FOREWORD

Global economic prospects have worsened significantly since our last *World Economic Outlook* forecast in January. At the time, we had projected the global recovery to strengthen from the second quarter of this year after a short-lived impact of the Omicron variant. Since then, the outlook has deteriorated, largely because of Russia's invasion of Ukraine—causing a tragic humanitarian crisis in Eastern Europe—and the sanctions aimed at pressuring Russia to end hostilities.

This crisis unfolds while the global economy was on a mending path but had not yet fully recovered from the COVID-19 pandemic, with a significant divergence between the economic recoveries of advanced economies and emerging market and developing ones. In addition to the war, frequent and wider-ranging lockdowns in China—including in key manufacturing hubs—have also slowed activity there and could cause new bottlenecks in global supply chains. Higher, broader, and more persistent price pressures also led to a tightening of monetary policy in many countries. Overall risks to economic prospects have risen sharply and policy trade-offs have become ever more challenging.

Beyond the immediate humanitarian impacts, the war will severely set back the global recovery, slowing growth and increasing inflation even further. This report projects global growth at 3.6 percent in 2022 and 2023—0.8 and 0.2 percentage points lower than in the January forecast, respectively. The downgrade largely reflects the war's direct impacts on Russia and Ukraine and global spillovers.

Both Russia and Ukraine are projected to experience large GDP contractions in 2022. The severe collapse in Ukraine is a direct result of the invasion, destruction of infrastructure, and exodus of its people. In Russia, the sharp decline reflects the impact of the sanctions with a severing of trade ties, greatly impaired domestic financial intermediation, and loss of confidence.

The economic effects of the war are spreading far and wide—like seismic waves that emanate from the epicenter of an earthquake—mainly through commodity markets, trade, and financial linkages. Because Russia is a major supplier of oil, gas, and metals, and, together with Ukraine, of wheat and corn, the current and anticipated decline in the supply of these commodities has already driven their prices up sharply. Europe, Caucasus and Central Asia, Middle East and North Africa, and sub-Saharan Africa are most affected. The food and fuel price increases will hurt lower-income households globally—including in the Americas and Asia.

As Chapter 1 details, the war adds to the series of supply shocks that have struck the global economy over the course of the pandemic, contributing to more shortages beyond the energy and agricultural sectors. Through closely integrated global supply chains, production disruptions in one country can very quickly cascade globally. Firms in Russia and Ukraine supply specialized inputs, and shortfalls in some of those inputs are already having impacts on European car manufacturers. Some countries in eastern Europe and central Asia have large direct trade and remittance links with Russia. Activity in those economies is expected to suffer. The displacement of more than 4 million Ukrainian people to neighboring countries, especially Poland but also Romania, Moldova, and Hungary, will also add to economic pressures in the region.

Even prior to the war, inflation had surged in many economies because of soaring commodity prices and pandemic-induced supply-demand imbalances. Some emerging markets and developed economies' central banks, such as the US Federal Reserve and those in Latin America, had already come under pressure before the war, bringing forward the timing of their monetary policy tightening. War-related supply shortages will greatly amplify those pressures, notably through increases in the price of energy, metals, and food. Although bottlenecks are expected to eventually ease as production elsewhere responds to higher prices and new capacity becomes operational, supply shortages in some sectors are expected to last into 2023. As a result, inflation is now projected to remain elevated for much longer than in our previous forecast, in both advanced and emerging market and developing economies.

In many countries, inflation has become a central concern. In some advanced economies, including the United States and some European countries, it has reached its highest level in more than 40 years, in the context of tight labor markets. There is a rising risk that inflation expectations become de-anchored, prompting a more aggressive tightening response from central banks. In emerging market and developing economies, increases in food and fuel prices could significantly increase the risk of social unrest.

Immediately after the invasion, capital outflows increased markedly from emerging market and developing economies, tightening financial conditions for vulnerable borrowers and net importers of commodities, and putting downward pressure on the currencies of the most exposed countries. So far, this repricing has been mostly orderly. Yet the April 2022 *Global Financial Stability Report* highlights several financial fragility risks. A wider range of emerging market economies could come under pressure if the pace of global monetary tightening accelerates further, especially in the United States, or if financial markets start to reprice more aggressively, which would further weigh on the global outlook.

On the fiscal side, policy space was already eroded in many countries by necessary COVID-related spending. Debt levels have risen significantly, and extraordinary fiscal support was expected to be removed in 2022–23. The war and the impending increase in global interest rates will further reduce fiscal space in many countries, especially oil- and food-importing emerging market and developing economies. The analysis in Chapter 2 shows that non-financial corporate and household leverage increased in many countries during the pandemic, as many governments helped maintain access to credit. Looking ahead, this may create some credit market vulnerabilities as interest rates and risk premia rise, with implications for financial stability.

The war has also increased the risk of a more permanent fragmentation of the world economy into geopolitical blocks with distinct technology standards, cross-border payment systems, and reserve currencies. Such a tectonic shift would entail high adjustment costs and long-run efficiency losses as supply chains and production networks are reconfigured. It also represents a major challenge to the rules-based framework that has governed international and economic relations for the last 70 years.

Because of the unprecedented nature of the shock, we highlight that the uncertainty around these projections is considerable, well-beyond the usual range. Growth could slow significantly more while inflation could turn out higher than expected if, for instance, sanctions aimed at ending the war extend to an even broader volume of Russian energy and other exports. These possibilities are explored in more detail in a Scenario Box in Chapter 1. Moreover, the pandemic is still with us. The continued spread of the virus could give rise to more lethal variants that escape vaccines or immunity from past infections, prompting new lockdowns and production disruptions.

In this difficult and uncertain environment, effective national-level policies and multilateral efforts have an ever more important role in shaping economic outcomes. Central banks will need to adjust their monetary stances even more aggressively should medium- or long-term inflation expectations start drifting from central bank targets or core inflation remains persistently elevated. As advanced economy central banks tighten policy and interest rates rise in those countries, emerging market and developing economies could face a further withdrawal of capital and currency depreciations that increase inflation pressures. Clear central bank communications on the drivers of inflation and forward guidance on the outlook for monetary policy, supplemented—when appropriate—with capital flow management measures in line with the IMF's revised Institutional View on capital flows, will be essential to minimize the risk of disruptive adjustments.

Although several economies will need to consolidate their fiscal balances, this should not impede governments from providing well-targeted support for refugees displaced by conflict, households squeezed by higher food and fuel prices, and those affected by the pandemic, as argued in the April 2022 *Fiscal Monitor*. Social and health spending more broadly should continue to be prioritized. Embedding these fiscal initiatives in a medium-term framework with a clear, credible path for stabilizing public debt can also help create room to deliver the needed support.

Even as policymakers focus on cushioning the impact of the war and the pandemic, attention will need to be maintained on longer-term goals. This includes reskilling workers for the ongoing digital transformation while facilitating the labor market transformation necessary to achieve net zero emissions, as discussed in Chapter 3 of this report. A comprehensive approach that combines carbon pricing, investment in renewables, and compensation for those adversely affected by the transition can help hasten the needed green transition. Another long-term goal will be to improve the resilience of global supply chains, as discussed in Chapter 4. The analysis in that chapter highlights how reshoring policies could leave economies more exposed to supply disruptions, not less.

Multilateral cooperation remains essential to advance these goals. An immediate priority is to find a peaceful resolution to the war. On the climate front, it is imperative to close the gap between stated ambitions and policy actions. An international carbon price floor differentiated by country income levels and multilateral finance initiatives will be required to coordinate national efforts aimed at reducing the risks of catastrophic climate events. Equally important is the need to secure equitable worldwide access to the full complement of COVID-19 tools—tests, therapies, and vaccines—to contain the virus, and to address other global health priorities.

Policymakers should also ensure that the global financial safety net operates effectively to help vulnerable economies adjust as interest rates rise in the fight against inflation. For some economies, this will mean securing adequate liquidity support to tide over short-term refinancing difficulties. But for other economies, comprehensive sovereign debt restructuring will be required to free up resources for vital health, social, and development spending. The G20's Common Framework for Debt Treatments offers guidance for such restructuring but has yet to deliver. The absence of an effective and expeditious framework is a fault line in the global financial system. Particular attention should also be paid to the overall stability of the global economic order to make sure that the rules-based framework that has lifted hundreds of millions out of poverty is not dismantled.

Importantly, these risks and policies interact in complex ways, at short, medium, and longer horizons. Rising interest rates, the need to protect vulnerable populations against high food and energy prices, or increased defense spending, make it more difficult to maintain fiscal sustainability. In turn, the erosion of fiscal space makes it harder to invest in the climate transition, while delays in dealing with the climate crisis make economies more vulnerable to commodity price shocks, which feeds into inflation and economic instability. Geopolitical fragmentation worsens all these trade-offs by increasing the risk of conflict and economic volatility and decreasing overall efficiency.

In the matter of a few weeks, the world has yet again experienced a major, transformative shock. Just as a durable recovery from the pandemic-induced global economic collapse appeared in sight, the war has created the very real prospect that a large part of the recent gains will be erased. The long list of challenges calls for commensurate and concerted policy actions at the national and multilateral levels to prevent even worse outcomes and improve economic prospects for all.

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