INTERNATIONAL MONETARY AND FINANCIAL COMMITTEE

Forty-Seventh Meeting
April 13–14, 2023

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Written Statement to the International Monetary Fund Committee: 2023 IMF and World Bank Spring Meetings

The Global Economic Outlook

1. **Global growth in 2022 slowed to 3.2%, some 1.3 percentage points weaker than expected in late 2021, reflecting the effects of Russia's war of aggression against Ukraine, the cost-of-living crisis, rising interest rates and continued COVID-related disruptions in China**. The war in Ukraine increased inflationary pressure, driving up energy and food prices in the first half of 2022. More positive signs regarding activity and inflation have appeared in early 2023, with business and consumer sentiment improving, food and energy prices falling back, and China having ended its zero-COVID policy. Nonetheless, the improvement in the outlook remains fragile. Risks are still tilted to the downside and significant policy challenges persist.

2. **Global GDP is projected to grow at 2.6% in 2023 and 2.9% in 2024 according to the OECD's March 2023 Interim Economic Outlook**. This would be the weakest global growth outcome over a two-year period since the global financial crisis, excluding the slump at the beginning of the pandemic. The quick and widespread monetary policy tightening over the past year is a key factor moderating growth.

3. **Annual GDP growth in the United States is projected to slow to 1.5% in 2023 and 0.9% in 2024** as monetary policy moderates demand pressures. However, quarter-on-quarter growth rates are expected to bottom out in the latter half of 2023 and improve thereafter. **Growth in the euro area will also be subdued in 2023, but the benefits of lower energy prices and declining inflation should help growth pick up to 1.5% in 2024 from 0.8% in 2023.** The United Kingdom is also expected to have a mild rebound in 2024, with output rising by 0.9% after contracting slightly in 2023. Japan, which will have additional fiscal stimulus this year, is projected to grow between 1 and 1½ per cent per annum in 2023 and 2024.

4. **Outcomes in the major emerging-market economies in Asia are projected to remain relatively strong, helped by the full reopening of China and less acute inflation pressures**. Growth in China is projected to rebound to 5.3% this year and 4.9% in 2024. India's growth is projected to slow to around 6% in FY 2023-24, amidst tighter financial conditions, before picking up to around 7% in FY 2024-25, while Indonesia's economy will continue to expand by around 5% per annum over 2023-24. Growth in many other emerging-market economies, including Brazil and South Africa, is projected to be sluggish over the next two years, at about 1% per year on average. Activity in Türkiye is likely to have been held back significantly in early 2023 by the consequences of the recent earthquakes, but to recover helped by reconstruction spending. Output in Russia is expected to decline this year and next, as the drag from economic and financial sanctions starts to build.

5. **While headline inflation has declined in most economies in recent months, core inflation remains persistently high**, with cost pressures from tight labour markets being reinforced by higher margins in some sectors. As monetary tightening by most of the major central banks increasingly takes effect, consumer price inflation is generally expected to moderate gradually: headline inflation is projected to fall in 2023 and 2024 in almost all G20 economies. Even so, annual inflation will remain well above target almost everywhere through most of 2024. Headline inflation in the G20 economies is expected to decline to 4.5% in 2024 from 8.1% in 2022. Core inflation in the G20 advanced economies is projected to average 4.0% in 2023 and 2.5% in 2024.

6. **Significant uncertainty about economic prospects persists, and risks remain tilted to the downside**. In particular, uncertainty remains high due to the fraught geopolitical situation, including the course of Russia's war of aggression against Ukraine and its consequences for the global economy. An important related risk is a renewed worsening of food security in emerging-market and developing economies. Despite recent declines, food and fertiliser prices remain well above the levels seen prior to the pandemic and food markets remain vulnerable both to renewed disruption in grain shipments from Ukraine as well as extreme weather events, which have become more common. Pressures in global gas and oil markets could also reappear, leading to renewed price spikes and higher inflation.

7. **Trade-related tensions also remain a concern**, with the cumulative coverage of import restrictions imposed by the G20 economies remaining high, and several non-G7 countries having introduced new export restrictions on food, feed and fertilisers in the past year. Medium-term risks to growth and prices are also rising from growing fragmentation of global-value chains and, in some cases, a shift to higher-cost but less distant locations from parent companies.

8. **Another key concern is that the strength of the impact from monetary policy tightening is difficult to gauge**, particularly after an extended period of very low interest rates. While a cooling of overheated markets and moderation of credit growth are standard channels through which monetary policy takes effect, higher interest rates could have stronger effects on economic growth than expected, particularly if they expose underlying financial vulnerabilities from high debt and elevated asset prices. Increased stress on households and companies, and the greater potential for loan defaults, raise risks of potential losses at banks and non-bank financial institutions, and an abrupt tightening of lending standards. In addition, sharp changes in market interest rates and in the current market value of bond portfolios could also further expose liquidity risks and duration risks in the business models of financial institutions, as highlighted by the failure of Silicon Valley Bank and the takeover of Credit Suisse in March. House prices have already begun to adjust to policy tightening, with nominal price declines now under way in many economies and real house prices falling even faster, given high inflation. Past experience suggests that slumps in housing markets can exert a substantial drag on economic activity, and significantly heighten financial risks. A sizeable disconnect also remains between market expectations of interest rate declines later in 2023 and the stated intention of many central banks to maintain rates at their current level into 2024, which could potentially trigger renewed volatility in financial markets.

9. **Many emerging-market economies could also face increasing difficulties in servicing elevated debt and deficits as global interest rates rise**, especially commodity-importing economies and countries with high foreign currency denominated debt. Low-income economies are particularly at risk of debt distress. IMF debt-sustainability analyses for low-income countries suggest that, as of January 2023, over half of the 69 economies assessed were either experiencing debt distress or at high risk of distress.

Policy requirements

10. **Policy makers generally continue to face a difficult balancing act, with a need to restrain demand to get inflation under control without tipping the economy into a deep recession**, while at the same time attempting to mitigate the impact of high inflation on household incomes and advancing key longer-term objectives such as net zero emissions and higher productivity growth. These challenges are exacerbated by worsening geopolitical tensions.

11. **Monetary policy needs to remain restrictive until there are clear signs that underlying inflationary pressures are durably reduced.** Several quarters of below-trend growth and positive (forward-looking) real interest rates will likely be needed to achieve this outcome. Central banks have become increasingly data-dependent, reflecting the uncertainty that they currently face about financial market developments and the need to take stock of the cumulated impact of past interest rate increases. Nonetheless, some additional interest rate increases may still be needed in economies in which high core inflation is projected to otherwise prove persistent. In most major economies, policy rates are likely to remain high until well into 2024 given the current economic outlook. The OECD sees policy interest rates peaking at 5¼-5½ per cent in the United States and 4¼ per cent in the euro area (the main refinancing rate) and the United Kingdom in 2023. In Japan, underlying price pressures remain relatively modest, allowing an accommodative policy stance to be maintained but with further gradual adjustments to the yield curve control framework to allow a steeper yield curve.

12. **Tighter global financial conditions, the continued rise in policy rates in the advanced economies and persisting inflation pressures limit the room for policy manoeuvre in most emerging-market economies**. The differential between domestic and US policy rates is likely to remain an important policy consideration, especially in countries with sizeable foreign currency denominated debt and where inflation expectations are particularly sensitive to the domestic currency price of food and energy. The frontloading of policy tightening in Brazil could allow some easing in policy interest rates from the latter half of 2023, with other major economies starting to lower policy rates only in 2024.

13. **Some central banks have also been tightening financial conditions by contracting their balance sheets**, unwinding part of the quantitative easing conducted when policy makers were constrained by the effective lower bound on interest rates. If significant financial vulnerabilities materialise, as in the United Kingdom last autumn and the United States in March of this year, clear communication will be essential if quantitative tightening is to continue as planned alongside temporary policy measures designed to improve market liquidity and minimise the risk of contagion.

14. **Ensuring the sustainability of the public finances has become more challenging due to the multiple impacts of the pandemic, the war and energy shocks**. Almost all countries have higher budget deficits and debt levels than before the pandemic, and many face rising future spending pressures, including from the growing burden of servicing debt levels if higher interest rates persist. Credible fiscal frameworks setting out future expenditure and tax plans would help to provide clear guidance about the medium-term trajectory of the public finances and mitigate concerns about debt sustainability.

15. **Over the past year, many countries have introduced new fiscal policy measures or extended existing ones to cushion the impact of higher food and energy prices on households and businesses**. In the absence of such support there would almost certainly have been sizeable real income declines in many countries and widespread hardship amongst poorer households. Support to energy consumers was about 0.7% of GDP in the median OECD economy in 2022, but above 2% of GDP in some countries, especially in Europe. For the OECD as a whole, similar levels of support are foreseen for 2023, though the eventual fiscal costs will heavily depend on the evolution of energy prices. Policy support has so far been predominantly untargeted, reflecting the need for swift implementation as prices surged.

16. **With food and energy prices having recently declined, fiscal support to mitigate the impact of higher food and energy prices should become more focused on those most in need.** Better targeting and a timely reduction in overall support would help to ensure fiscal sustainability, preserve incentives to lower energy use and improve energy efficiency, and limit additional demand stimulus at a time of persistent inflation. More broadly, support should seek to avoid hampering reallocation by preserving energy-intensive activities that are not sustainable in the medium term. Effective targeting requires the accurate identification of the households and firms most in need of support. Households already receiving low-income-related assistance are one indicator, but others could include the inability to renovate an energy-inefficient dwelling or high energy needs. Where possible, advantage should be taken of digitalisation, both for timely data collection on energy use and faster payment delivery.

17. **Both the immediate conjuncture and the long-term decline in underlying growth rates point to the important role for supply-boosting structural reforms**, in advanced and emerging economies alike. Rekindling reform efforts to reduce constraints in labour and product markets and strengthen productivity growth would both improve sustainable living standards and reinforce the recovery from the current slowdown by mitigating supply shortages that contribute to inflation pressures. Enhancing business dynamism, lowering barriers to cross-border trade and economic migration, and fostering flexible and inclusive labour markets, including through skill improvements and reductions in gender gaps, are all key policy areas where well-designed reforms would help to boost competition, revive investment, mitigate supply shortages and strengthen gains from digitalisation.

18. **Enhanced international cooperation is needed to help overcome food and energy insecurity, assist low-income countries service their debts, and achieve a better co-ordinated approach to carbon mitigation efforts**. In this context, the launching in February 2023 of a new OECD forum, the Inclusive Forum on Carbon Mitigation Approaches (IFCMA), is intended to help its members achieve the common global net zero objective through data sharing, mutual learning and dialogue. The first actions of the IFCMA are to take stock of the policy instruments in use across members of the Forum and measure their emission-reducing effects.