IMF *World Economic Outlook* projects 25% probability global growth could fall below 2%

By Pierre-Olivier Gourinchas

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The IMF projects global growth is slowing under the burden of high inflation, impact of Russia's war in Ukraine and lingering effects of the pandemic.

Source: Supplied. Pierre-Olivier Gourinchas, the International Monetary Fund's chief economist.

The Fund expects global growth to remain unchanged in 2022 at 3.2% and to slow to 2.7% in 2023—0.2 percentage points lower than the July forecast—with a 25% probability that it could fall below 2%.

“The global economy is weakening further and facing a historically fragile environment. The outlook continues to be shaped by three forces. Persistent and broadening inflation, causing a cost-of-living crisis, the Russian invasion of Ukraine and the associated energy crisis, and the economic slowdown in China.

For this year, our projection for world GDP growth is unchanged at 3.2%, as in the July World Economic Outlook update.

Global growth is forecast to slow down to 2.7% in 2023, a 0.2 percentage point lower than projected in July. The slowdown is broad based. More than a third of the global economy will contract in 2023, while the three largest economies in the world, the United States, the Euro area, and China will continue to stall.

For the first time, we calculated risks around the baseline projections. We find there is a 25% chance that growth will fall below 2% in 2023. This happened exceedingly rarely in the past and there is a 10 to 15% chance it will fall below 1%, corresponding to a decline in real output per capita.

Downside risks remain elevated, while policy trade-offs to address the cost-of-living crisis have become acutely challenging. The risk of monetary, fiscal, or financial policy miscalibration has risen sharply at a time when the world economy remains historically fragile and financial markets are showing signs of stress.

Unfortunately, most risks to the outlook are to the downside. There's a risk of monetary policy miscalibration at a time of high uncertainty and fragility. In particular, we are concerned that central banks will ease too early, causing inflation to remain excessively high and requiring a much larger loss of output later.

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A persistently strong dollar could fuel inflation and amplify financial tightening, especially in emerging markets and developing economies. High post-pandemic debts and higher borrowing costs could cause widespread debt distress in low-income countries.

A deeper real-estate crisis in China could cause severe financial stress. The war could further destabilise energy markets. A resurgence of the pandemic could hit under-vaccinated regions hard, especially Africa. Lastly, further geopolitical fragmentation could hamper global-policy co-ordination and trade..

Persistent and broadening inflation pressures have triggered a rapid and synchronised tightening of monetary conditions, alongside a powerful appreciation of the US dollar against most other currencies. Tighter global monetary and financial conditions will work their way through the economy, weighing demand down and helping to gradually subjugate inflation.

Our core priorities

The biggest fight now is the fight against inflation.

Central banks are laser focused and they need to keep a steady hand. Growth will slow in 2023 as conditions tighten and some financial fragilities may emerge.

But the main priority should be to restore price stability. This is the bedrock of future economic prosperity. Next, fiscal policy needs to be guided by coherent economic principles.

First, pandemic-era stimulus should be withdrawn, and buffers rebuilt. Second, fiscal policy should not work at cross-purposes with monetary policy. Third, the energy crisis will be long lasting. Solving it requires supply to increase and demand to decrease.

Price signals will be important to achieve that.

Governments should provide direct, temporary and targeted help to low- and middle-income families. Finally, many countries are struggling with the strength of the dollar. Yet this reflects mostly the speed of the tightening cycle in the United States, as well as the energy crisis.

Unless financial markets become severely disrupted, monetary policy should focus on inflation while allowing the exchange rate to adjust to underlying economic forces.

To read the full report, click here.

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