.8	3.0	4.0	4.2	0.0	0.0
Central African Republic	1.0	1.0	0.0	3.0	3.8	3.8	0.0	0.0
Chad	-1.6	-1.2	2.2	3.2	3.4	3.1	-0.1	0.1
Congo, Dem. Rep.	1.7	6.2	8.6	7.7	7.6	7.5	1.3	1.0
Eritrea	-0.5	2.9	2.5	2.7	2.9	2.8	0.0	0.0
Ethiopia ^d	6.1	6.3	6.4	6.0	6.6	7.0	0.7	0.5
Gambia, The	0.6	4.3	4.3	5.0	5.5	5.8	1.0	0.0
Guinea	4.9	4.3	4.7	5.6	5.8	5.6	0.3	0.2
Guinea-Bissau	1.5	6.4	3.5	4.5	4.5	4.5	0.0	0.0
Liberia	-3.0	5.0	4.8	4.3	5.5	5.6	-0.4	-0.2
Madagascar	-7.1	5.7	3.8	4.2	4.8	5.1	0.0	0.2
Malawi	0.8	2.8	0.9	1.4	2.4	3.0	-1.6	-1.0
Mali	-1.2	3.1	1.8	4.0	4.0	5.0	0.0	0.0
Mozambique	-1.2	2.3	4.1	5.0	8.3	5.3	0.0	0.3
Niger	3.6	1.4	11.5	6.9	12.5	9.1	-0.2	2.4
Rwanda	-3.4	10.9	8.1	6.2	7.5	7.5	-0.5	0.5
Sierra Leone	-2.0	4.1	3.0	3.4	3.7	4.4	-0.3	-0.7
South Sudan ^d	9.5	-5.1	-2.3	-0.4	2.3	2.4	0.4	0.2
Sudan	-3.6	-1.9	-1.0	0.4	1.5	2.0	-1.6	-1.0
Syrian Arab Republic ^c	-0.2	1.3	-3.5	-5.5	-2.3	..
Togo	1.8	5.3	4.9	4.9	5.3	5.5	-0.7	-1.1
Uganda ^d	3.0	3.4	4.7	5.7	6.2	6.7	0.2	0.1
Yemen, Rep. ^c	-8.5	-1.0	1.5	-0.5	2.0	..	-1.5	..
Zambia	-2.8	4.6	3.9	4.2	4.7	4.8	0.3	0.6

Source: World Bank.

Note: e = estimate; f = forecast. World Bank forecasts are frequently updated based on new information and changing (global) circumstances. Consequently, projections presented here may differ from those contained in other Bank documents, even if basic assessments of countries' prospects do not significantly differ at any given moment in time.

a. The Democratic People's Republic of Korea and Somalia are not forecast on account of data limitations.

b. Aggregate growth rates are calculated using GDP weights at average 2010-19 prices and market exchange rates.

c. Forecasts for Afghanistan (beyond 2021), the Syrian Arab Republic (beyond 2023), and the Republic of Yemen (beyond 2024) are excluded because of a high degree of uncertainty.

d. GDP growth rates are on a fiscal year basis. For example, the column labeled 2022 refers to FY2021/22.

(Rwanda, Uganda), increasing output in agriculture (The Gambia), and moderating inflation.

Progress with poverty reduction in LICs—set back by the cost-of-living shock following Russia's invasion of Ukraine—is expected to remain slow, given the subdued per capita income growth projected for many countries, especially those affected by fragility (figure

B1.2.2.B). Although per capita incomes in LICs are projected to grow by 2.7 percent a year on average in 2023-24, they are expected to increase at only half this pace in the fragile LICs, excluding the Democratic Republic of Congo and Ethiopia—the two most populous LICs. At the end of 2024, per capita incomes are expected to remain below 2019 levels in about 40 percent of LICs. Moreover, in 40 percent of LICs—

BOX 1.2 Recent developments and outlook for low-income countries (*continued*)

accounting for half of the total LIC population—average per capita income growth rates in 2023-24 are expected to still fall short of their pre-pandemic averages.

Risks

Risks to the outlook remain tilted to the downside, especially for countries affected by fragility or those vulnerable to sharp cost-of-living increases and adverse weather events. Pressures in global commodity markets could lead to increased price volatility, especially if the war in Ukraine were to escalate. The economic recovery in China could further amplify commodity market volatility if its pace were to falter.

Debt sustainability risks are considerable in a number of LICs, as increased current account and budget deficits, combined with weak growth and high debt-service costs, have lifted LICs' financing needs. If inflation persists above targets and causes global monetary policy to tighten more than expected or if stress in the global banking system re-emerges, financing conditions and access to external borrowing could become even more challenging for LICs. With over half of all LICs at high risk of, or already in, debt distress, unfavorable debt dynamics could trigger severe financial stress or even debt crises in some countries.

Domestic vulnerabilities and fragility have worsened across many LICs, while depleted policy space has eroded buffers to absorb additional shocks (Burkina Faso, Malawi). Meanwhile, climate change is exacerbat-

ing overlapping exposures to macroeconomic and weather-related shocks, as LICs are generally more reliant on natural resources to support the growth of output, exports, and jobs than other EMDEs (UNCTAD 2022). Countries that are most vulnerable to climate change often also have large vulnerable populations, elevated levels of civil insecurity, and are at high risk of debt distress (Chad, Sudan; World Bank 2022b; figure B1.2.2.C). An escalation in violence or adverse weather events could substantially worsen ongoing humanitarian crises and dampen growth.

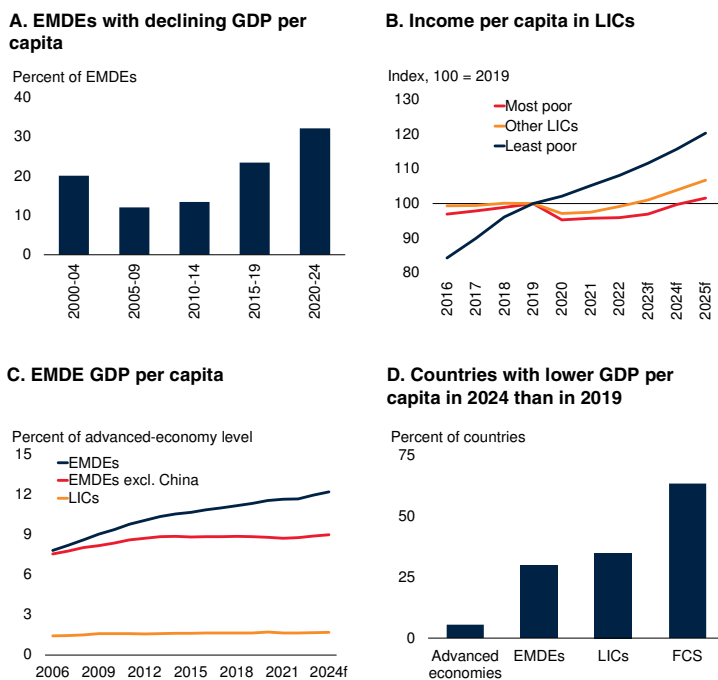
Progress with economic development in LICs—already upended by the COVID-19 pandemic and the repercussions of the invasion of Ukraine—may face further reversals as the adverse impacts of climate change become more severe. Several LICs are already experiencing catastrophic consequences of extreme weather. In the Sahel region, which is warming faster than the global average (IPCC 2023), nearly 40 million people need emergency food assistance. The number of people facing extreme hunger is rising rapidly across Eastern Africa, which is confronting the worst drought in recorded history. Last year, over 40 thousand people—half of them children younger than 5 years—are estimated to have died in Somalia because of the drought (UNICEF 2023). These risks could intensify sharply if global greenhouse gas emissions continue to rise and LICs with substantial adaptation gaps are unable to secure adequate financing to improve their climate resilience.

In LICs, especially the very poorest economies, the damage is stark. In close to half of LICs, per capita incomes will remain below their 2019 levels this year, by about 5 percent on average. Income per capita in the poorest LICs is expected to recover at a much slower pace compared with other LICs (figure 1.10.B). More broadly, fragility continues to aggravate humanitarian crises and remains a substantial deterrent to development across EMDEs—income per capita growth in fragile EMDEs is expected to average only 1.1 percent a year in 2023-24, further entrenching extreme poverty.

The unequal distribution of growth is weighing on median living standards in many EMDEs. In the upper quartile of EMDEs, food prices have risen more than 40 percent since end-2020, with disproportionate impacts on the consumption of the least well-off, who spend more of their income on food. Moreover, informal workers, who tend to have lower incomes, are likely to have seen steeper real income cuts in the context of high inflation (Ohnsorge and Yu 2021). In contrast, workers in formal employment have greater capacity to wage-bargain to retain purchasing power.

FIGURE 1.10 Per capita GDP growth

In the first half of this decade, per capita GDP is expected to decline in about one-third of emerging market and developing economies (EMDEs). For many low-income countries (LICs), especially the very poorest economies, income per capita remains below its pre-pandemic level. Catch-up of EMDEs excluding China—especially of LICs—with advanced-economy income per capita levels has been feeble for an extended period. For nearly two-thirds of EMDEs in fragile and conflict-affected situations, per capita incomes are expected to be lower in 2024 than they were in 2019.



Sources: World Bank (2023b); World Bank.

Note: EMDEs = emerging market and developing economies; FCS = fragile and conflict-affected situations; LICs = low-income countries. Data for 2023-25 are forecasts.

A.C.D. GDP per capita for aggregates are calculated as aggregated GDP divided by the aggregate population. GDP aggregates are calculated using real U.S. dollar GDP weights at average 2010-19 prices and market exchange rates.

A. Figure shows the proportion of EMDEs for which per capita growth was negative, on average, in each 5-year period. Sample includes 149 EMDEs.

B. Most poor LICs refer to countries with the poverty headcount ratio at \$2.15 a day above the 75th percentile (63.5 percent); least poor are the ones where the poverty headcount is below the 25th percentile (25.3 percent). Poverty headcount estimates for 2023 are from the World Bank (2023b). Per capita income is calculated as each group's GDP divided by its population.

D. Figure shows the share of countries in respective groups with real per capita GDP in 2024 lower than in 2019.

Subdued per capita income growth is a long-term trend in many EMDEs. On present projections, EMDEs excluding China will register only modest catch-up toward advanced economy income levels in 2022-2024, following several years of backsliding (figure 1.10.C). In fact, nearly a third of EMDEs, including two-thirds of countries in fragile and conflict-affected situations, are expected to have lower per capita incomes in 2024 than they did in 2019 (figure 1.10.D). Even in the medium term, EMDEs as a whole are likely to

make only incremental progress in this regard. Under current assumptions about the expected evolution of its fundamental drivers, potential per capita growth in EMDEs is projected to be 3.5 percent per year in 2022-30, 0.6 percentage point lower than in 2011-21.

Global outlook and risks

Global growth is expected to slow this year as credit conditions tighten due to ongoing monetary tightening and banking sector stress in advanced economies. The drag from tighter financial conditions is becoming increasingly apparent and is expected to peak this year. Inflation has proved persistent but should decline as demand slows and commodity prices moderate, provided longer-term inflation expectations remain stable. Stress in systemically important banks could lead to financial crisis and protracted economic losses. Unexpected persistence in core inflation or further commodity price shocks could result in greater-than-expected monetary tightening and hence increase the risk of a resurgence of financial stress. In the longer term, the slowdown in the fundamental drivers of growth may be exacerbated by trade fragmentation and intensified climate change.

Global outlook

Global growth is expected to slow to 2.1 percent in 2023 before rebounding to 2.4 percent in 2024. The weakness in activity projected for this year is widespread across countries—especially in advanced economies (figure 1.11.A). The primary driver of the short-term dynamics continues to be the combination of elevated inflation, alongside the global monetary policy tightening it has provoked. The drag from these factors is expected to peak this year before gradually dissipating. In the longer term, global output is expected to decelerate because of a broad-based slowdown in all the fundamental drivers of growth.

Nonetheless, developments since the beginning of the year have resulted in the forecast for global growth being revised up by 0.4 percentage point for 2023. Activity in major advanced economies and some EMDEs did not slow as much as expected at the turn of the year. Notably, the rapid reopening of China's economy contributed

materially to an upward revision to this year’s growth forecast. While the aggregate global forecast has been revised up, projections for most economies have been revised down, with larger downgrades among countries that have had a greater degree of monetary tightening (figure 1.11.B).

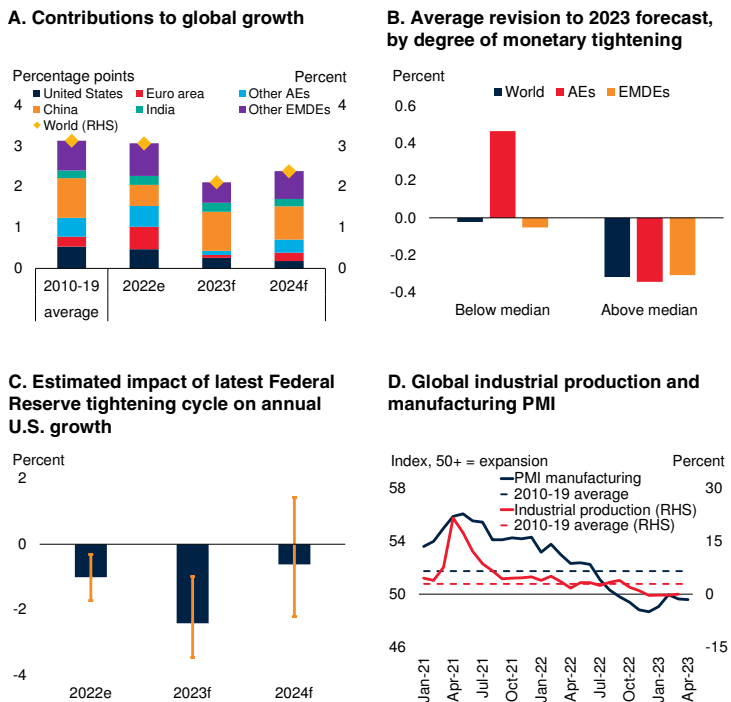
The surprising economic strength at the turn of the year is not expected to last. According to model-based estimates, the impact of monetary tightening on growth in the United States—which has substantial global spillovers—is envisaged to peak this year (figure 1.11.C). Although household consumption has been quite resilient in the first half of 2023, the impact of rising borrowing costs has been apparent in interest-rate-sensitive activities such as business and residential investment (figure 1.11.D). Banking sector stress has encouraged lenders to strengthen balance sheets and tighten credit standards, which may further slow credit issuance (Gropp et al. 2019).

The pace of monetary transmission may be somewhat slower than usual in the current cycle for a variety of reasons. In some major economies, the share of variable-rate mortgages has fallen in recent years, delaying the pass-through from policy rates to mortgage payments by households (Berger et al. 2021). The substantial buffers built up through excess household savings and elevated corporate profits may also be muting or delaying the response to higher interest rates. Similarly, increasing market concentration and high profit margins may insulate some firms from the impacts of rising borrowing costs and slow the pace of monetary policy pass-through (Duval et al. 2021). The lagged effects of monetary tightening and the slowdown in credit growth have been factored into the 0.3 percentage point downward revision to the baseline 2024 forecast for global growth.

Headline inflation remains high despite a recent deceleration due to falling energy prices. Elevated core inflation has proven more persistent than expected. As a result, the global inflation forecast for this year has been revised up by 0.3 percentage point since January. Headline inflation is now projected to fall from 7.3 percent in 2022 to 5.5 percent in 2023. The combination of weaker

FIGURE 1.11 Global outlook

Global growth is expected to slow substantially this year, with a pronounced deceleration in advanced economies and a sizable pickup in China. Most country forecasts have been revised down, particularly for those countries that have had greater monetary policy tightening. The impact of central bank tightening on growth is expected to peak this year in many countries, including the United States, and is already apparent in rate-sensitive activities such as manufacturing.



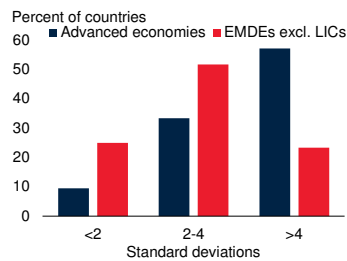
Sources: Anderson et al. (2013); Blagrove et al. (2020); Brayton, Laubach, and Reifschneider (2014); CPB Netherlands Bureau for Economic Policy Analysis; Haver Analytics; Oxford Economics; World Bank.
 Note: AEs = advanced economies; EMDEs = emerging market and developing economies.
 A. Aggregate growth rates are calculated using real U.S. dollar GDP weights at average 2010-19 prices and market exchange rates. Data for 2023-24 are forecasts.
 B. Figure shows average 2023 forecast change between the January and June 2023 editions of the *Global Economic Prospects* report according to whether the central bank’s policy rate has increased by more or less than the global median. This is expressed in country-specific standard deviations. Sample includes 19 advanced economies and 77 EMDEs.
 C. Estimated impact on U.S. GDP growth of the rise in the U.S. policy rate from 0.25 to 5.25 percent, between 2022Q1 and 2023Q4, according to several major published global projection models. This includes the Oxford Economic Model, the Federal Reserve’s FRB/US model (using both adaptive and forward-looking expectations), the Bank of Canada’s IMPACT model, and the IMF’s GIMF model. Bars indicate simple averages; orange whiskers indicate minimum-maximum values.
 D. Figure shows global manufacturing Purchasing Managers’ Index (PMI) and annual percentage change of global industrial production. PMI readings above (below) 50 indicate expansion (contraction) in economic activity. Last observation is April 2023 for the PMI and March 2023 for industrial production.

growth, lower commodity prices, and still-anchored inflation expectations is expected, by 2024, to dampen core inflation, with headline inflation falling to 3.7 percent. Despite this expected decline, inflation is set to remain above central bank targets in many countries throughout next year.

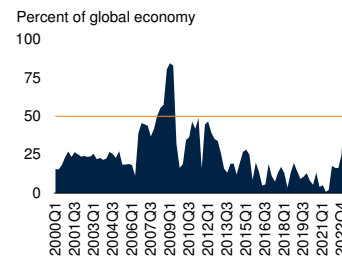
FIGURE 1.12 Risk of financial stress

Bank balance sheets have sustained losses from recent economic weakness and the unusually rapid rise in interest rates. This could be exacerbated by declines in house prices, which are already taking place in countries accounting for half of global activity. The nature of banking sector vulnerabilities varies, with greater risks in some regions associated with potential loss of liquidity, and others suffering from low bank profitability or limited capital buffers.

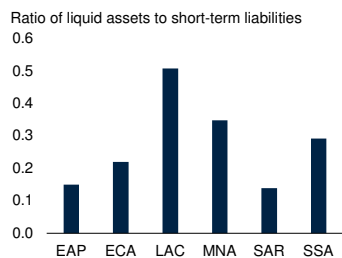
A. Magnitude of monetary policy tightening since 2020



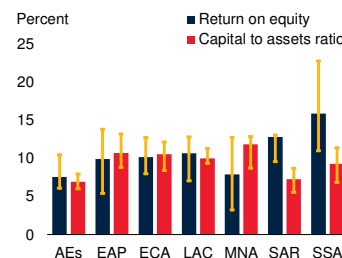
B. Share of the global economy in countries with falling housing prices



C. Banking exposure to liquidity risks



D. Banking exposure to solvency risks



Sources: BIS (database); FinStats 2023 (database); Haver Analytics; J.P. Morgan; World Bank.

Note: AEs = advanced economies; EMDEs = emerging market and developing economies; EAP = East Asia and Pacific, ECA = Europe and Central Asia, LAC = Latin America and the Caribbean, MNA = Middle East and North Africa, SAR = South Asia, SSA = Sub-Saharan Africa; LICs = low-income countries.

A. Figure shows the number of standard deviations from the lowest point since January 2021 to its peak. The standard deviation is calculated on the sample period between 2011-2023. Sample includes 21 advanced economies and 71 EMDEs; the countries in the euro area are counted as 1 unit.

B. Figure shows the GDP-weighted share of the global residential real estate market where nominal prices declined over the preceding 2 quarters. Sample includes up to 36 advanced economies and 21 EMDEs. Orange line indicates 50 percent.

C. Bars show GDP-weighted data. Short-term liabilities include deposits and short-term funding. Data are as of 2021.

D. Capital to assets ratio shows banks' capital to assets. Bars indicate medians. Whiskers indicate interquartile range. Data are as of 2021.

Risks to the outlook

Risks to the outlook remain tilted to the downside. The collapse of multiple banks this year highlights the possibility of more disorderly failures, which could lead to systemic banking crises and protracted economic losses. These failures could be triggered by rising non-performing loans, lower asset values impairing balance sheets, a deeper correction in house

prices, or losses from the heavily leveraged commercial real estate sector. In addition, higher or more persistent inflation—especially, more persistent core inflation—could trigger further monetary tightening. In the longer term, the slowdown in the fundamental drivers of growth may be exacerbated by trade fragmentation and climate change. On the upside, the resilience of economic activity in the face of substantial headwinds, thus far, points to the risk that the prospects for major economies may be stronger than currently estimated.

Financial stress

Balance sheets in many banks and non-bank financial institutions (NBFIs) have been weakened by the rise in interest rates, which has reduced the value of long-term assets acquired when interest rates were low and were expected to remain so for an extended period. The scale of the increase in interest rates has been outside of recent historical norms, particularly in advanced economies, and outside of the range of many regulators' stress tests (figure 1.12.A; Federal Reserve 2023). High interest rates, along with slowing activity, may lead to an increase in non-performing loans, further reducing asset quality.

Banks with a large share of loans backed by commercial real estate are especially vulnerable, as the sector's high leverage makes it exposed to rising borrowing costs in the context of protracted weakness in demand for office space since the emergence of COVID-19. Another important source of potential bank losses could be falling real estate prices. House prices are already falling in many countries that constitute more than half of global activity (figure 1.12.B). A combination of falling house prices and softening job markets could raise mortgage defaults. This would further weaken bank balance sheets, while also weighing on household wealth and consumption (Berger et al. 2017).

As borrowing costs rise, the decline in the market value of banks' assets can trigger concerns that they may lack the resources to repay their depositors, especially when the funds are withdrawn from low-yielding deposits in search of higher rates elsewhere. When deposits are not fully

insured, this can result in a self-reinforcing bank run. These dynamics have been apparent in the failures of several banks this year, with contagion throughout the financial system so far avoided by aggressive policy responses. New revelations of financial weakness in some systemically important banks or NBFIs could raise investor risk aversion, result in disorderly flight to safety, tighten financial conditions, and further weaken bank and firm balance sheets (Agénor and da Silva 2018). Increasing cross-border linkages between banks and NBFIs can be an important channel of transmission of financial stress between advanced economies and EMDEs (Feyen et al. 2022).

Banking system vulnerabilities differ across various parts of the world. Some regions have greater risks associated with potential loss of liquidity (LAC, MNA, SSA), while others suffer from low bank profitability (advanced economies) or limited capital buffers (SAR, SSA; figures 1.12.C and D). Depending on the nature of adverse shocks, governments may be unable to respond rapidly enough to stem contagion or may lack the resources to engineer a rescue. In some cases, the health of the financial system and that of the sovereign may be interlinked as a result of large bank holdings of government debt and government support for failing banks—the so-called “sovereign-bank nexus”—resulting in financial stress being transmitted to governments, which could lead to sovereign defaults (Feyen and Zuccardi 2019). This nexus has become more important since the pandemic, as many EMDEs have increased their reliance on local banks and NBFIs for local-currency debt issuance (Hardy and Zhu 2023; IMF 2023a).

A severe banking crisis would likely cause substantial and persistent economic damage. The median magnitude of cumulative losses around banking crises is estimated at a third of output in high-income economies and 14 percent in low- and middle-income countries (Laeven and Valencia 2018). High levels of debt function as a shock amplifier, making financial crises more likely and more severe (Kose et al. 2021). Financial crises also weigh on long-term productivity through multiple channels, the clearest of which is through investment as corporate earnings, confidence, and access to finance are reduced while uncertainty is

heightened (Dieppe, Celik, and Okou 2021). Furthermore, a cascading banking crisis in a major economy would have global spillovers through cross-border financial linkages and confidence.

Quantifying scenarios of financial stress

In the baseline, credit conditions in advanced economies are expected to continue worsening for the rest of the year amid a higher cost of deposit retention and funding and remain tight over the remainder of the projection horizon. Nonetheless, as discussed above, financial conditions could worsen more drastically, with significant repercussions on global activity.

To quantify these repercussions, two scenarios of financial stress are considered, centered on the banking system in advanced economies. In these scenarios, the revelation of financial weakness in more banks or NBFIs causes a tightening in financial conditions. The two scenarios mainly differ in the extent of global spillovers from the bank failures. The impacts of these shocks on activity, inflation, and interest rates are quantified using a global macroeconomic model.²

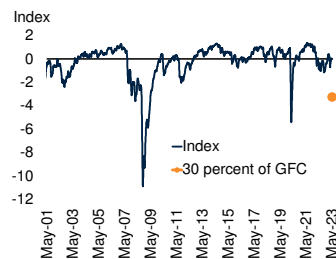
First scenario: Financial stress in advanced economies. In this scenario, banking stress would result in a severe credit crunch but would remain largely contained within advanced economies. Financial conditions—as modeled by investor risk aversion, widening corporate and sovereign spreads, and lower confidence—would tighten considerably more than the moderate amount assumed in the baseline, worsening approximately 30 percent as much as seen in advanced economies during the 2007-09 global financial crisis (figure 1.13.A). This shock is assumed to occur in the third quarter of 2023 and persist for four quarters before gradually fading. Policy makers would take meaningful steps that limit contagion, such as bailing out failing banks and providing liquidity to markets. As a result, spillovers to EMDEs would

²These scenarios are produced using the Oxford Economics' Global Economic Model, a global semi-structural macroeconomic projection model which includes 81 individual country blocks, most of which are available at a quarterly frequency, with behavioral equations governing domestic economic activity, monetary and fiscal policy, global trade, and commodity prices (Oxford Economics 2019).

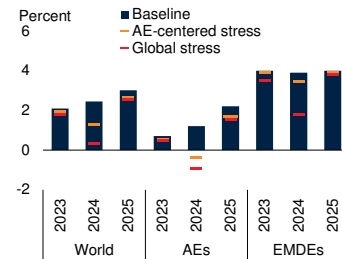
FIGURE 1.13 Quantifying scenarios of financial stress

Financial stress scenarios center on a sharp tightening of financial conditions in advanced economies equivalent to 30 percent of that seen during the 2007-09 global financial crisis. In the first scenario, advanced-economy stress does not lead to major spillovers, and the global economy avoids recession as central banks loosen policy, with inflation declining more rapidly than the baseline. In the second scenario, substantial spillovers lead to global financial stress. This pushes the global economy into recession, with inflation falling below target in many countries despite aggressive policy loosening.

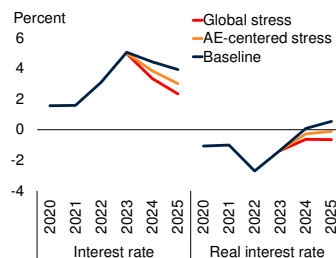
A. U.S. Financial Conditions Index



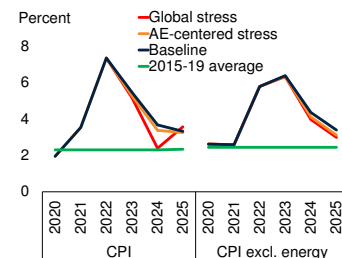
B. Global growth under different scenarios



C. Global short-term interest rates



D. Global inflation



Sources: Bloomberg; Consensus Economics; Oxford Economics; World Bank.

Note: AEs = advanced economies; EMDEs = emerging market and developing economies. CPI = consumer price index. Scenarios produced using the Oxford Economics *Global Economic Model*. Unless otherwise indicated, aggregate growth rates are calculated using real U.S. dollar GDP weights at average 2010-19 prices and market exchange rates. Data are estimates for 2022 and forecasts for 2023-25.

A. GFC = 2007-09 global financial crisis. Figure shows the 14-day moving average of the Bloomberg US Financial Conditions Index. Last observation is May 25, 2023.

B. Global growth aggregate is computed by Oxford Economics using 2015 market exchange rates and prices.

C. Global nominal short-term interest rate is measured as GDP-weighted averages of national rates. Real policy rate is computed as nominal short-term rate minus GDP-weighted consumer price inflation excluding energy.

D. Model-based projection of annual global year-on-year CPI inflation using Oxford Economics *Global Economic Model*. Projection embeds global oil price forecast presented in table 1.1.

be generally limited, with a modest rise in risk-off sentiment, weaker confidence, and capital outflows.

Under this risk scenario, global GDP would grow 1.9 percent in 2023 and 1.3 percent in 2024—below baseline projections in both years (figure 1.13.B). As a result, global GDP would be 1.3 percent below baseline by 2024. This weakness would be concentrated in advanced economies,

where the gap relative to the baseline is 1.8 percent, compared with 0.5 percent for EMDEs. The response of fiscal policy to the slowdown in activity would be muted given limited fiscal space. However, central banks would start cutting policy rates in a synchronous manner in the second half of this year, such that the nominal global aggregate policy rate would be 0.6 percentage point lower than the baseline next year (figure 1.13.C). Monetary policy accommodation, which occurs endogenously in the model, would not be sufficient to offset the impact of weaker demand on prices. Global headline CPI inflation would fall to 3.4 percent in 2024—0.3 percentage point below the baseline forecast (figure 1.13.D). Both core and energy price disinflation would contribute to the decline, with oil prices falling to \$77 per barrel in 2024, \$5 below the baseline.

Second scenario: Global financial stress. In the second scenario, banking stress would propagate globally to a far greater degree. As in the first scenario, financial conditions in advanced economies would worsen by 30 percent as much as seen during the global financial crisis. Unlike the first scenario, however, spillovers to EMDEs would interact with some pre-existing vulnerabilities in these economies, such as banks' undercapitalization, the sovereign-bank nexus, and high levels of public and private debt. EMDEs would suffer from weakening consumer and business confidence, and increases in corporate and consumer borrowing spreads equivalent to about a third of the shock observed in the global financial crisis, along with a significant weakening in international trade. Global trade would be affected by the contraction of demand in advanced economies as well as a lack of trade credit, as large parts of the global financial system struggle to maintain liquidity flows.³

In this scenario, global growth would be 1.8 percent in 2023 and 0.3 percent in 2024. This scenario would entail a contraction in per capita global GDP next year, implying a global recession.

³Lack of trade credit explains about half of the overall impact on trade in the scenario. This channel is proxied by a confidence shock specific to international trade in the Oxford Economics' Global Economic Model.

Global trade would also suffer a disproportionate impact, contracting in 2024 and 2025. Central banks would reduce nominal policy rates on average by a full percentage point, with those in advanced economies lowering rates to a greater extent. Governments would also provide fiscal support, with more stimulus in advanced economies relative to EMDEs given differences in fiscal space. Widespread weakness in activity would result in a faster decline in inflation, with the global headline CPI inflation averaging 2.4 percent in 2024, 1.3 percentage point below the baseline and just above the 2015-19 average of 2.3 percent. Because of widespread weakness in demand and increased uncertainty around the global outlook, oil prices would decline sharply in this scenario to average \$47 in 2024, \$35 below the baseline.

Persistently high inflation, additional monetary tightening, and escalation of financial stress

Inflation forecasts have been revised up considerably in recent years, and additional inflationary pressures remain possible (figure 1.14.A). While headline inflation has started to decelerate in most countries, primarily due to falling energy prices, core inflation generally remains well above central bank targets. Despite ongoing global monetary tightening and slowing growth, core inflation could continue to prove more persistent than expected as a result of surprisingly resilient labor markets and consumer spending, or an upward drift in expectations in response to above-target inflation.

In addition, negative supply shocks could raise commodity prices. A significant disruption to oil supplies caused by geopolitical disturbances could have a persistent impact on global markets, since OPEC+ has limited spare capacity to offset a major shortfall in oil production. Higher energy prices would pass through to core consumer prices, and further increase the risk of inflation expectations becoming unanchored. A similar dynamic could take hold if China's demand for commodities proved stronger than expected. Metal prices would respond strongly, for example, if the government provided substantial stimulus through infrastructure investment and support for

residential construction. Ramped-up production of clean energy equipment—especially of electric vehicles—would tighten the markets for various metals, such as copper, nickel, and cobalt.

An upside shock to global inflation would cause central banks to tighten monetary policy more than is currently expected, and keep policy rates higher for longer. This would result in a more severe growth slowdown. The global implications of additional tightening in the United States to rein in inflation would be particularly important, given the scale of international spillovers from policy actions by the Federal Reserve. Increases in the perceived hawkishness of the Federal Reserve—policy “reaction-function” shocks—have empirically driven a disproportionate share of the recent hiking cycle (figures 1.14.B and 1.14.C; chapter 3). A renewed period of rapid policy tightening would make borrowing in international markets essentially unaffordable for an even larger number of countries (figure 1.14.D).

EMDEs are particularly vulnerable to spillovers from sharply higher policy rates in the United States and other advanced economies as well as persistent domestic inflation pressure. Further tightening abroad could put additional strains on the financial systems of many EMDEs, including currency depreciation pressures, increasing the chance of capital outflows and currency crises in more vulnerable countries. Increased debt financing costs could cause corporate or even sovereign defaults, particularly in EMDEs already facing substantial sovereign risk spreads. Accumulated risks on banks' balance sheets, including those related to sovereigns, could endanger financial stability in these countries. Elevated borrowing costs, along with credit tightening due to financial stress, could further hinder investments needed to address development and climate-related goals in EMDEs (World Bank 2023c).

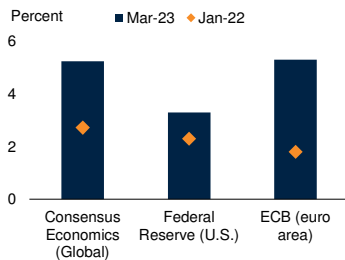
Weaker-than-expected long-term growth

Global potential growth is expected to fall to a three-decade low of 2.2 percent over the remainder of the 2020s—0.4 percentage point below the average from 2011-21 and continuing a long-running downward trend. This trend has multiple

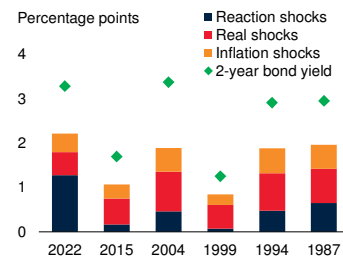
FIGURE 1.14 Other risks to the outlook

Inflation forecasts have been repeatedly revised up—further such revisions could lead to more monetary tightening. Spillovers to emerging market and developing economies (EMDEs) from rising U.S. rates are especially severe when they reflect a more hawkish Federal Reserve, an important feature of the latest tightening cycle. Further increases in bond yields would make borrowing unaffordable for many EMDEs. Global potential growth may decline more than expected. On the upside, continued resilience in advanced-economy labor markets could boost consumption.

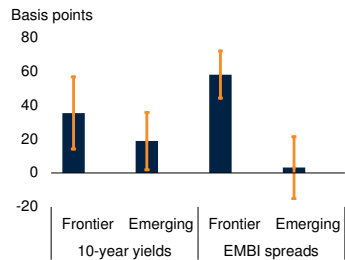
A. Inflation forecasts for 2023



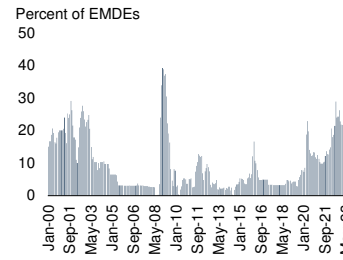
B. Contributions of shocks during Fed hiking cycles, cumulative



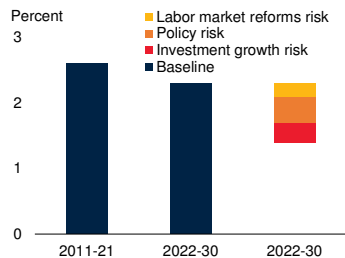
C. Impact of 25-basis-point reaction shock on EMDE financial variables after one quarter



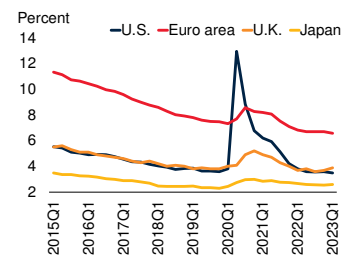
D. EMDEs with sovereign spreads above 10 percentage points



E. Global potential growth, adjusted for risks



F. Unemployment rate



Sources: Arteta, Kamin, and Ruch (2022); BIS (database); Consensus Economics, Federal Reserve; European Central Bank; Haver Analytics; J.P. Morgan; Kose and Ohnsorge (2023a); MSCI; World Bank.

Note: ECB = European Central Bank; EMBI = emerging market bond index; EMDEs = emerging market and developing economies; FED = Federal Reserve.

A. Figure shows 2023 inflation expectations as of December 2021 and March 2023 from the Federal Reserve and the ECB, and January 2022 and March 2023 from Consensus Economics.

B. Shocks estimated from a Bayesian vector autoregression model. Inflation shocks are prompted by rising expectations of U.S. inflation, and real shocks by anticipation of improving U.S. activity. Reaction-function shocks are prompted by a hawkish shift by the Federal Reserve. Current episode is January 2022 to mid-May 2023.

C. Estimated with panel non-linear local projection model with fixed effects and robust standard errors. Sample includes up to 9 frontier markets and 19 emerging markets, using 2022 MSCI classification. Whiskers reflect 90 percent confidence bands. "EMBI spreads" based on EMBI global.

D. Figure shows share of countries with EMBI spread above 10 percentage points. Unbalanced sample includes 69 EMDEs. Last observation is May 23, 2023.

E. Baseline assumes investment growth will match consensus forecasts. Correction for investment growth risk assumes investment growth falls by the country-specific average forecast error; correction for policy risk assumes health and education outcomes repeat the smallest increase on record over any 10-year period; correction for labor market reforms risk assumes that female labor force participation rate will repeat the smallest increase.

F. Last observation is 2023Q1.

causes: the global labor force is aging and growing more slowly, and the growth rates of investment and total factor productivity are declining. This negative trend could be even worse than assumed in this baseline if labor market, education, or health outcomes disappoint, if investment is weaker than expected, or if new recessions or climate disasters cause lasting damage (figure 1.14.E).

The rising number of restrictions on international trade suggests that long-term growth could also be weakened by growing geopolitical and economic fragmentation. Further increases in geopolitical tensions could result in finance, trade, labor, and commodity markets being increasingly segmented into regional blocks. By reducing technological diffusion and the efficiency of capital and resource allocation, this would lower productivity, raise prices, and make export-led development more challenging to achieve. It could also make the financial sector more volatile by reducing the scope for risk diversification (IMF 2023a).

The global economy is increasingly vulnerable to shocks arising from climate change. Extreme weather events that inflict significant economic damage—including droughts, floods, wildfires, and windstorms—are becoming more frequent. In the near term, increased prevalence and severity of climate-related disasters would inflict substantial human costs, through failed harvests, damaged infrastructure, generalized disruptions to activity, and worsened government fiscal positions. Changes in climate may further increase food insecurity in regions with large numbers of subsistence farmers, who lack the resources to easily adjust production.

Upside risk: Stronger consumption alongside falling inflation in major economies

Labor markets in many economies—including the United States and the euro area—have shown resilience in the face of tightening monetary policy, with unemployment rates in some cases at historic lows (figure 1.14.F). Labor market strength may persist even as activity slows if rising wages cause labor force participation to rise, or a continued period of excess labor demand drives up

productivity. Just as resilient labor markets in advanced economies have contributed to the current strength of consumption spending, unexpected increases in employment would further boost consumption. This would yield stronger-than-expected growth domestically and, through trade spillovers, for EMDEs as well.

In the baseline forecast, the reopening of China's economy provides a temporary boost to consumer spending, which fades over the course of 2023. It is possible that the boost will be both stronger and more persistent than envisaged. For example, household balance sheets might prove healthier than expected. Another possibility for upside surprises is that potential output might be less affected by the pandemic, and by the declining return on investment, than assumed in the baseline. If labor market strength or stronger growth in China were the result of higher-than-expected potential output, it would also have a beneficial impact on global inflation.

Policy challenges

Recent bank collapses and bouts of financial instability underline the importance of sound international financial regulation. Central bank credibility is critical amid high inflation and heightened financial risks. Depleted fiscal buffers can be restored through increased expenditure effectiveness and domestic revenue mobilization. Many sovereigns are already under stress and more are at risk, highlighting the need for globally coordinated debt relief. To reverse a projected decline in EMDE potential growth, it will be critical to implement reforms to bolster physical and human capital, labor-supply growth, productivity of services, and international trade. Continued cooperation is necessary to tackle climate change and support populations affected by crises and hunger.

Key global challenges

The collapse of multiple banks amid sharply higher interest rates has highlighted potential trade-offs between the goals of price and financial stability, which are likely to be more acute in the presence of high debt levels. While policy makers' interventions have been successful at stabilizing the global financial system for now, the recent

bank failures have important implications for international financial regulation going forward.

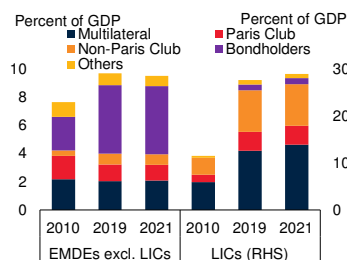
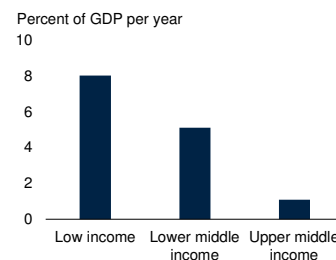
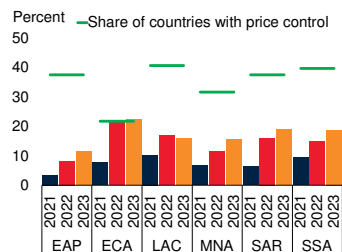
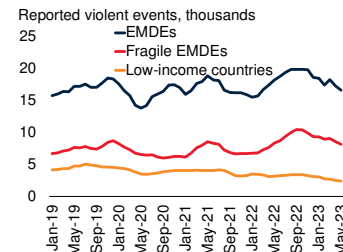
Among the issues to be considered are the reach and calibration of stress tests, the risks of over-reliance on binary capital and liquidity thresholds, the causes of occasional illiquidity in markets for essential collateral, and the treatment of government liabilities in risk assessments. While recent stress emerged in advanced economies, negative cross-border spillovers could emanate from further bouts of financial instability, underscoring the need for regulatory principles that reinforce the stability of the global financial system. The reforms enacted after the global financial crisis to strengthen the framework of regulation and supervision have generally worked well, but need to be strengthened. Recent financial turmoil also highlights the stress that could emerge from gaps in financial supervision—including in the supervision of non-bank financial institutions (Aramonte, Schrimpf, and Shin 2022; Carstens 2021).

The stress generated by rising global borrowing costs and slower growth has adversely affected sovereigns, particularly those with limited fiscal space. The international community needs to bolster efforts to reduce debt distress and attenuate the risk of EMDEs being unable to finance debt at sustainable rates. At least 50 percent of the world's poorest countries are already in debt distress or at high risk of distress (IMF 2023b). This challenge has been made more difficult by the increasing diversity of lenders relative to previous rounds of debt relief as well as the lower transparency of their lending (figure 1.15.A; Horn et al. 2023). In EMDEs with unsustainable levels of debt, relief efforts by the international community can help generate fiscal space. In particular, G20 creditors need to accelerate debt restructurings when needed. It is also critical that private sector creditors grant debt relief on terms comparable to the G20 Common Framework.

Addressing climate change and mitigating its consequences is a critical global development challenge. Climate change is resulting in more frequent and severe natural disasters and is set to exacerbate extreme poverty and inequality by worsening health outcomes, reducing agricultural

FIGURE 1.15 Global policy challenges

Debt of low-income countries (LICs) is held by an increasingly diverse group of creditors, which may complicate relief efforts. More generally, emerging market and developing economies (EMDEs) have become more vulnerable to rising interest rates given their increased share of market-financed debt. Low-income and lower-middle-income countries need substantial investments to achieve a robust, resilient, and low-carbon growth trajectory. Food price inflation picked up further in 2023 across EMDE regions, highlighting the need for global efforts to mitigate food insecurity. Violence and conflict remain pervasive in many EMDEs.

A. Composition of external debt, by creditor**B. Additional investment needs for a resilient and low-carbon pathway, 2022-30****C. Food inflation, by region****D. Violence and conflict**

Sources: ACLED (database); IDS (database); WDI (database); World Bank (2022a); World Bank.

Note: EMDEs = emerging market and developing economies; LICs = low-income countries; EAP = East Asia and Pacific, ECA = Europe and Central Asia, LAC = Latin America and the Caribbean, MNA = Middle East and North Africa, SAR = South Asia, SSA = Sub-Saharan Africa.

A. Figure shows the U.S. dollar GDP-weighted average of public and publicly guaranteed external debt. "Others" includes multiple lenders. Sample includes 119 EMDEs, of which 24 are LICs.

B. Bars show the annual investment needs to build resilience to climate change and reduce emissions by 70 percent by 2050. Depending on availability, estimates include investment needs for transport, energy, water, urban adaptations, industry, and landscape. In some Country Climate and Development Reports, especially those for low-income and lower-middle-income countries, estimated investments include development needs and cannot be considered entirely "additional" to pre-existing financing needs.

C. Figure shows annual averages of food consumer price inflation. Sample includes 134 EMDEs. Regional inflation rates are based on averages across countries.

D. Figure shows 3-month rolling averages. Reported violent events include battles, explosions, violence against civilians, riots, and protests. Sample includes 149 EMDEs, out of which 35 are fragile EMDEs and 27 are low-income countries. Last observation is May 2023.

productivity, increasing food prices, and aggravating food and water insecurity in EMDEs (Jafino et al. 2020; World Bank 2022a). Low-income and lower-middle-income countries will need substantial investments to build a pathway to resilient, low-carbon-emission growth (figure 1.15.B). Decarbonization can also provide other benefits.

For example, reducing air pollution, including from fossil fuels, could save 7 million lives every year, mostly in EMDEs where most people exposed to poor air quality live (Peszko et al. 2022).

While the transition to low-carbon sources of energy is already underway, sustained international cooperation is needed to accelerate it. To that end, energy-related policies, fiscal regimes, and energy sector structures can be adjusted in such a way as to move energy production away from a reliance on fossil fuels and toward the use of renewables (IRENA 2022). Electricity generation from renewables has been growing, boosted by disruptions to fossil fuel distribution resulting from Russia's invasion of Ukraine, and is expected to reach 38 percent of the power mix in 2027 (IEA 2023c). Introducing carbon pricing instruments and reducing fuel subsidies can help continue this transition while adding to fiscal space.

Food price inflation remains high across all EMDE regions (figure 1.15.C). LICs tend to use more cash transfers than other EMDEs and advanced economies to mitigate the social impact of higher food and energy prices, which highlights the need to strengthen their social safety nets (Björn et al. 2022). The international community needs to safeguard the global commodity trading system by avoiding and phasing out restrictive trade measures, such as export bans on food and fertilizers. Furthermore, food shortages can be attenuated by making agriculture more productive and climate-resilient.

Greater international efforts are needed to mitigate humanitarian crises stemming from rising incidents of war and conflict (figure 1.15.D). Besides their direct toll on human life and welfare, war and conflict have substantially impaired living standards through their adverse effects on output and productivity (Dieppe, Celik, and Okou 2021). Violent conflict destroys physical assets and institutions, disrupts labor markets, provokes capital flight, and causes resources to be diverted away from productive uses and toward weaponry and defense (Collier 1999; Hutchinson and Margo 2006; Mueller 2013).

Challenges in emerging market and developing economies

EMDE monetary and financial policy challenges

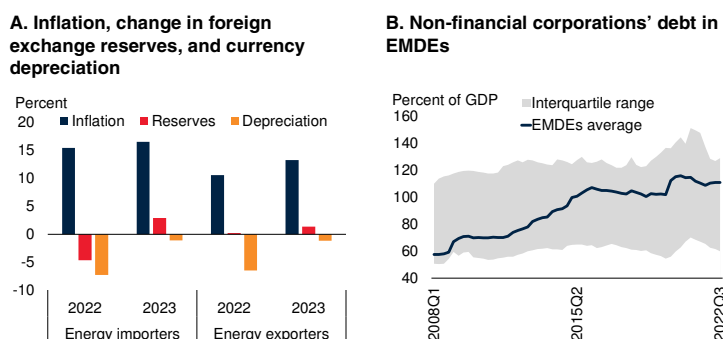
In many countries, elevated core inflation has proved stickier than expected, which may lead central banks to further tighten monetary policy and maintain restrictive stances for longer than previously envisaged. At the same time, slowing growth and the risk of financial distress may lead to pressure for loosening policy. To ward off any drift in inflation expectations, safeguarding central bank independence and credibility remains critical.⁴ The increase in central bank credibility in many EMDEs in recent decades has been an important policy accomplishment, as it can make monetary policy more effective, shield the economy from cross-border spillovers, and keep inflation expectations anchored (Ha, Kose, and Ohnsorge 2019). A loss of credibility at a critical juncture could cause a sudden change in investors' risk perception and trigger capital outflows.

Another way EMDEs can bolster their resilience to capital flow fluctuations and exchange rate volatility is by properly replenishing foreign currency reserves following sizable drawdowns, such as those that occurred among EMDE energy importers last year (figure 1.16.A). EMDEs can strengthen their reserve buffers, for instance by improving domestic investment conditions to attract foreign capital and reducing dependence on volatile sources of funding. Funding volatility may also affect EMDE financial institutions, for example through spillovers from stress in advanced economies' financial markets or lower risk tolerance. These institutions can also be made more resilient through regulatory reforms. Reforms implemented after the global financial crisis have strengthened banks' capital and liquidity buffers, which have recently been tested by the exception-

⁴The special liquidity support measures introduced by central banks during the COVID-19 pandemic mean that their balance sheets carry assets at very low interest rates, even as the rates they pay on their liabilities have risen. Central bank balance earnings statements have in consequence shown declines in net income, and in some cases losses. This unusual situation need not compromise their ability to achieve and maintain low inflation (Bell et al. 2023).

FIGURE 1.16 Monetary policy challenges in emerging market and developing economies

Many emerging market and developing economies (EMDEs), especially energy importers, need to continue to rebuild foreign exchange reserve buffers to attenuate vulnerability to capital outflows and currency volatility. Corporate leverage continues to rise, both in absolute terms and as a share of total EMDE debt.



Sources: BIS (database); Haver Analytics; World Bank.

Note: EMDEs = emerging market and developing economies.

A. Figure shows changes in inflation, reserves, and exchange rates since 2021; for 2023, available data as of data cut-off. Aggregates are calculated as simple averages. Sample includes 77 EMDEs, excluding Argentina, Belarus, Lebanon, Russian Federation, Türkiye, and Ukraine. Last observation is April 2023.

B. Figure shows the share of GDP-weighted averages. Sample includes 16 EMDEs. Last observation is 2022Q3.

ally steep global monetary policy tightening. However, non-bank corporations in EMDEs have become highly leveraged, after extensive borrowing, which makes them particularly vulnerable to rising interest rates (figure 1.16.B; Koh and Yu 2020). Accurate, timely, and transparent reporting of credit quality and nonperforming loan balances is essential to ensure that prompt corrective action can be taken, if needed. Furthermore, EMDEs can strengthen bank resolution frameworks to limit the impact of potential shocks on the financial sector.

Where necessary, banking sector resilience can be bolstered through a combination of increased regulatory capital buffers; strengthened macroprudential measures, such as tighter loan-to-value ratios and loan service-to-income ratios, and enhanced safeguarding against market risks, such as currency and maturity mismatches, through hedging and diversification. Moreover, attenuating the overreliance of some EMDE governments on domestic bank financing can help limit the extent to which financial sectors amplify external shocks

(Deghi et al. 2022). Recent experience in the United States underlines that governments need to be mindful of gaps in the coverage of regulation and supervision, especially during times of tightening financial conditions.

EMDE fiscal policy challenges

Fiscal space in EMDEs continues to be limited, with government debt higher than its pre-pandemic level in more than three-quarters of EMDEs (figure 1.17.A; Kose et al. 2023). High inflation and the ensuing increases in nominal GDP did contribute to a decline in government debt as a share of GDP in 2021 and 2022 in many EMDEs (Kose et al. 2023). However, this only partially reversed the substantial rise in the debt ratio that occurred in 2020. The rising cost of servicing this debt, alongside slowing growth, is increasing the risk of debt distress among EMDEs and LICs (figure 1.17.B). Moreover, a further tightening of advanced-economy monetary policy could increase borrowing costs and worsen fiscal positions and debt sustainability (Arteta, Kamin, and Ruch 2022).

Policy makers need to strike a balance between ensuring fiscal sustainability and meeting spending needs. The aggregate EMDE fiscal stance is expected to remain almost unchanged this year but tighten in 2024 (figure 1.17.C). In fiscally constrained EMDEs, redirecting spending to better target support for vulnerable households can help maintain necessary spending without eroding sustainability. Improving spending efficiency is critical in EMDEs with limited fiscal space and can be achieved through strengthened institutions and domestic governance. Bolstering fiscal and public financial management and improving the effectiveness of fiscal rules and expenditure reviews can also strengthen spending efficiency and help boost investor confidence. Long-run fiscal positions can be improved through investments committed to development needs, such as infrastructure, education, and climate change adaptation, as they support growth prospects.

At the same time, countries will need to mobilize additional domestic revenue, which may be more difficult given the current context of high borrow-

ing costs, slowing growth, and a declining pace of potential growth (Kose and Ohnsorge 2023b). Revenue collection has proven to be a challenge for many EMDEs and LICs, with government revenues expected to be lower than the pre-pandemic levels (figure 1.17.D). EMDEs can improve domestic revenue mobilization and make collection mechanisms more efficient by broadening tax bases, simplifying tax systems, closing loopholes in revenue collection, and improving tax administration. Tax avoidance can be mitigated through international coordination in taxation rules.

The composition of government debt poses another fiscal policy challenge. In 2022, in the median EMDE, foreign-currency-denominated debt accounted for nearly 50 percent of government debt, as did debt held by nonresidents (figure 1.17.E). This makes EMDEs vulnerable to rising debt service costs through currency depreciation or through increased sovereign risk premia (IMF 2023c). In some EMDEs, especially those with lower income levels, rising external public debt on non-concessional terms presents an additional debt service burden.

Fiscal policy poses a particularly difficult challenge for LICs, which have seen rapid growth in debt over the past decade. The debt-reducing effects of rapid growth were more than offset by the sizable fiscal deficits that resulted from persistent revenue weakness and rising spending pressures (chapter 4). Total revenue in LICs is about 10 percentage points of GDP lower than in overall EMDEs, largely reflecting broader underdevelopment and weaker institutions. The composition of government expenditures in LICs has shifted toward public sector wages, with spending efficiency remaining low (figure 1.17.F). In addition, LICs spend less on social protections that benefit the vulnerable relative to other countries: social benefit expenditures in LICs average about 3 percent of total government spending, compared with 26 percent in EMDEs and more than 40 percent in advanced economies. Amid the current steep increase in borrowing costs and tight global monetary policy, debt service—especially on external public debt—is becoming costlier. LICs will need to allocate additional revenues to service

their debt repayments, which could make it more difficult to secure spending on health and education. Improving LIC debt positions is likely to require debt restructuring in some cases alongside better domestic governance and institutional arrangements.

EMDE structural policy challenges

The major shocks to the global economy over the past three years—including the pandemic, Russia’s invasion of Ukraine, and a substantial rise in inflation that led to the sharpest tightening of global monetary policy in four decades—have compounded an underlying, longer-term trend weakening of potential growth (that is, the growth rate that can be sustained over the longer term at full employment and full capacity). Policy makers need to implement decisive structural reforms to reverse the potential growth slowdown currently underway. These would foster investments in physical and human capital, boost labor-supply growth, improve investment conditions, bolster services sector growth, and promote international trade.

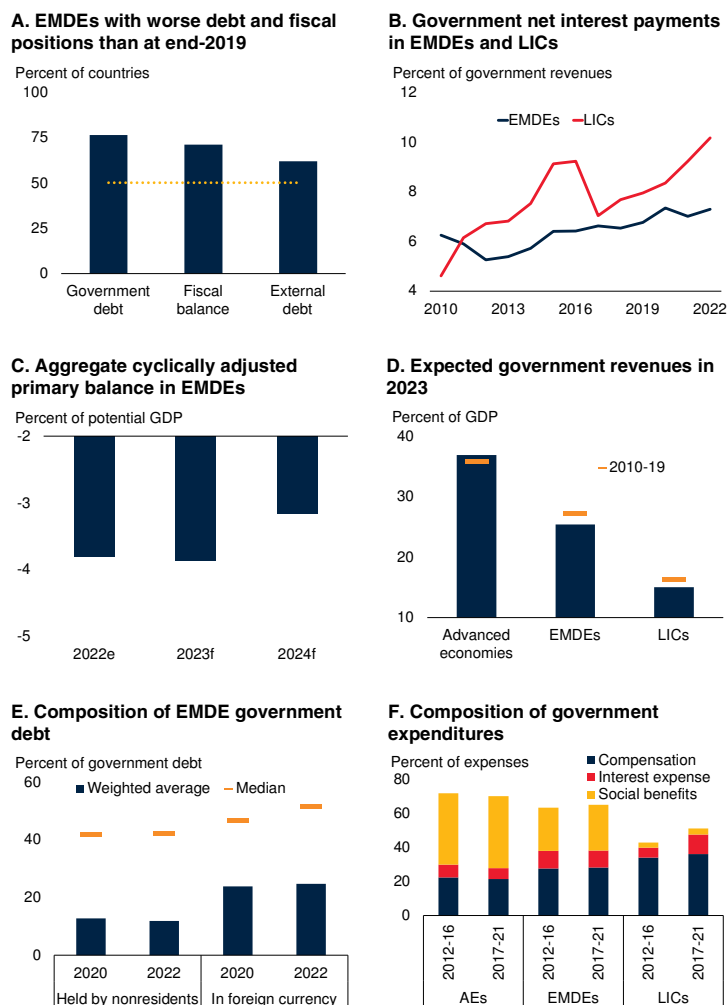
Boosting the key drivers of potential growth

EMDE potential growth is projected to fall to an annual average of 4 percent a year during 2022-30, about one percentage point below the average of the previous decade (figure 1.18.A). Weaker long-term growth poses serious challenges for EMDEs (Kilic Celik et al. 2023b). It slows the pace of poverty reduction, reduces the resources available to invest in addressing global challenges such as climate change, limits job creation and wage growth, and adds to the difficulty of servicing elevated debt burdens.

A number of policies could help reverse the projected weakening of global potential growth. Reforms associated with higher physical capital investment, enhanced human capital, and faster labor-supply growth could raise annual potential growth by 0.7 percentage point over the period 2022-30, both globally and in EMDEs. This would offset the 0.4 percentage point decline in potential growth between 2011-21 and 2022-30 projected in the baseline scenario for the global

FIGURE 1.17 Fiscal policy challenges in emerging market and developing economies

In more than three-quarters of emerging market and developing economies (EMDEs), fiscal positions have worsened since the pandemic. Rising debt service costs have increased the risk of debt distress, especially for low-income countries (LICs). The aggregate EMDE fiscal stance is expected to tighten in 2024, and revenue collection remains a challenge. A substantial share of government debt is still held in forms susceptible to heightened volatility. In LICs, the share of government spending on public sector wages tends to be higher than in other countries at the expense of spending on social protection.

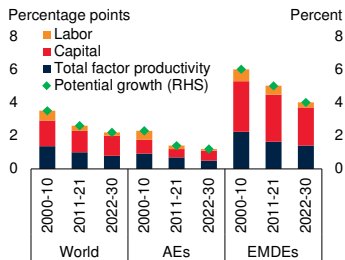


Sources: Haver Analytics; International Monetary Fund; Kose et al. (2022); World Bank.
 Note: AEs = advanced economies; EMDEs = emerging market and developing economies; LICs = low-income countries.
 A. Figure shows share of EMDEs with higher government or total external debt or with worse fiscal balances (all in percent of GDP) in the latest quarter with data than in 2019Q4. Fiscal balances are a 4-quarter moving sum. Debt and fiscal data are for central governments in some countries. Sample includes 59, 68, and 62 EMDEs for government debt, fiscal balance, and external debt, respectively. Dotted line indicates 50 percent.
 B. Net interest payments are the difference between primary balances and overall fiscal balances. Aggregates computed with government revenues in U.S. dollars as weights, based on 150 EMDEs, including 27 LICs.
 C. Aggregates calculated using potential GDP as weights. Sample includes 44 EMDEs. Data for 2023-24 are forecasts.
 D. Aggregates computed with GDP in U.S. dollars as weights, based on 41 advanced economies and 147 EMDEs, including 25 LICs.
 E. Weighted averages computed using government debt in U.S. dollars as weights. Sample includes 43 EMDEs for debt held by nonresidents and 32 EMDEs for debt in foreign currency.
 F. "Compensation" of employees and includes wages and salaries, and social contributions. In some countries, data are for central governments. Sample includes 38 advanced economies and 116 EMDEs, including 18 LICs.

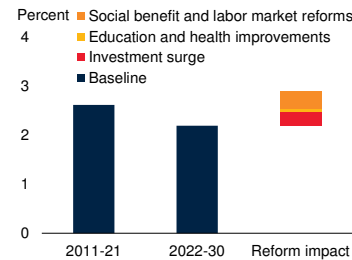
FIGURE 1.18 Structural policy challenges in emerging market and developing economies

The slowdown in potential growth over the past decade can be reversed by well-designed reforms. These reforms include additional investments in physical and human capital, as well as increases in labor force participation to offset the declining growth of working-age populations. The current limited role of services trade in emerging market and developing economies (EMDEs), compared with advanced economies, indicates substantial scope for expansion.

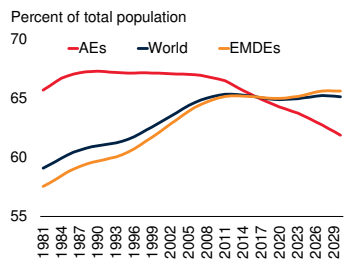
A. Contributions to potential growth



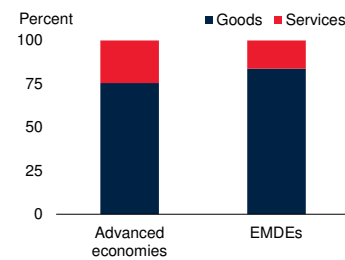
B. Global potential growth under reform scenarios



C. Working-age population



D. Composition of global trade, 2010-19



Sources: Kose and Ohnsorge (2023a); UN World Population Prospects 2022; World Bank staff estimates.

Note: AEs = advanced economies; EMDEs = emerging market and developing economies.

A. Figure shows GDP-weighted averages of production function-based potential growth estimates for a sample of 29 advanced economies and 53 EMDEs as described in Kose and Ohnsorge (2023a). Data for 2022-30 are forecasts.

B. Figure shows period averages of annual GDP-weighted averages. Scenarios assume a repeat of each country's best 10-year improvement as described in Kose and Ohnsorge (2023a). Data for 2022-30 are forecasts.

C. Figure shows population-weighted averages. The working-age population is defined as people aged 15-64 years. Data for 2023-29 are forecasts.

D. Figure shows the 2010-19 average of shares of global goods and services trade in global trade as described in Kose and Ohnsorge (2023a).

economy, and most of the 1 percentage point slowdown projected for EMDEs (figure 1.18.B).

Higher physical capital investment is key to boosting potential output growth. Investment growth slowed over the past decade and may remain muted for some time as a result of slow growth and continuing effects of the pandemic, Russia's invasion of Ukraine, tightening financial conditions, and limited fiscal policy space. Invest-

ment growth slowed during the past decade in all six EMDE regions (Kasyanenko, Kenworthy, Ruch et al. 2023a). Addressing gaps between current spending on infrastructure and the level needed to meet development goals can contribute to a sustained rise in per capita incomes while also bolstering activity in the short term (Vagliasindi and Gorgulu 2021). In particular, investment in green infrastructure projects with high economic returns and the widespread adoption of environmentally sustainable technologies can support economic growth, while contributing to tackling climate change. Sound investments, including by the private sector, that are aligned with climate goals in key areas—such as transport and energy, climate-smart agriculture and manufacturing, and land and water systems—can all boost long-term growth.

Human capital in EMDEs would benefit from strengthening education systems, in particular by improving learning outcomes. Increasing investment in human capital can help reverse the losses caused by the overlapping adverse shocks of recent years—especially the pandemic (Schady et al. 2023). Improvements in education would also boost labor force participation, as better-educated workers tend to be more firmly attached to labor markets (Kose and Ohnsorge 2023b). Furthermore, since high-productivity technologies often require complementary skilled human capital, better-quality education systems can foster private investment (Kasyanenko, Kenworthy, Ruch et al. 2023b).

The working-age population in EMDEs has started to stagnate (figure 1.18.C). The negative effect of slowing working-age population growth is expected to be sizable, though with wide variation across regions (Kasyanenko, Kenworthy, Kilic Celik et al. 2023). Policies can help maintain the size of the labor force, in particular those that engage discouraged workers or groups with historically low participation rates, such as women and older workers. Improvements to health and education, in particular, are crucial to boost overall labor force participation, since better-educated workers are more likely to remain attached to labor markets, while also increasing productivity. Raising female labor force participa-

tion is particularly important given high female unemployment rates and a continued gap in female labor force participation relative to men. In some regions, female labor force participation is about half the EMDE average, underscoring ample opportunities for improvement. Relevant policies include job training programs specifically aimed at women such as vocational training, as well as the promotion of childcare services. They also include expanded access to financial products to foster female entrepreneurial capacity.

Total factor productivity growth can be promoted by reforms that buttress institutional quality, such as by strengthening the rule of law and reining in corruption; that foster greater political stability; and that improve the business environment. Given that institutions and governance remain weak in many EMDEs, there is considerable scope for higher productivity through institutional reforms (World Bank 2018a). Such reforms can encourage private sector investment and innovation by establishing enforceable property rights, minimizing expropriation risk, promoting competition and limiting market concentration, creating a stable policy environment, lowering the costs of doing business, and encouraging participation in the formal sector where productivity tends to be higher (World Bank 2018b, 2019).

Promoting trade and fostering productivity of services

Global trade, facilitated by trade liberalization and falling transport costs, has historically been an important engine of productivity and output growth in EMDEs. A large part of the gains from trade can be attributed to the expansion of global value chains (World Bank 2020). While participation in global value chains generates efficiency gains and boosts productivity via the transfer of knowledge, capital, and other inputs across countries, it also increases sensitivity to external shocks (Constantinescu, Mattoo, and Ruta 2020). As technological innovation tends to occur in a limited number of countries, advances globally depend on international spillovers (Keller 2004). International trade is one of the primary channels of diffusion of new technology as it makes available to importers processes and products that

embody foreign knowledge and that would otherwise be unavailable or very costly (Grossman and Helpman 1991; Helpman 1997).

This role of trade as an engine of output and productivity growth is now under threat as policy interventions have adversely affected trade relations in recent years. Following Russia's invasion of Ukraine, some countries introduced food trade restrictions, which distorted the functioning of global food markets. Tariffs have risen over the past five years as trade tensions have mounted, contributing to concerns about a protectionist turn among some major economies (World Bank 2021). Geopolitical tensions have led to the imposition of a widening range of restrictions on trade in goods. The growth of global trade in goods and services was almost twice as fast as global output growth during 1970-2008, but only half as fast during 2011-19. Goods trade accounted for 75 percent of global trade in goods and services during 2010-19, with a higher share in EMDEs compared with that in advanced economies (figure 1.18.D).

To reduce elevated trade costs in EMDEs, comprehensive reforms are needed. Trade agreements can reduce trade costs and promote trade, especially if they lower both tariff and non-tariff barriers and generate momentum for further domestic reforms—including reforms that foster private sector development and domestic competition. Trade costs are still often inflated by costly administrative border and customs procedures (Moïse and Le Bris 2013). Policy-related nontariff barriers that can be standardized include sanitary, phytosanitary, and other standards (often aimed at protecting consumer health and safety), pre-shipment inspections, licensing requirements, and quotas. Trade costs can be lowered significantly by streamlining trade and customs compliance procedures and processes (Staboulis et al. 2020). In addition, end-to-end supply chain digitalization would allow EMDEs to shorten port delays (Arvis et al. 2023). Finally, regulatory restrictions on services trade can add to trade costs. This reflects to a large extent regulations that create market entry barriers—especially with respect to the entry of foreign firms in EMDEs (Ohnsorge and Quaglietti 2023).

Services could emerge as a new engine of global growth. Future growth opportunities linked to greater digitalization could boost productivity in EMDE services sectors. Increased digitalization has improved prospects for economies of scale and innovation in the services sector that previously required face-to-face interactions. Policies to support the diffusion of digital technologies in EMDEs can bring particularly high returns, given the low starting level of digitalization in the services sector. For instance, the share of firms using email to communicate with clients was less

than one-third in several EMDEs as recently as 2018 (Nayyar, Hallward-Driemeier, and Davies 2021).

Investing in information and communication technology infrastructure, updating regulatory frameworks, and strengthening management capabilities and worker skills, can boost the adoption of digital technologies. Policies to improve market access for, and skills in, ICT and professional services could ease constraints on growth.

TABLE 1.2 Emerging market and developing economies¹

Commodity exporters ²		Commodity importers ³	
Algeria*	Kyrgyz Republic	Afghanistan	Samoa
Angola*	Lao PDR	Albania	Serbia
Argentina	Liberia	Antigua and Barbuda	Sri Lanka
Armenia	Libya*	Bahamas, The	St. Kitts and Nevis
Azerbaijan*	Madagascar	Bangladesh	St. Lucia
Bahrain*	Malawi	Barbados	St. Vincent and the Grenadines
Belize	Mali	Belarus	Syrian Arab Republic
Benin	Mauritania	Bosnia and Herzegovina	Thailand
Bhutan*	Mongolia	Bulgaria	Tonga
Bolivia*	Mozambique	Cambodia	Tunisia
Botswana	Myanmar*	China	Türkiye
Brazil	Namibia	Djibouti	Tuvalu
Burkina Faso	Nicaragua	Dominica	Vanuatu
Burundi	Niger	Dominican Republic	Vietnam
Cabo Verde	Nigeria*	Egypt, Arab Rep.	
Cameroon*	Oman*	El Salvador	
Central African Republic	Papua New Guinea	Eswatini	
Chad*	Paraguay	Georgia	
Chile	Peru	Grenada	
Colombia*	Qatar*	Haiti	
Comoros	Russian Federation*	Hungary	
Congo, Dem. Rep.	Rwanda	India	
Congo, Rep.*	São Tomé and Príncipe	Jamaica	
Costa Rica	Saudi Arabia*	Jordan	
Côte d'Ivoire	Senegal	Kiribati	
Ecuador*	Seychelles	Lebanon	
Equatorial Guinea*	Sierra Leone	Lesotho	
Eritrea	Solomon Islands	Malaysia	
Ethiopia	South Africa	Maldives	
Fiji	South Sudan*	Marshall Islands	
Gabon*	Sudan	Mauritius	
Gambia, The	Suriname	Mexico	
Ghana*	Tajikistan	Micronesia, Fed. Sts.	
Guatemala	Tanzania	Moldova	
Guinea	Timor-Leste*	Montenegro	
Guinea-Bissau	Togo	Morocco	
Guyana*	Uganda	Nauru	
Honduras	Ukraine	Nepal	
Indonesia*	United Arab Emirates*	North Macedonia	
Iran, Islamic Rep.*	Uruguay	Pakistan	
Iraq*	Uzbekistan	Palau	
Kazakhstan*	West Bank and Gaza	Panama	
Kenya	Yemen, Rep.*	Philippines	
Kosovo	Zambia	Poland	
Kuwait*	Zimbabwe	Romania	

* Energy exporters.

1. Emerging market and developing economies (EMDEs) include all those that are not classified as advanced economies and for which a forecast is published for this report. Dependent territories are excluded. Advanced economies include Australia; Austria; Belgium; Canada; Cyprus; Czechia; Denmark; Estonia; Finland; France; Germany; Greece; Hong Kong SAR, China; Iceland; Ireland; Israel; Italy; Japan; the Republic of Korea; Latvia; Lithuania; Luxembourg; Malta; the Netherlands; New Zealand; Norway; Portugal; Singapore; the Slovak Republic; Slovenia; Spain; Sweden; Switzerland; the United Kingdom; and the United States. Since Croatia became a member of the euro area on January 1, 2023, it has been removed from the list of EMDEs, and related growth aggregates, to avoid double counting.

2. An economy is defined as commodity exporter when, on average in 2017-19, either (1) total commodities exports accounted for 30 percent or more of total exports or (2) exports of any single commodity accounted for 20 percent or more of total exports. Economies for which these thresholds were met as a result of re-exports were excluded. When data were not available, judgment was used. This taxonomy results in the classification of some well-diversified economies as importers, even if they are exporters of certain commodities (for example, Mexico).

3. Commodity importers are EMDEs not classified as commodity exporters.

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