World Economic Situation and Prospects

Executive Summary

2023

United Nations

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Multiple shocks to the world economy

A series of severe and mutually reinforcing shocks struck the world economy in 2022 as it approached the midpoint for achieving the 2030 Sustainable Development Goals (SDGs). With the impacts of the COVID-19 pandemic still reverberating worldwide, the war in Ukraine ignited a new crisis, disrupting food and energy markets, and worsening food insecurity and malnutrition in many developing countries. High inflation unleashed an erosion of real incomes and a global cost-of-living crisis that has pushed millions into poverty and economic hardship. At the same time, the climate crisis continued to impose a heavy toll, with heat waves, wildfires, floods and hurricanes inflicting massive economic damages and generating humanitarian crises in many countries.

All these shocks will weigh heavily on the world economy in 2023. Persistently high inflation, which averaged about 9 per cent in 2022, has prompted aggressive monetary tightening in many developed and developing countries. Rapid interest rate hikes, particularly by the Federal Reserve in the United States of America, have had global spillover effects, triggering capital outflows and currency depreciations in developing countries, increasing balance of payment pressures and exacerbating debt sustainability risks. Financing conditions have tightened sharply amid high levels of private and public debt, pushing up debt-servicing costs, constraining fiscal space and increasing sovereign credit risks. Rising interest rates and diminishing purchasing power have weakened consumer confidence and investor sentiment, further clouding near-term growth prospects for the world economy. Global trade has softened due to tapering demand for consumer goods, the protracted war in Ukraine and continued supply chain challenges.

Against this backdrop, world output growth is projected to decelerate from an estimated 3 per cent in 2022 to only 1.9 per cent in 2023, marking one of the lowest growth rates in recent decades. Global growth is forecast to moderately pick up to 2.7 per cent in 2024, if, as expected, some macroeconomic headwinds begin to subside next year. Inflationary pressures are projected to gradually abate amid weakening aggregate demand in the global economy. This should allow the Federal Reserve and other major central banks to slow the pace of monetary tightening and, eventually, shift to a more accommodative monetary policy stance. The near-term economic outlook remains highly uncertain, however, as myriad economic, financial, geopolitical and environmental risks persist.

A sharp downturn in most developed economies

The current global economic slowdown cuts across both developed and developing countries, with many facing risks of recession in 2023.

Growth momentum has weakened in the United States, the European Union and other developed economies, adversely affecting the rest of the world economy. In the United States, gross domestic product (GDP) is projected to expand by only 0.4 per cent in 2023 after estimated growth of 1.8 per cent in 2022. Consumers are expected to cut back spending given higher interest rates, lower real incomes and significant declines in household net worth. Rising mortgage rates and soaring building costs will likely continue to weigh on the housing market, with residential fixed investment projected to decline further.

The short-term economic outlook for Europe has deteriorated sharply as the war in Ukraine continues. Many European countries are projected to experience a mild recession, with elevated energy costs, high inflation and tighter financial conditions depressing household consumption and investment. The European Union is forecast to grow by 0.2 per cent in 2023, down from an estimated 3.3 per cent in 2022, when further easing of COVID-19 restrictions and release of pent-up demand boosted economic activities. As the European Union continues its efforts to reduce dependence on fossil fuels from the Russian Federation, the region remains vulnerable to disruptions in the energy supply, including gas shortages. The prospects for the economy of the United Kingdom are particularly bleak given the sharp decline in household spending, fiscal pressures and supply-side challenges partly resulting from Brexit. A recession began in the United Kingdom in the second half of 2022; GDP is projected to contract by 0.8 per cent in 2023.

Despite growing at a moderate pace, Japan's economy is expected to be among the better-performing developed economies in 2023. Unlike in other developed economies, monetary and fiscal policy remain accommodative. Prolonged chip shortages, rising import costs (driven by a weakening Japanese yen) and slowing external demand are, however, weighing on industrial output. GDP is forecast to increase by 1.5 per cent in 2023, slightly lower than the estimated growth of 1.6 per cent in 2022.

The war in Ukraine heavily impacts near-term economic prospects for the Commonwealth of Independent States and Georgia. The contraction of the economy of the Russian Federation and the significant loss of output in Ukraine are having spillover effects on the rest of the region. Nonetheless, the Russian economy shrank less than initially expected in 2022, with GDP declining by only about 3.5 per cent due to a massive current account surplus, the continued stability of the banking sector and the reversal of initially sharp monetary tightening. Several of the region's economies have benefited from the relocation of businesses and residents as well as capital inflows, experiencing faster-than-expected growth in 2022. Improved terms of trade supported growth in the region's energy exporters. Overall, aggregate GDP of the Commonwealth of Independent States and Georgia (excluding Ukraine, for which this report is not presenting a forecast due to the uncertainties involved) is expected to contract by 1 per cent in 2023, following an estimated decline of 1.6 per cent in 2022.

A worsening outlook in most developing regions

Growth in China is projected to moderately improve in 2023 after weaker-than-expected performance in 2022. Amid recurring COVID-19-related lockdowns and prolonged stress in the real estate market, the economy expanded by only 3 per cent in 2022. With the Government abandoning its zero-COVID-19 policy in late 2022 and easing monetary and fiscal policies, economic growth is forecast to accelerate to 4.8 per cent in 2023. But the reopening of the economy is expected to be bumpy. Growth will likely remain well below the pre-pandemic rate of 6 to 6.5 per cent.

Economic recovery in East Asia remains fragile, although average growth is stronger than in other regions. In 2023, GDP growth in East Asia is forecast to reach 4.4 per cent, compared to 3.2 per cent in 2022, mainly reflecting the modest recovery of growth in China. Yet many economies in the region (other than China) are losing steam amid fading pent-up demand, rising living costs and weakening export demand from the United States and Europe. This coincides with a tightening of global financial conditions, and countries adopting contractionary monetary and fiscal policies to curb inflationary pressures. Although the expected recovery of China's economy will support growth across the region, any surge in COVID-19 infections may temporarily create slowdowns.

In South Asia, the economic outlook has significantly deteriorated due to high food and energy prices, monetary tightening and fiscal vulnerabilities. Average GDP growth is projected to moderate from 5.6 per cent in 2022 to 4.8 per cent in 2023. Growth in India is expected to remain strong at 5.8 per cent, albeit slightly lower than the estimated 6.4 per cent in 2022, as higher interest rates and a global slowdown weigh on investment and exports. The prospects are more challenging for other economies in the region. Bangladesh, Pakistan and Sri Lanka sought financial assistance from the International Monetary Fund (IMF) in 2022.

In Western Asia, oil-producing countries have emerged from the economic slump, benefitting from high prices and rising oil output as well as the recovery of the tourism sector. Recovery in non-oil-producing countries, by contrast, has remained weak given tightening access to international finance and severe fiscal constraints. Average growth is projected to slow from an estimated 6.4 per cent in 2022 to 3.5 per cent in 2023, given worsening external conditions.

In Africa, economic growth is projected to remain subdued with a volatile and uncertain global environment compounding domestic challenges. The region has been hit by multiple shocks, including weaker demand from key trading partners (especially China and Europe), a sharp increase in energy and food prices, rapidly rising borrowing costs and adverse weather events. As debt-servicing burdens mount, a growing number of governments are seeking bilateral and multilateral support. Economic growth is projected to slow from an estimated 4.1 per cent in 2022 to 3.8 per cent in 2023.

The outlook in Latin America and the Caribbean remains challenging given unfavourable external conditions, limited macroeconomic policy space and stubbornly high inflation. Regional growth is projected to slow to only 1.4 per cent in 2023, following an estimated expansion of 3.8 per cent in 2022. Labour market prospects are challenging. Reductions in poverty across the region are unlikely in the near term. The region's largest economies – Argentina, Brazil and Mexico – are expected to grow at very low rates due to tightening financial conditions, weakening exports and domestic vulnerabilities.

The least developed countries, many of which are highly vulnerable to external shocks, will confront significant challenges in 2023. Growth is projected at 4.4 per cent in 2023, about the same rate as last year and significantly below the 7 per cent growth target set in SDG 8. In many of these countries, the risk of a lost decade is rising on the back of limited productive capacity, insufficient fiscal space, large macroeconomic imbalances and intensifying debt vulnerabilities. For the small island developing States, the short-term outlook remains bleak. Tourist arrivals have not fully recovered, and many of these countries are disproportionately affected by growing climate risks and natural disasters.

Central banks are vigorously fighting inflation

After a long period of price stability, high inflation has returned in many countries, disproportionately affecting low-income households. Pandemic-induced inflationary pressures, with demand recovering quickly and supply lagging amid continued disruptions in supply chains, have been persistent. Soaring food and energy prices and renewed supply shocks caused by the war in Ukraine have driven a surge in inflation and pushed up short- and medium-term inflation expectations. Average global inflation in 2022 reached the highest level in two decades. Upward price pressures will likely ease due to aggressive monetary tightening and slowing demand, but global inflation is still projected to remain elevated in 2023.

In 2022, central banks worldwide raised interest rates in quick succession to bring inflation under control and anchor inflation expectations. This shift towards tighter monetary policy was exceptionally broad-based. Over 85 per cent of monetary authorities worldwide hiked rates in the past year. The Federal Reserve led global monetary tightening, lifting its key policy rate six times from 0 to 0.25 per cent in March to 4.25 to 4.5 per cent in December 2022. This was the largest cumulative rate increase in any given year since 1980. As inflation is likely to have peaked in late 2022, central banks, especially in the developed countries, are expected to slow the pace of interest rate hikes in 2023, particularly if inflation approaches respective national target rates.

Mounting debt and balance of payment vulnerabilities

Sharp and rapid interest rate increases, elevated geopolitical tensions and a weakening global economic outlook have triggered a "flight to safety" in many countries, marked by a reversal of non-resident portfolio flows and the depreciation of domestic currencies against the dollar. Weaker domestic currencies pushed up import bills and further amplified inflationary pressures in many developing countries. Tighter financial conditions in international capital markets raised financing costs and rollover risks, adversely affecting investment and growth prospects.

Rapidly tightening global financial conditions have exacerbated balance of payment and debt vulnerabilities in many developing countries. Several commodity-importing countries have seen a significant increase in gross external financing needs in recent years. Amid rising sovereign borrowing costs, servicing external debt has become more expensive, absorbing a growing share of fiscal revenues. Higher debt-servicing burdens are constraining much needed expenditures to support economic recovery, protect the most vulnerable population groups during the cost-of-living crisis and finance sustainable development.

In Africa, debt servicing on public and publicly guaranteed external debt averaged 10 per cent of government revenues in 2021, up from 3 per cent in 2011. Moreover, tightening financial conditions make it more difficult for many developing countries to roll over and restructure their existing debt, raising the risks of debt defaults. A growing number of developing countries, including several with large numbers of people living in poverty, find themselves in precarious debt situations.

Another blow to the Sustainable Development Goals

Jobs continued to recover from the pandemic in 2022 but with significant differences across countries. In many developed economies, labour markets became exceptionally tight as evidenced by record-low unemployment and record-high employment and job vacancy rates. Sectors such as construction, information and communication, and food and accommodation continued to suffer from severe labour shortages. Most developing countries, however, have seen a slower job recovery with considerable employment slack. The average unemployment rate in developing countries in 2022 was still notably higher than before the pandemic. Disproportionate losses in women's employment in 2020 have not been fully reversed; recent improvements mainly stem from a recovery in informal jobs. With a deteriorating global outlook, employment prospects for 2023 and 2024 have weakened in a vast majority of countries.

Slower growth, elevated inflation and mounting debt vulnerabilities threaten to further set back hard-won SDG achievements, deepening the already negative effects of the COVID-19 pandemic. A prolonged period of economic weakness and slow income growth would undermine poverty eradication efforts by constraining national capacities to invest in health, education, physical and digital infrastructure, and energy transition.

The global food and energy crisis unleashed by the war in Ukraine is hitting many developing countries hard. In addition, severe droughts and floods have damaged crops, especially in parts of Africa and South Asia, pushing millions into poverty. Amid soaring food and fertilizer prices and supply disruptions, the number of people facing severe food insecurity more than doubled between 2019 and 2022.

Some relief has come from the Black Sea Grain Initiative brokered by the United Nations and Türkiye. It has ensured the resumption of food exports from Ukraine to the rest of the world, with more than 15 million metric tons of grain and other foods transported between August and mid-December 2022. In addition, through a memorandum of understanding signed in July 2022, the Russian Federation and the Secretariat of the United Nations agreed to facilitate the unimpeded access to global markets for food and fertilizers, including materials required for producing fertilizers, originating from the Russian Federation. Nevertheless, uncertainty over the duration and intensity of the conflict, along with potential export restrictions in food-exporting countries, mean that food supply challenges will likely persist in 2023.

New challenges for macroeconomic policymaking

Policymakers face difficult trade-offs in steering their economies through current crises and supporting an inclusive and sustainable recovery. Macroeconomic policies need to be carefully calibrated to strike a balance between stimulating output and taming inflation, with effective coordination between monetary and fiscal policies to minimize chances of a prolonged and severe economic downturn. The risks of policy mistakes are significant, especially since macroeconomic policy responses have limited capacity to address non-economic shocks. Policy missteps could aggravate economic downturns and inflict further socioeconomic harm, especially on vulnerable groups.

The risk of overtightening monetary policy

Monetary policy faces major challenges and trade-offs. Many developed country central banks, including the Federal Reserve and the European Central Bank, were initially reluctant to raise policy rates, perceiving rising inflation as transitory. As it became clear that inflationary pressures were more persistent and risked de-anchoring inflation expectations, the banks embarked on an aggressive monetary tightening path, raising rates at a very fast clip in 2022. Central banks now find themselves at a critical juncture as economic prospects have weakened while inflation is not yet fully under control and fiscal challenges remain. Rapid and synchronized monetary tightening by the world's major central banks has pulled too much liquidity out of markets too quickly, generating significant negative spillover effects on the global economy and weakening the economic prospects of vulnerable countries.

Overtightening of monetary policy would drive the world economy into an unnecessarily harsh slowdown, an outcome that could be avoided if rate increases by individual central banks accurately consider the reciprocal impacts of similar rate hikes by others. This will require more effective coordination among the major central banks, supported by clear policy messages to manage and moderate inflationary expectations.

Revisiting inflation targets

Given the policy challenges of maintaining price stability while supporting growth, central banks need a maximum degree of policy flexibility to anchor longer-term inflation expectations. The current inflation crisis, once abated, presents an opportunity to revisit their monetary frameworks and reconsider overly rigid inflation targets. Various options exist that may enable central banks to exercise greater policy flexibility while ensuring the continued credibility of monetary policy. Raising inflation targets in developed countries from 2 per cent to 3 or 4 per cent may provide more room to stimulate employment and growth in difficult times. Other options are to move to a target range, for example, between 2 and 3.5 per cent, or to target the price level rather than the annual inflation rate.

While reforming existing frameworks could yield considerable benefits, central banks will also need to pursue a deliberate and comprehensive process to avoid losses in credibility and the de-anchoring of inflation expectations. A reappraisal and recalibration of monetary policy tools based on experiences accumulated since the global financial crisis may help better support price stability and policy credibility while promoting full employment and economic growth.

The imperative of avoiding fiscal austerity

Persistent fiscal deficits and elevated public debt levels have prompted calls for rapid fiscal consolidation even as recovery from the COVID-19 recession remains incomplete and fragile. But this is not the time for socially painful and potentially self-defeating fiscal austerity. On the one hand, fiscal retrenchment tends to be associated with painful cuts to social spending that disproportionately hurt the most vulnerable groups, including women and children. Public budget cuts often reduce or eliminate programmes and social services that benefit women more than men, resulting in income losses for women, restricting their access to health care and education, and increasing unpaid work and time poverty. Such impacts further exacerbate the already dire situation of those who have yet to regain employment and livelihoods due to a weaker-than-expected economic recovery. At the same time, an excessively early or larger-than-needed shift to austerity would also stifle growth, delay recovery from current crises and undermine much needed financing for achieving sustainable development and fighting climate change.

Amid an increasingly challenging macroeconomic and financial environment, many developing countries are at risk of entering a vicious cycle of weak investment, slow growth and rising debt-servicing burdens. Any rapid fiscal consolidation, through significant expenditure cuts or tax hikes, would likely push economies into recession or lead to protracted slow growth. This will worsen rather than improve debt sustainability in developing countries.

Fiscal expenditures, when properly directed, are particularly effective in supporting growth and development in times of economic slack due to the large multiplier effects of public spending. In most developing countries, actual output is still below potential output, implying persistent economic slack. In such a situation, public investment does not crowd out private investment but can instead be a powerful tool to generate jobs and reinvigorate growth. Public investment not only boosts short-term aggregate demand but also stimulates capital formation, expanding productive capacities and lifting potential growth. Especially at a moment of many uncertainties, strategic public investment signals policy commitment and will likely crowd in private investment, which will remain critical for mitigating the scarring effects of the pandemic. By expanding productive capacities, public investment can also lessen supply-side constraints and reduce inflationary pressures in the medium term. As fiscal space is constrained in most countries, public expenditures need to be well managed, targeted and efficient.

Current challenges demand a transformative SDG stimulus package as recently proposed by the United Nations Secretary-General. This would help offset deteriorating financing conditions and allow developing countries to scale up investment in sustainable development. The package addresses both urgent short-term needs and requirements for long-term sustainable development finance. It calls for a massive increase in such finance, including for humanitarian support and climate actions, through concessional and non-concessional funding.

Fiscal policy for stimulating growth and SDG progress

Developing countries do have some options to protect and expand existing fiscal policy space and maximize the positive impacts of public spending on growth and sustainable development. Governments will need to reallocate and reprioritize public expenditures to support vulnerable groups through direct policy interventions. This will require strengthening social protection systems and ensuring continued support through targeted and temporary subsidies, cash transfers and discounts on utility bills, which can be complemented with reductions in consumption taxes or custom duties.

Governments may target, support and crowd in private investment in critical sectors, including in education, health, digital infrastructure, new technologies, and climate change mitigation and adaptation. Strategic public investment in these sectors can offer large social returns, accelerate productivity growth, and strengthen resilience to economic, social and environmental shocks.

In addition, governments will need to redouble their efforts to expand the revenue base and thus improve tax collection and strengthen fiscal sustainability. In the short term, the use of digitalization and new technologies, for example, can reduce tax avoidance and evasion and improve tax revenues. In the medium term, governments will need to implement tax reforms and expand tax bases with progressive income and wealth taxes.

Stronger international cooperation is imperative

The pandemic, the global food and energy crises, climate risks and the looming debt crisis in many developing countries are testing the limits of existing multilateral frameworks. International cooperation has never been more important than now to face multiple global crises and bring the world back on track to achieve the SDGs.

Since the start of the pandemic, the international community has offered financial support with a sharp increase in the provision of IMF emergency lending to developing countries, most recently, for example, through a new food shock window. In August 2021, a $650 billion IMF special drawing rights (SDRs) allocation – the largest in history – was approved to provide liquidity to the global financial system. Only a small fraction – $21 billion – was allocated to low-income countries, however. Some countries have reallocated a share of their SDRs to Africa, led by China, which has pledged $10 billion of its $40 billion allocation to the continent. While the SDRs remain an important source of liquidity support for countries facing balance-of-payment challenges, the interest rate on them rose sharply in 2022. The international community will need to cap interest and charge rates to ensure that the poorest and most vulnerable countries can access the facility to meet near-term financing needs.

Stronger support from the international community is also needed to resolve debt distress, where exogenous shocks constrain countries' abilities to meet their debt obligations. The Group of 20 Common Framework for Debt Treatments remains the main international debt relief mechanism available to the least developed countries and other low-income countries facing debt distress. The framework has, however, fallen short of expectations. Only three countries have requested debt relief; none has concluded a restructuring since the framework came into effect over a year and a half ago. There is broad consensus that the framework is not working, especially in providing pragmatic, swift, comprehensive and forward-looking solutions for all countries facing debt distress. Such solutions must include a standstill in debt-servicing payments, engagement of official creditors with the debtor and with private creditors, and a clearly defined restructuring process. Beyond these immediate measures, an international statutory mechanism for sovereign debt restructuring needs to be established. There is also scope to improve lending contracts, for example, through State-contingent debt instruments or enhanced collective action clauses.

The world is at a critical juncture as it approaches the midpoint of the SDGs. A number of entities have estimated the financing requirements for developing countries to reach the goals and address the climate crisis. Most predictions fall in a range amounting to several trillion dollars per year. Given already limited fiscal space in developing countries and growing needs for stimulating recovery and protecting the most vulnerable, these countries face significant challenges in making such investments. At the same time, favourable climate and SDG outcomes, initially realized through action in specific countries, can have significant positive spillover effects across the world. More robust international cooperation in mobilizing the resources needed to secure such outcomes is in the interest of all countries, developed and developing.

For more information
www.un.org/en/desa

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