

Global Economic Prospects

January 2023

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WORLD BANK GROUP

Equitable Growth, Finance & Institutions

Prospects Group

Global Economic Prospects – *January 2023*

- **Global Outlook (Chapter 1)**
- **Regional Outlooks (Chapter 2)**
- **Investment Growth After the Pandemic (Chapter 3)**
- **Small States: Overlapping Crises, Multiple Challenges (Chapter 4)**

Four Questions

1 What are near-term prospects for the global economy?

2 How do Fed policy changes affect EMDEs?

3 What are prospects for investment?

4 What are the policy priorities?

Global Growth Forecasts

A Sharp Downturn in 2023

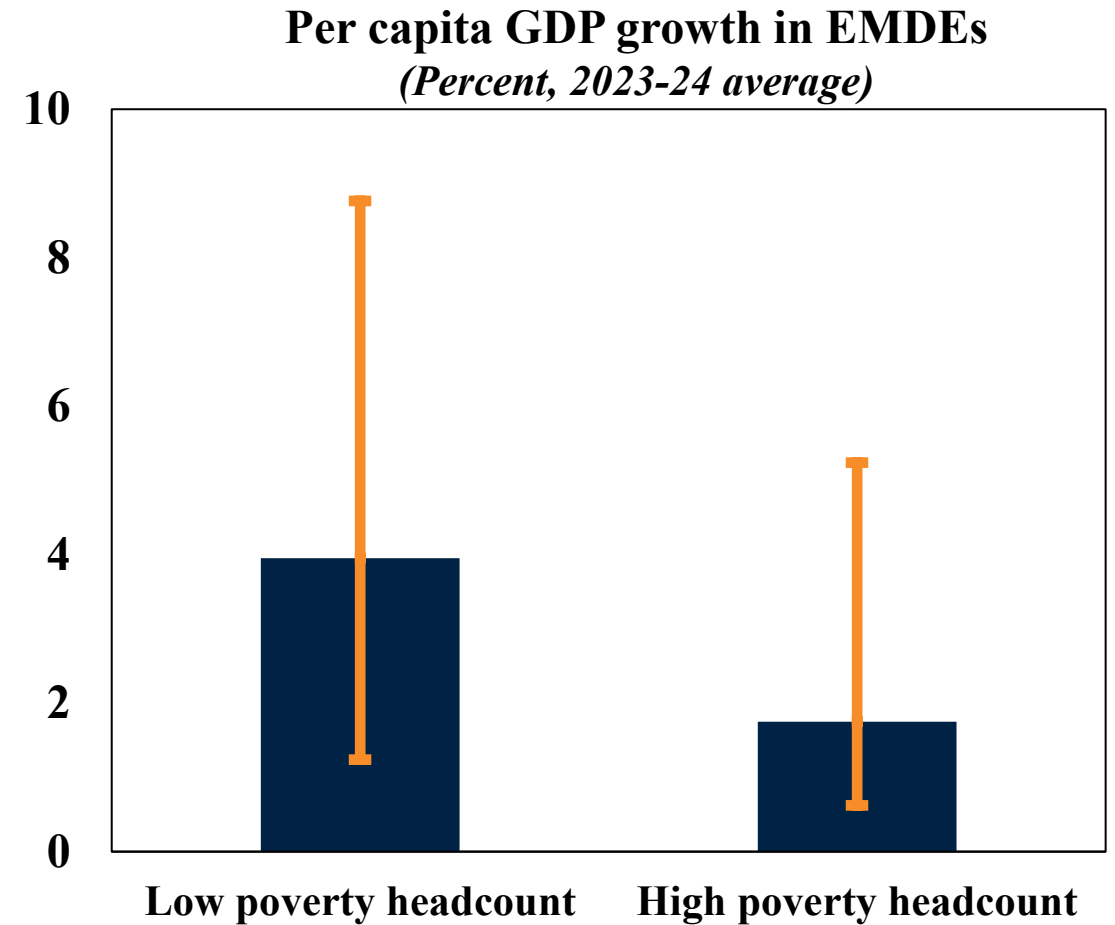
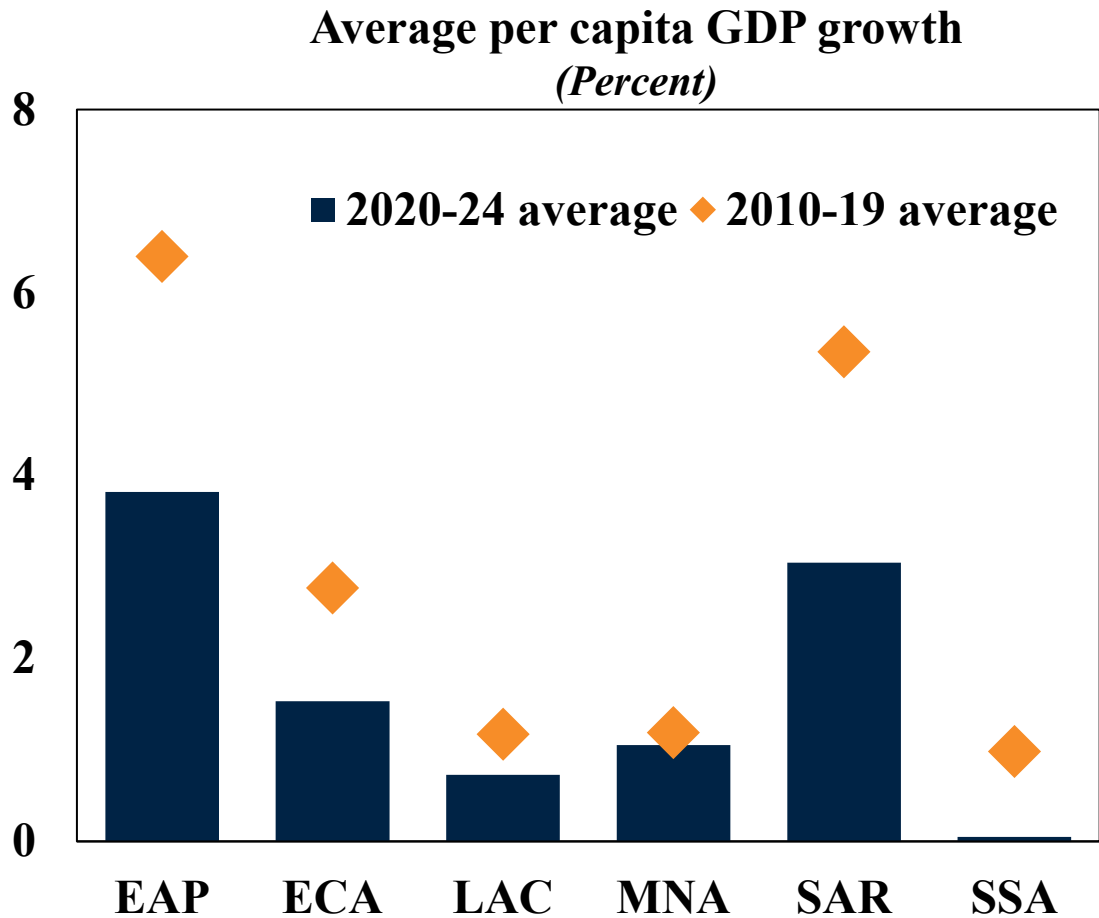
	GDP growth (Percent)						Change from June 2022		
	2013-19	2020	2021	2022e	2023f	2024f	2022	2023	2024
World	2.9	-3.2	5.9	2.9	1.7	2.7	0.0	-1.3	-0.3
Advanced economies	2.0	-4.3	5.3	2.5	0.5	1.6	-0.1	-1.7	-0.3
EMDEs	4.5	-1.5	6.7	3.4	3.4	4.1	0.0	-0.8	-0.3
<i>Excluding China</i>	3.2	-3.9	5.7	3.8	2.7	3.6	1.1	-0.7	-0.4
East Asia and Pacific	6.6	1.2	7.2	3.2	4.3	4.9	-1.2	-0.9	-0.2
Europe and Central Asia	2.7	-1.7	6.7	0.2	0.1	2.8	3.2	-1.4	-0.5
<i>Excluding Russia and Ukraine</i>	4.1	-1.0	8.2	4.2	2.1	3.4	1.5	-1.4	-0.4
Latin America and the Caribbean	1.3	-6.2	6.8	3.6	1.3	2.4	1.1	-0.6	0.0
Middle East and North Africa	2.6	-3.6	3.7	5.7	3.5	2.7	0.4	-0.1	-0.5
South Asia	6.4	-4.5	7.9	6.1	5.5	5.8	-0.7	-0.3	-0.7
Sub-Saharan Africa	3.2	-2.0	4.3	3.4	3.6	3.9	-0.3	-0.2	-0.1

Source: World Bank.

Note: Aggregate growth rates are calculated using GDP weights at average 2010-19 prices and market exchange rates; e and f refer to estimates and forecasts, respectively.

Impact of Multiple Global Shocks

Weaker Income Growth Especially for Poorest

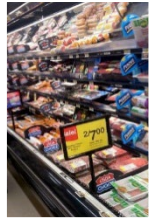


Sources: Consensus Economics; Guenette, Kose, and Sugawara (2022); Oxford Economics; World Bank.

Left Panel. Population projections from UN World Population Prospects 2022. Center Panel. “Low poverty headcount” are EMDEs with poverty headcount below the 25th percentile, and “high poverty headcount” are those above the 75th percentile. Bars show per capita GDP growth simple average for 2023-24 for 40 EMDEs and orange whiskers indicate the minimum-maximum range. Sample excludes the Russian Federation and Belarus. Poverty data are the poverty headcount ratios at \$2.15 a day (2017 PPP).

Risks

Multiple Downside Risks



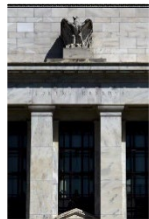
Persistent inflation



Geopolitical turmoil



Climate-related disasters



Unanticipated monetary tightening



Energy and food insecurity



Fragmentation of global trade, investment, and financial networks



Financial stress



Social tensions



Weaker longer-term growth prospects and larger development challenges



COVID-19 outbreaks

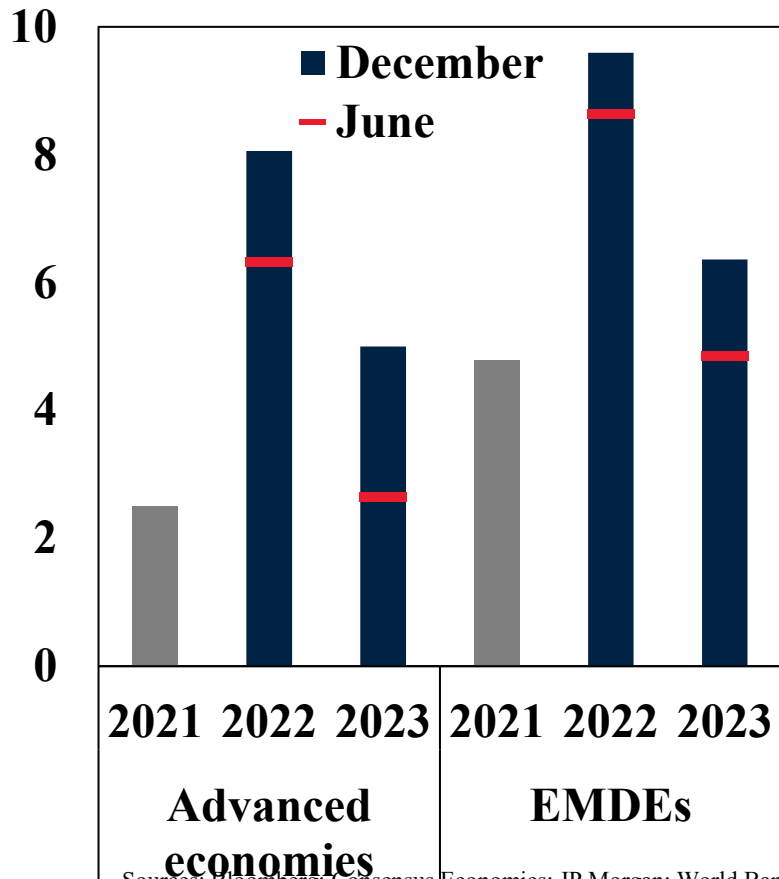
Four Questions

2 **How do Fed policy changes affect EMDEs?** *Monetary policy reaction shocks substantially tighten financial conditions in EMDEs and increase the risk of currency crises.*

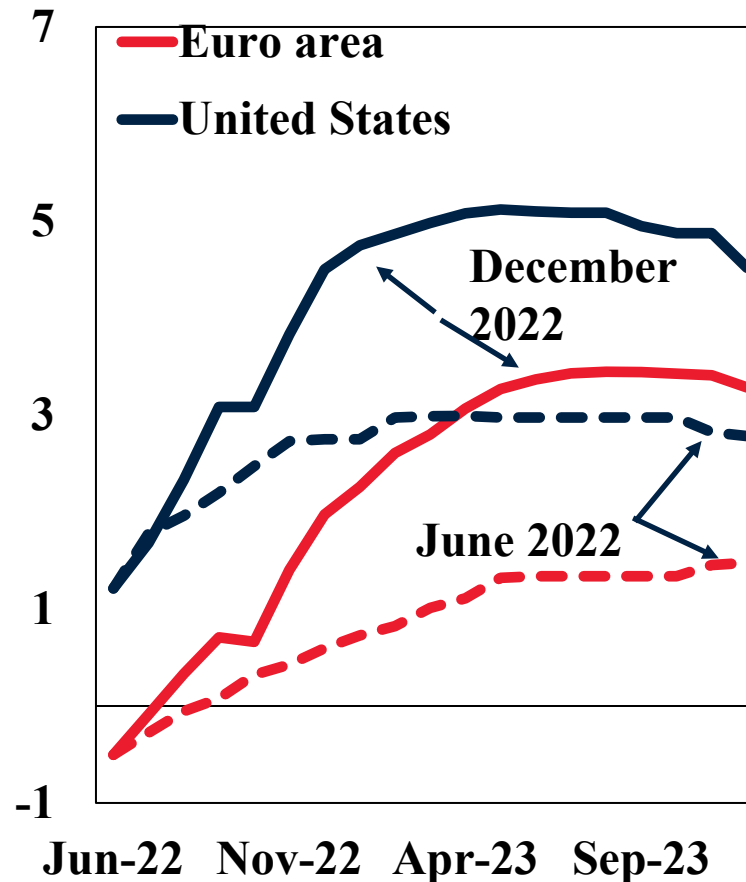
Tighter Monetary Policy and Financial Stress

Higher Interest Rates; Elevated Inflation; Tighter Financial Conditions

Survey-based inflation expectations
(Percent)

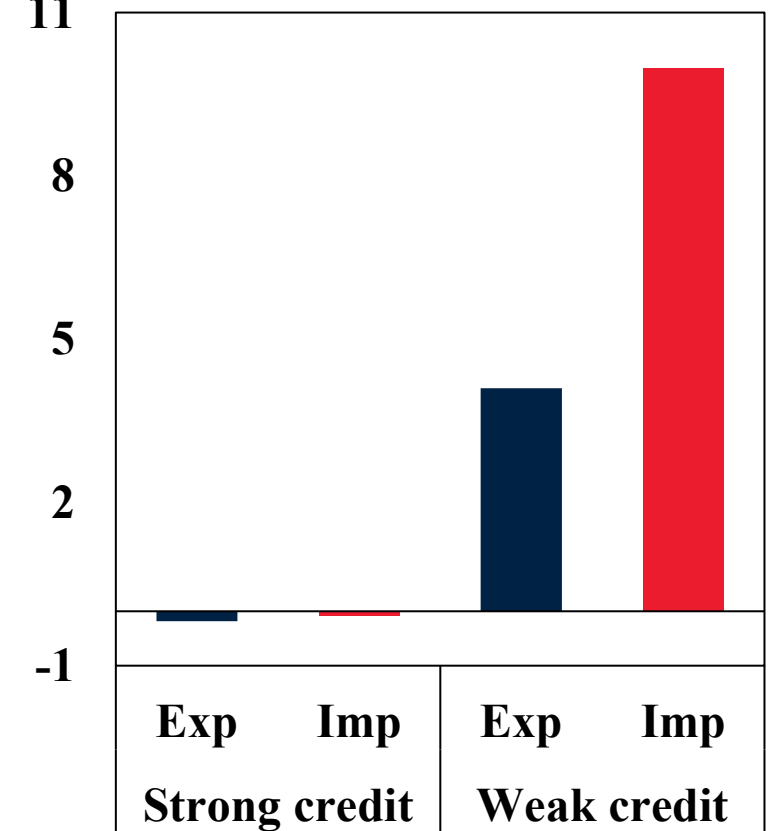


Interest rate expectations
(Percent)



EMDE sovereign spread changes,
since June 2022

(Percentage points, by energy trade)



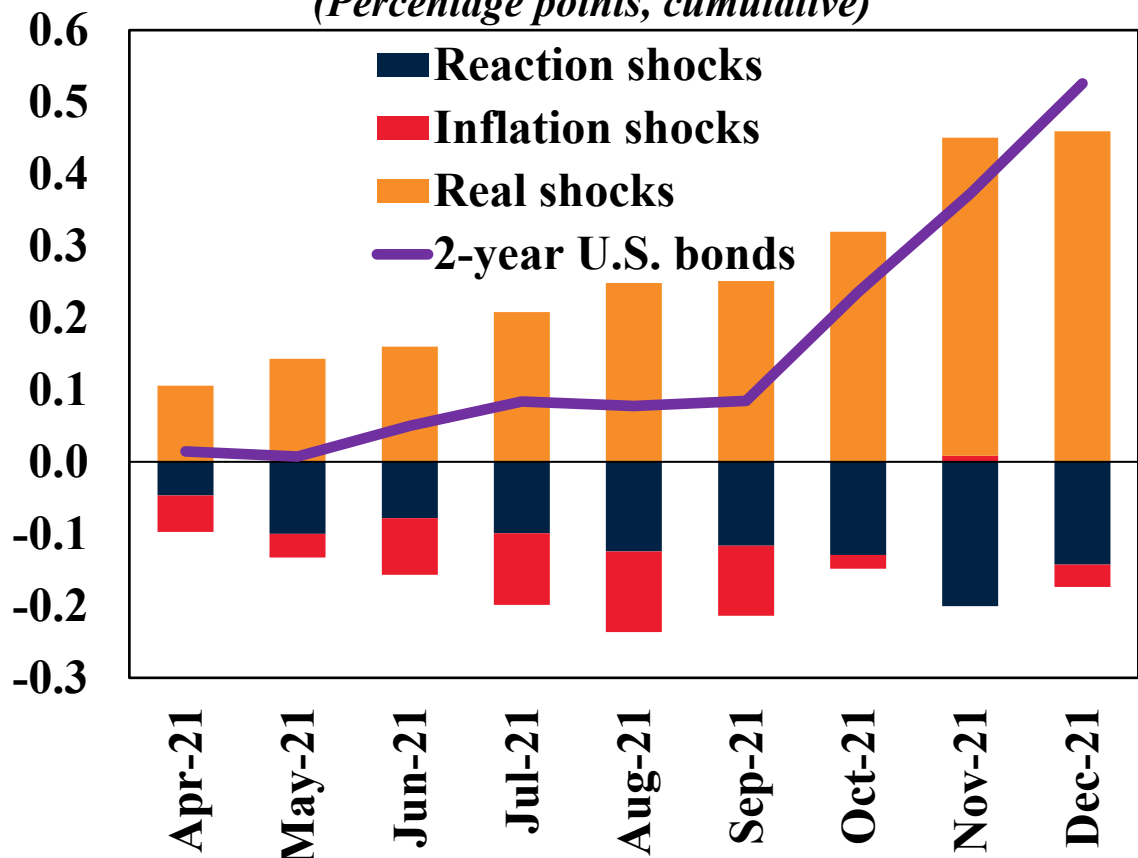
Sources: Bloomberg; Consensus Economics; JP Morgan; World Bank.

Left Panel. The median headline CPI inflation expectations for 33 advanced economies and 50 EMDEs derived from Consensus Economics surveys in respective months of 2022. Center Panel. Policy rate expectations derived from futures curves. The lines for December 2022 are as of December 15, 2022, and those for January 2022 are as of end-2021. Right Panel. Change in EMBI spreads since January 2022, using Moody's sovereign foreign currency ratings. Sample includes 11 EMDE energy exporters and 35 EMDE energy importers, and excludes Belarus, the Russian Federation, and Ukraine. Last observation is November 25, 2022. Strong credit defined as ratings from Aaa to Baa3. Weak credit defined as ratings from Caa to Ca.

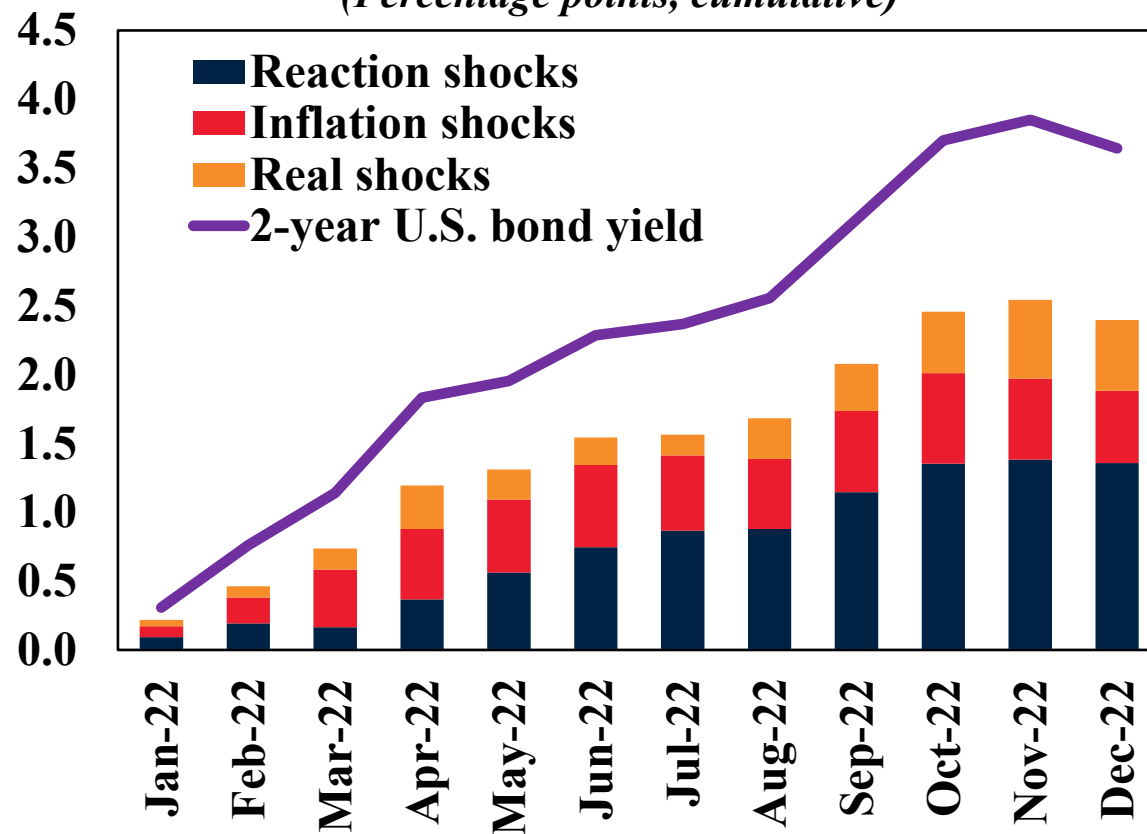
Drivers of U.S. Interest Rate Shocks

Recently, Perception of changing U.S. Fed Policy Reaction

Contributions to changes in 2-year U.S. treasury yields: 2021 rebound
(Percentage points, cumulative)



Contributions to changes in 2-year U.S. treasury yields: Current tightening cycle
(Percentage points, cumulative)



Sources: Arteta, Kamin, and Ruch (2022); World Bank.

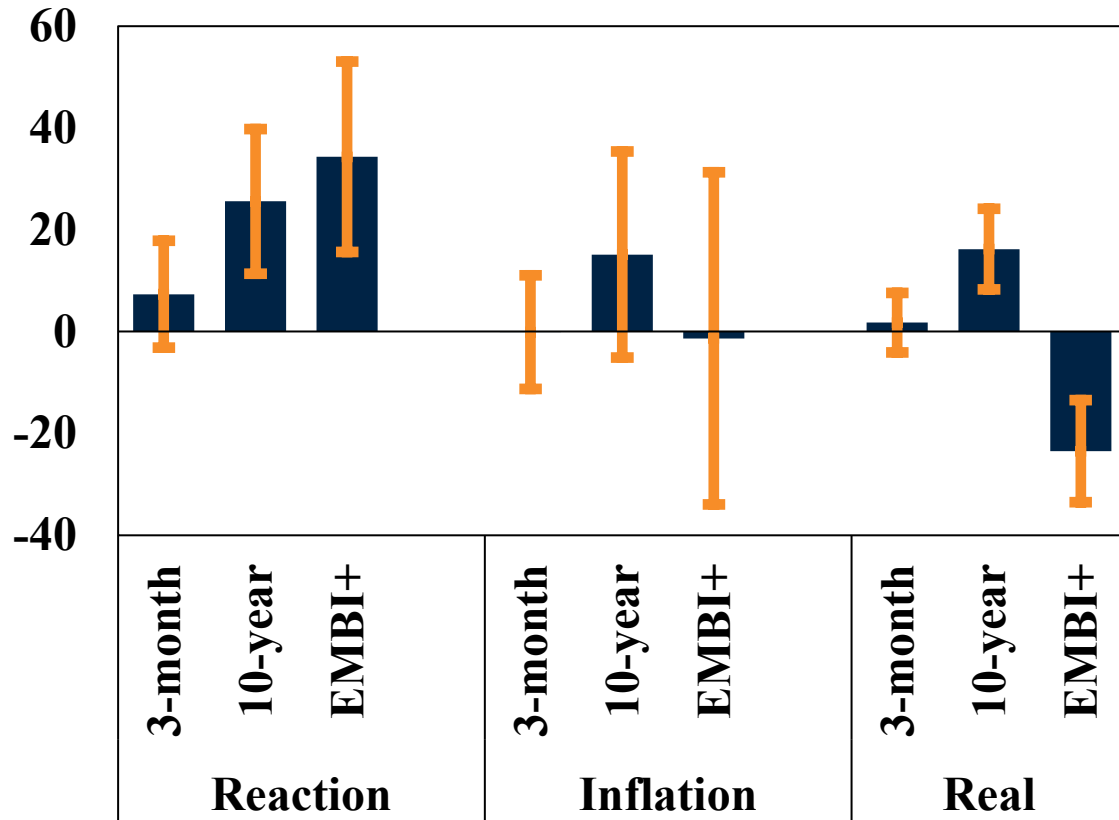
Note: Based on a sign-restricted Bayesian VAR model with stochastic volatility using U.S. data for January 1982-December 2022. A positive “real shock” is an increase in interest rates in response to strong growth. It is accompanied by rising equity prices and inflation expectation. A positive “inflation expectations shocks” is an increase in interest rates that is a response to rising inflation expectations. This is accompanied by lower growth, proxied by equity prices. A positive “policy reaction shock” is an interest in interest rates that is in response to a perceived Fed pivot to a more hawkish stance. It is accompanied by lower growth (proxied by equity prices) and lower inflation expectations.

Impact of U.S. Interest Rate Shocks

Capital Outflows; Rising Borrowing Cost; Depreciation

Impact of 25 basis point shock on EMDE interest rates after one quarter

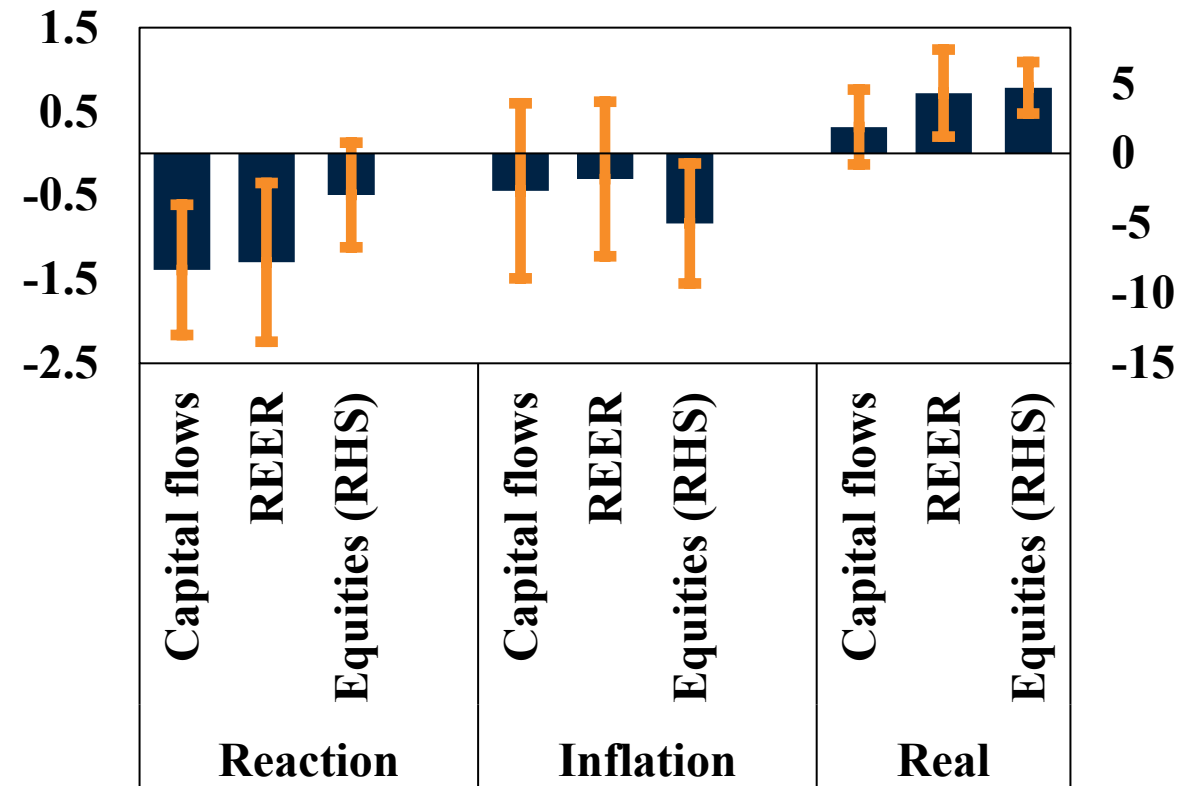
(Basis points)



Impact of 25 basis point shock on EMDE financial variables after one quarter

(Percent/Percent of GDP)

(Percent)



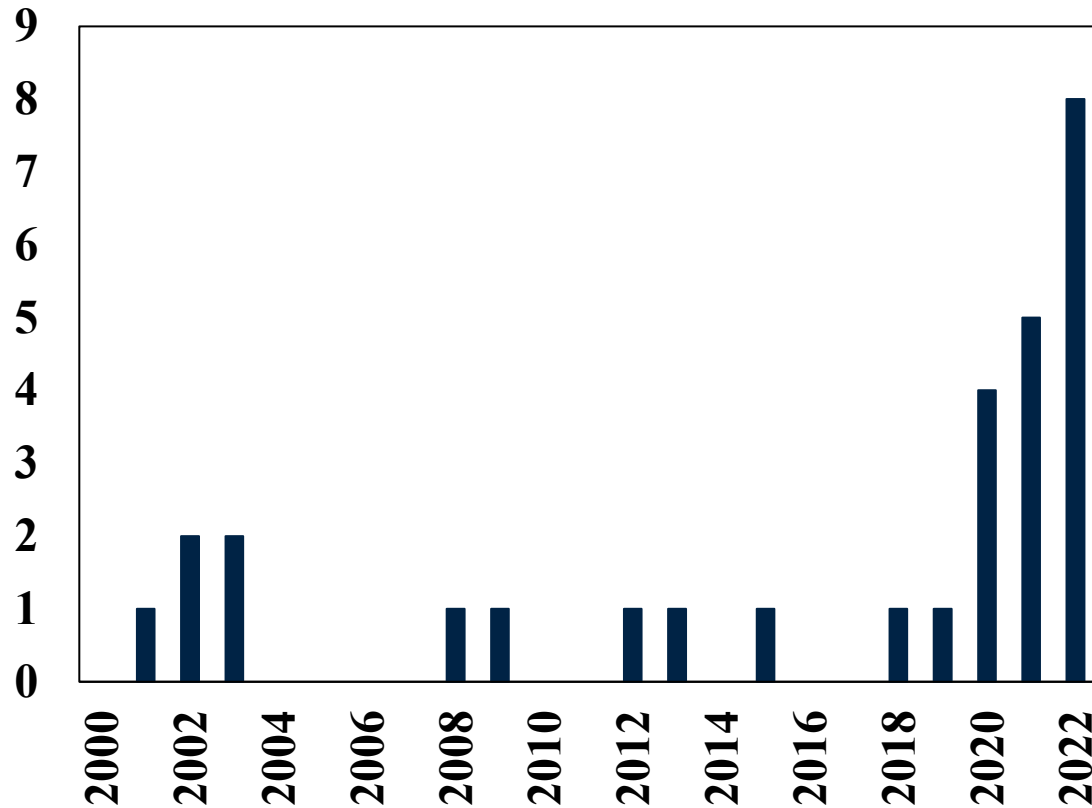
Sources: Arteta, Kamin, and Ruch (2022); World Bank.

Note: Panel local projection models with fixed effects and robust standard errors. See table A3 of Arteta, Kamin, and Ruch (2022) for details. Models estimated over periods as long as 1997Q2-2019Q4; they exclude observations during global financial crisis (2008Q4-2009Q4) and the COVID-19 pandemic. Bars reflect impact on first quarter (y_{t+1}). Orange whiskers reflect 90 percent confidence intervals. EMBI = emerging market bond index. Right Panel: Positive “capital flows” values reflect an increase in net liabilities of portfolio and other investments as a percent of GDP for EMDEs. Positive “REER” values reflect an appreciation in the exchange rate. Figure excludes fixed exchange rate economies. REER = real effective exchange rate.

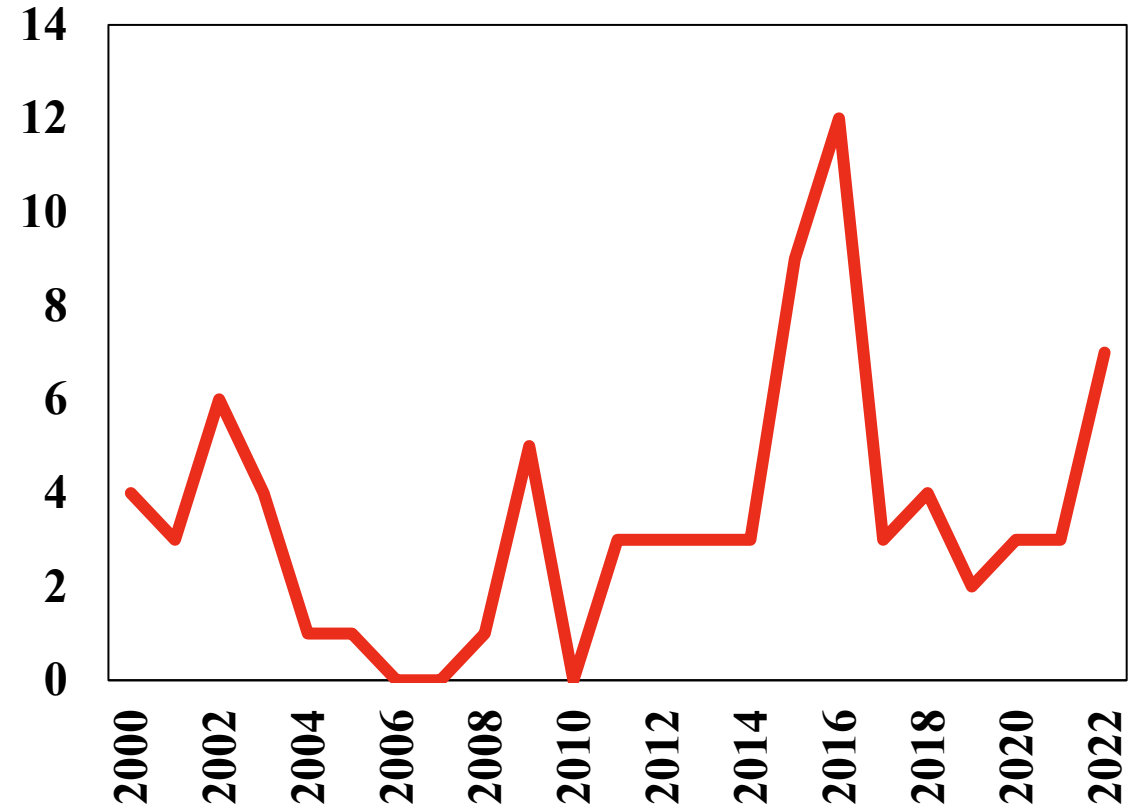
Impact of U.S. Policy Reaction Shocks on Crisis Probability

Higher Probability of Currency and Banking Crisis

EMDEs in debt default
(Number of EMDEs)



EMDEs in currency crises
(Number of EMDEs)

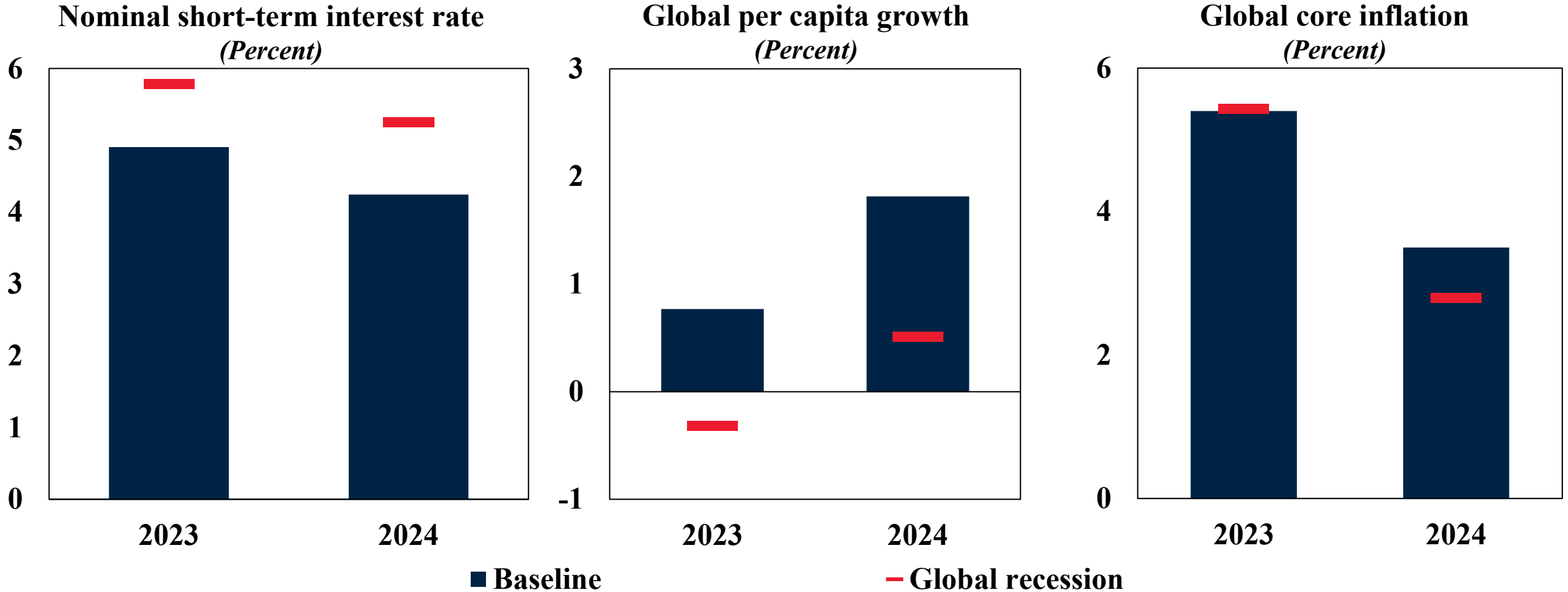


Sources: Kose et al. (2022); Laeven and Valencia (2020); Schumacher, Trebesch, and Enderlein (2021); World Bank.

Left Panel: Currency crises as defined in Laeven and Valencia (2020) as 30 percent depreciation of more. Countries rated by Moody's C (Obligations rated C are the lowest rated and are typically in default, with little prospect for recovery of principal or interest) or Ca (Obligations rated Ca are highly speculated and are likely in, of very near, default, with some prospect of recovery of principal or interest). Number of countries that were at some point during the year rated C or Ca. Unbalanced sample of 61-108 EMDEs since 2000. Right Panel: Based on results from panel logit model with random effects. Right Panel: Reflects a 1.4 percentage point increase in the 2-year U.S. treasury yield driven by a reaction shock (the increase seen in 2022). Orange whiskers reflect one standard deviation confidence intervals.

Global Growth Scenarios for 2023-24

Heightened Risk of Global Recession with Higher Interest Rates



Sources: Guenette, Kose, and Sugawara (2022); Oxford Economics; World Bank.

Note: In addition to the baseline scenario, the Oxford Economics Global Economic Model is used to quantify the downside risks to growth of higher anticipated inflation, additional monetary tightening in response, and the potential resultant financial stress. Under the global recession scenario, not only are the major central banks' policies even more restrictive, but tighter financial conditions are assumed to lead to widespread financing stress across EMDEs.

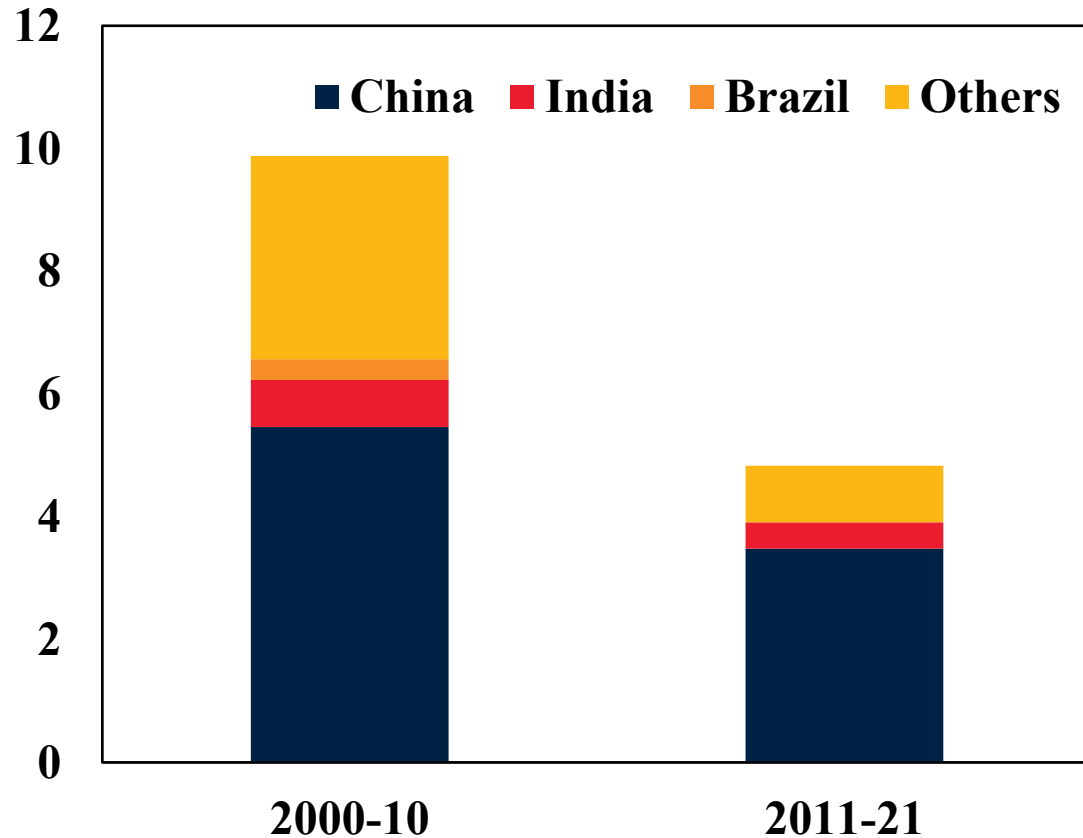
Four Questions

3 **What are prospects for investment?** *Further investment slowdown, on the heels of a decade of subdued investment in the 2010s.*

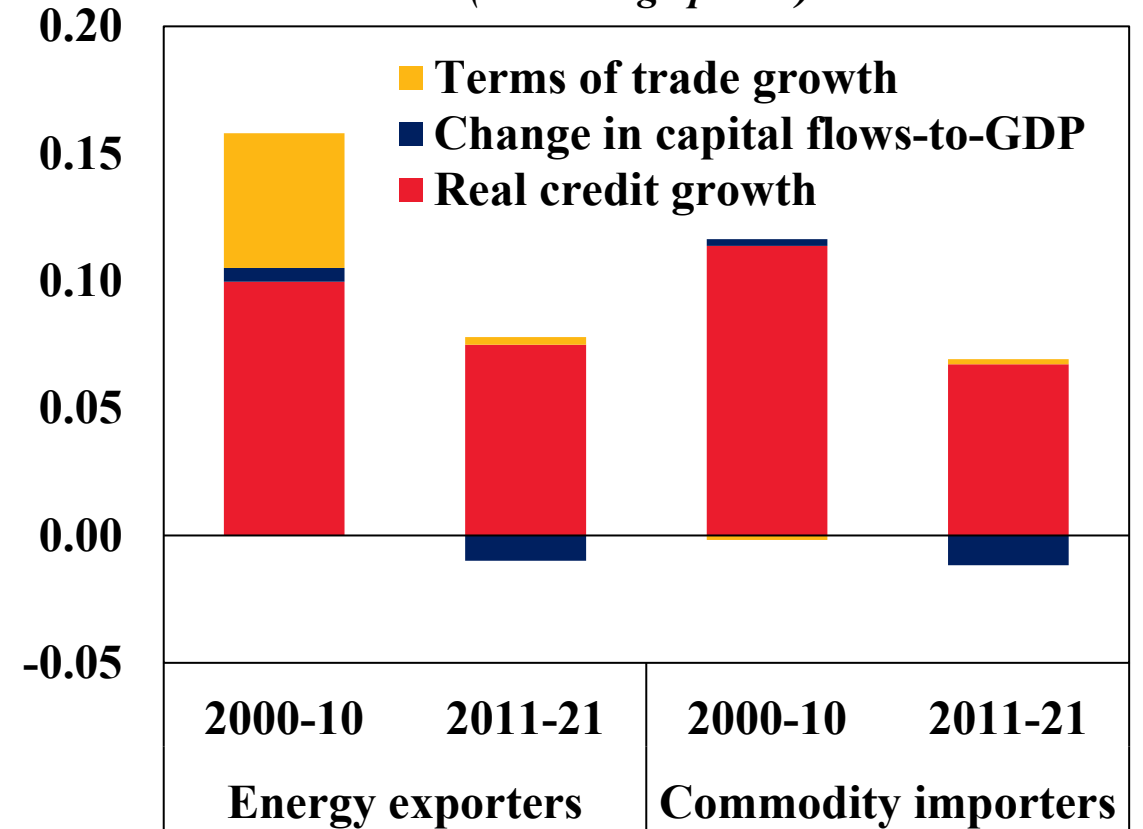
Investment in EMDEs

Decade-Long Slowdown, With Many Drivers

**Contribution to EMDE investment growth
(Percent)**



**Contributions to EMDE investment
growth in excess of GDP growth
(Percentage points)**



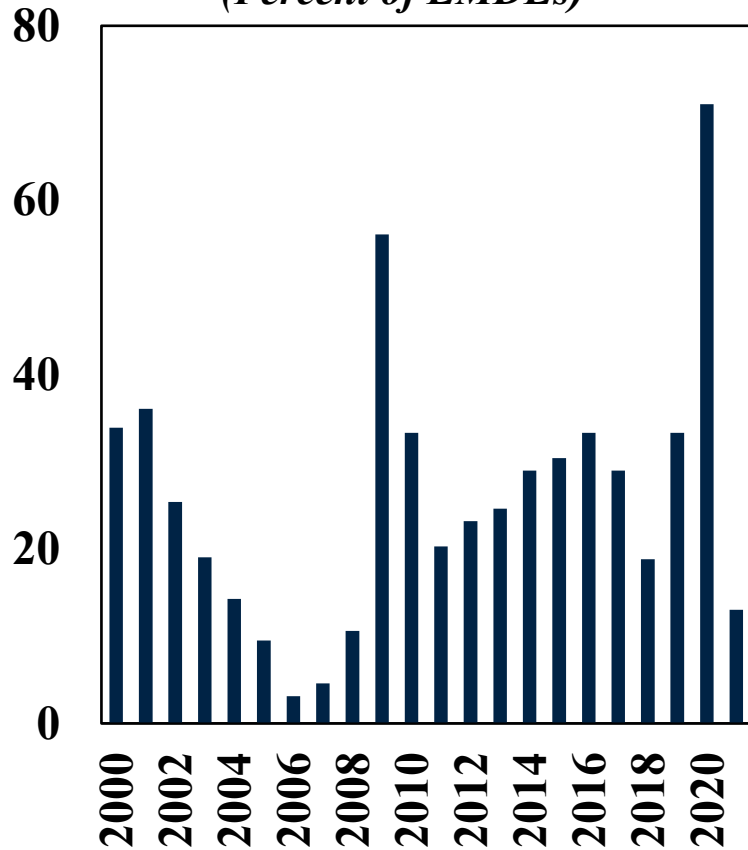
Source: World Bank.

Left Panel. : Investment refers to gross fixed capital formation. Sample includes 69 EMDEs. Left Panel. Bars show the percentage point contribution of country groups to EMDE investment growth during the indicated years. Height of the bars is average EMDE investment growth during the indicated years. Sample includes 69 EMDEs. Right Panel. Annual averages of estimated impact of explanatory variables on investment growth in 57 EMDEs during 2000-21, based on the system generalized method of moments (GMM) estimation. Bars show the contribution of each explanatory variable to predicted investment growth (defined, for each variable, as the coefficient shown in the regression results in column 1 of annex table 3.1.1 multiplied by the actual value of the variable). For presentational clarity, the charts show only the four explanatory variables with the largest contributions to predicted investment growth.

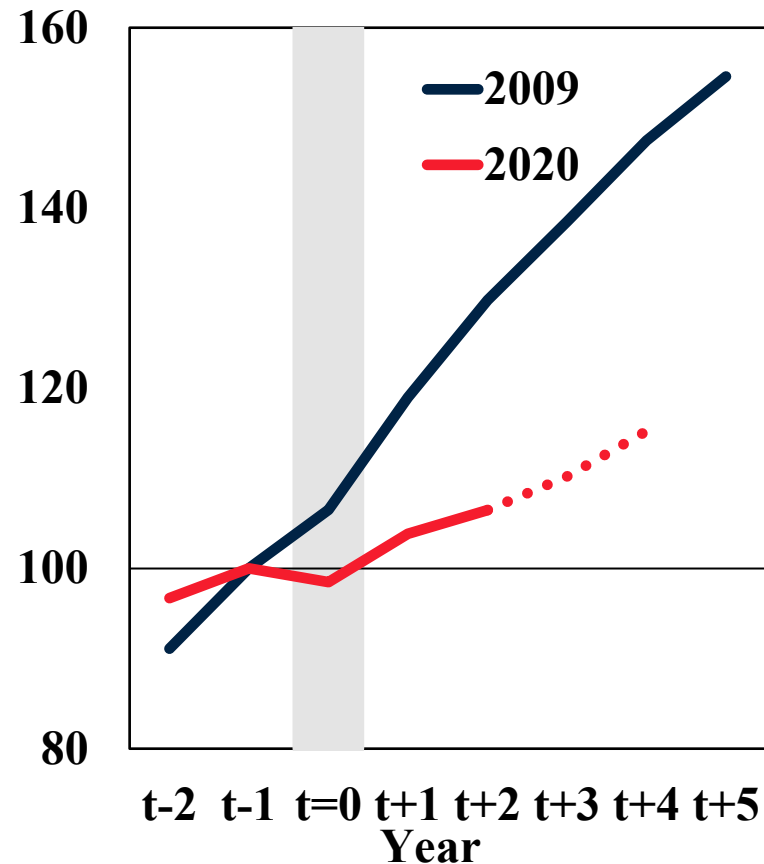
Investment in EMDEs

Slower Recovery Going Forward

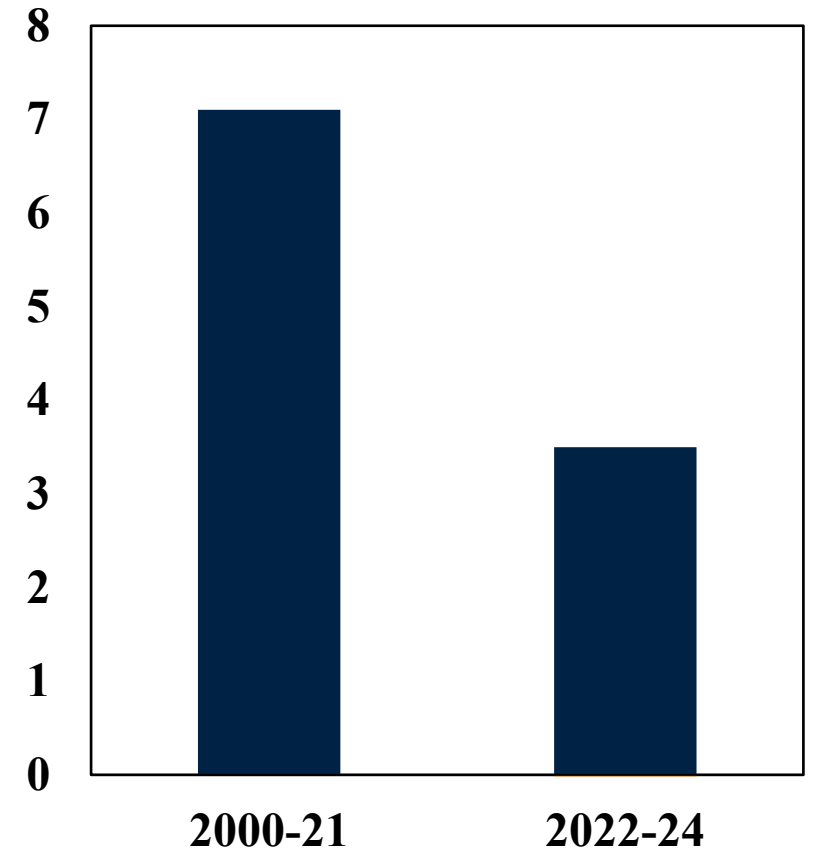
Share of EMDEs with an investment contraction
(Percent of EMDEs)



Investment in EMDEs
(Index, $t-1 = 100$)



EMDE investment growth
(Percent)



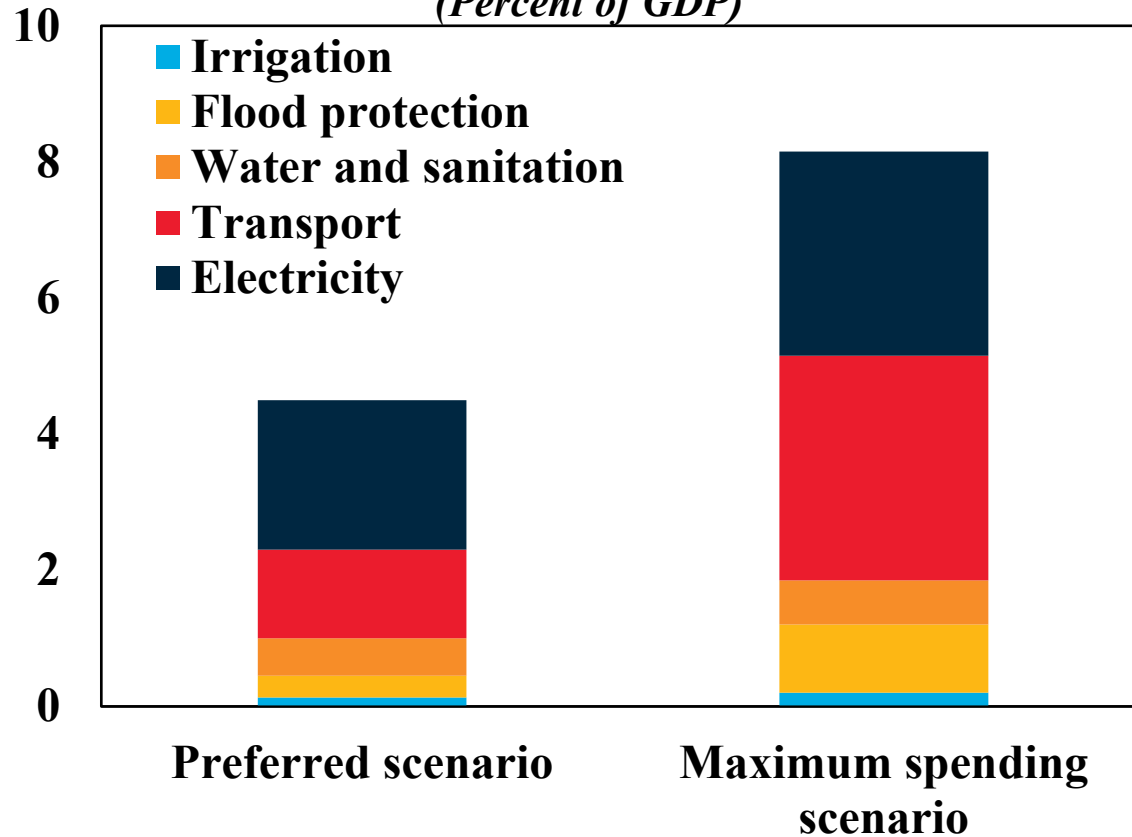
Sources: Haver Analytics; World Bank.

Note: Investment refers to gross fixed capital formation. Sample includes 69 EMDEs. Center Panel. Year "t" on the x-axis refers to the year of global recessions in 2009 and 2020. Dotted portion of the line is a forecast. Right Panel. Bars show EMDE investment growth during the indicated years. Height of the bars is average EMDE investment growth during the indicated years. Sample includes 69 EMDEs.

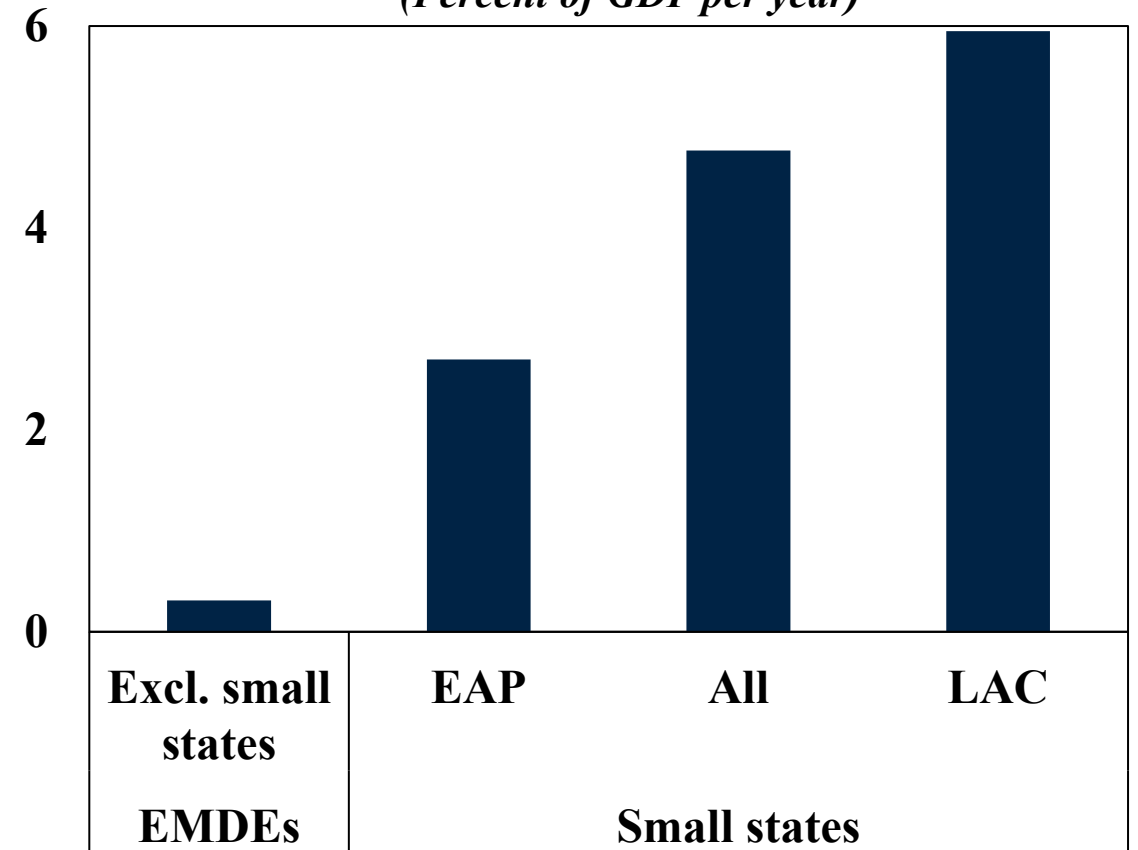
Investment Needs

Large for Both Development Goals and Climate Goals

Average annual investment needs in infrastructure sectors related to SDGs
(Percent of GDP)



Damages and losses from natural disasters, 1990-2021
(Percent of GDP per year)



Sources: EM-DAT; Rozenberg and Fay (2019); World Bank.

Left Panel. Bars show average annual spending needs on capital (not including maintenance) during 2015-30. "Preferred scenario" is constructed using ambitious goals and high spending efficiency, and "maximum spending scenario" using ambitious goals and low spending efficiency. Country sample includes low and middle-income countries, as defined in the technical appendix of Rozenberg and Fay (2019). Bars are calculated by summing the damages in each country in each year, dividing by nominal GDP, then weighting by nominal GDP. Right Panel.

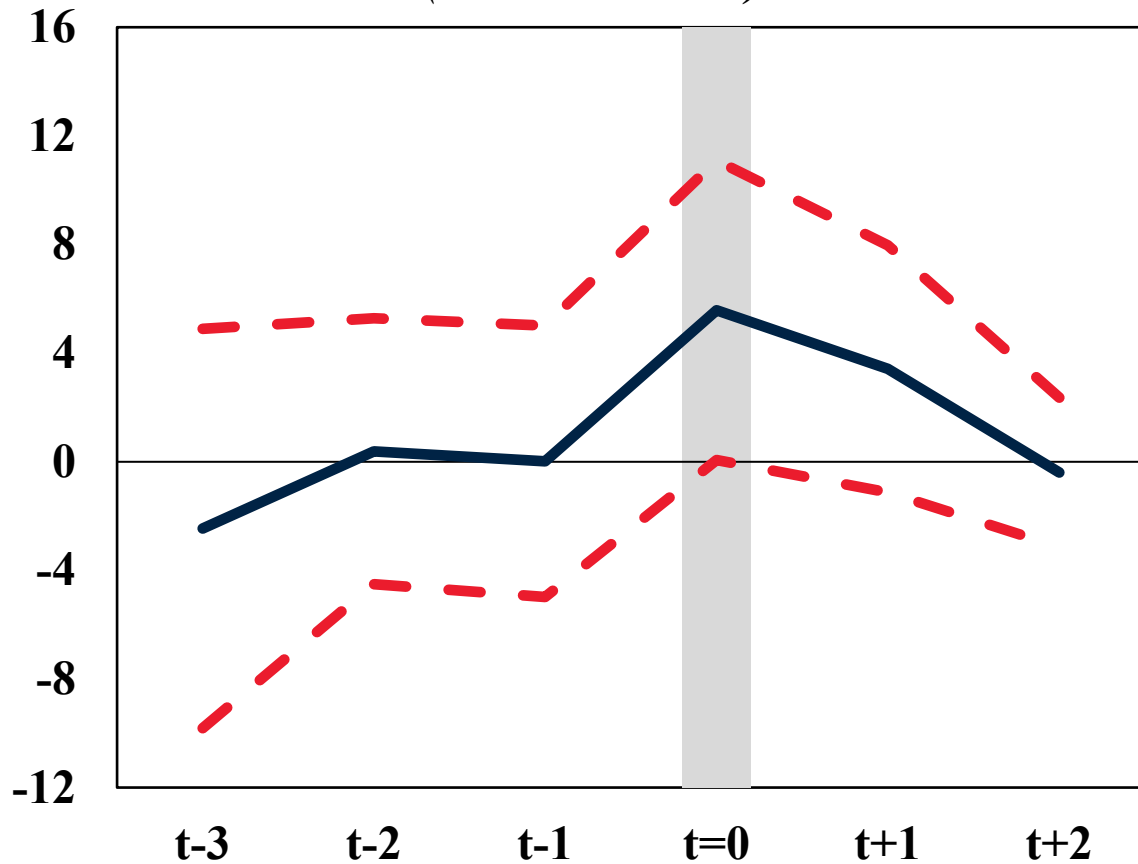
Four Questions

4 **What are the policy priorities?** *Globally: cooperating to address global challenges. Nationally: implementing credible policies to set the foundations for a green, resilient and inclusive development path.*

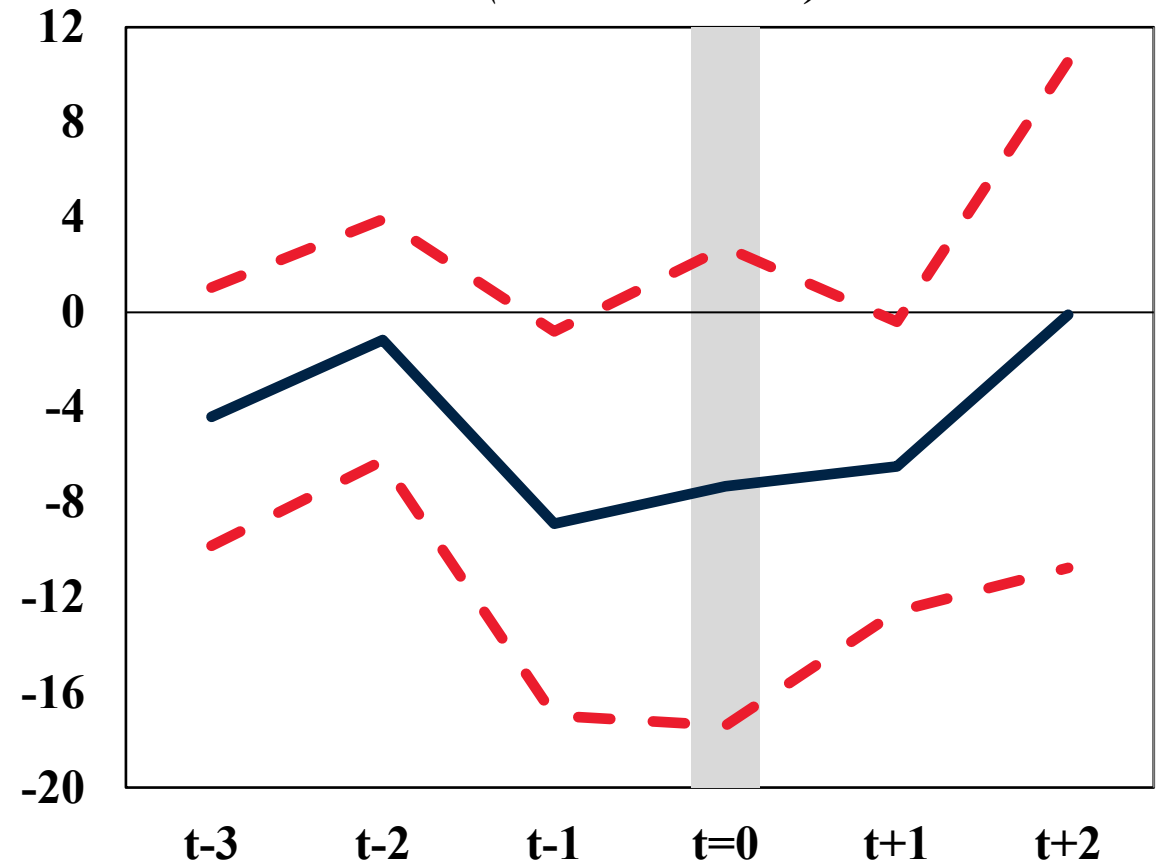
Policies to Lift Investment

Reforms to Investment Climate

Investment growth around reform spurts
(Percent deviation)



Investment growth around reform setbacks
(Percent deviation)



Sources: International Country Risk Profile; World Bank.

Note: EMDEs = emerging market and developing economies. Sample includes 60 EMDEs from 1984- 2022. Reform spurts and setbacks are defined in annex 3.2. Solid lines show the increase in investment growth around a reform spurt (panel A) or setback (panel B) at t=0 relative to the countries not experiencing a reform spurt or setback. Dashed lines shows the 95 percent confidence interval.

Policy Priorities

National and Global Policies to Boost Growth

Boosting Investment

- Strengthen investment to meet development and climate goals
- Improve public spending efficiency, reallocate spending towards priority investments
- Improve governance frameworks and business climates to foster private investment
- Streamline regulatory environment to encourage private investment
- Facilitate trade and global value chain integration and digitalization to attract private investment

Global cooperation

- Mitigate risk of global recession by considering cross-border spillovers of domestic monetary policy actions
- Address debt distress in EMDEs, especially frontier markets and LICs
- Bolster international cooperation to reduce food insecurity and avoid protectionist measures
- Tackle climate change and accelerate energy transition

Improving growth and resilience in small states

- Enable diversification through digitalization, reducing trade costs, and fostering new industries (e.g., eco-tourism)
- Invest in climate adaptation and domestic renewable energy sources
- Ensure disciplined financial management of state-owned enterprises
- Establish fiscal mechanisms (e.g., fiscal rules, disaster stabilization funds) to enhance disaster risk management

Policy Priorities

Need for Macroeconomic Stability and Resilience

Fiscal policy challenges

- Curtail inefficient spending, including by moving away from/repurposing expensive and regressive subsidies
- Enhance efficiency of critical productive spending while providing targeted support to vulnerable groups
- Improve revenue collection by broadening tax base and improving tax administration
- Strengthen fiscal frameworks and debt management

Monetary and financial policy challenges

- Tighten policy to the extent needed to ensure inflation expectations are well anchored
- Communicate policy actions clearly, leverage credible frameworks, and safeguard central bank independence
- Strengthen macroprudential policy to reduce vulnerability to capital outflows and currency pressures

Structural policies to strengthen resilience and inclusion

- Establish flexible social protection systems to support vulnerable groups during major shocks
- Reduce food insecurity by avoiding market distortions and pursuing investments in agricultural R&D, diversification of food sources, and targeted interventions such as nutrition programs
- Increase female labor force participation and promote financial inclusion

Four Questions

- 1 What are near-term prospects for the global economy?** *The weakest growth performance outside global recessions of the past three decades. Multiple downside risks cloud the outlook.*
- 2 How do Fed policy changes affect EMDEs?** *Monetary policy reaction shocks substantially tighten financial conditions in EMDEs and increase the risk of currency crises.*
- 3 What are prospects for investment?** *Further investment slowdown, on the heels of a decade of subdued investment in the 2010s.*
- 4 What are the policy priorities?** *Globally: cooperating to address global challenges. Nationally: implementing credible policies to set the foundations for a green, resilient and inclusive development path.*

Select Publications by EFI Prospects Group

- *Global Economic Prospects* – *January 2023*
(January and June)
- *Commodity Markets Outlook* – *October 2022*
(April and October)
- *Global Monthly*
- *How do Rising U.S. Interest Rates Affect Emerging and Developing Economies?* – *December 2022*

Questions & Comments

Thanks!

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