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DEVELOPMENT COMMITTEE: THE MANAGING DIRECTOR'S WRITTEN STATEMENT

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Several simultaneous shocks are weighing on the global economic outlook and complicate policymaking. Inflationary pressures are on the rise and increasingly broad based. Russia's war in Ukraine continues to send shockwaves through the global economy, including by disrupting commodity markets and contributing to higher sovereign risk spreads. Lower growth in China as a result of lockdowns and a weaker housing market curtails global demand, while climate change is generating increasingly costly extreme weather events. The combination of lower growth and high prices squeezes household budgets, especially in low-income developing countries (LIDCs) where hard-to-replace spending items, such as food, account for a large share of consumption. Central banks face difficult policy trade-offs, as both over- and under-tightening the monetary stance would come with significant costs. Emerging and Developing Economies (EMDEs) need to cope with less favorable financial conditions and weaker currencies that raise the domestic currency value of foreign debt—a constellation that contains potential for wider debt distress. Policymakers should focus on gaining control over inflation, preserving financial stability, and using focused and well-targeted fiscal interventions to support those most in need. Global cooperation is more important than ever, but it is also under acute threat from geopolitical developments.

ECONOMIC OUTLOOK AND RISKS

Several shocks are hitting the global economy at the same time

The global economy has again entered turbulent waters as it is experiencing simultaneous economic, geopolitical, and ecological shocks. Inflation has reached levels not seen in decades, squeezing household budgets and putting pressure on central banks to accelerate monetary policy normalization. Russia's war in Ukraine and other security issues provoke geopolitical dislocations, they also risk fragmenting global trade networks that have generated wealth and lifted millions out of poverty in previous decades. While the COVID-19 pandemic's most acute phase seems over, local and regional outbreaks continue to disrupt economic activity. Natural disasters linked to climate change are exerting an increasingly heavy human and economic toll.

Global growth in 2022 is projected to slow to 3.2 percent from 6.0 percent in 2021, a downward revision of 0.4 percentage point relative to the April 2022 World Economic Outlook. The growth forecast for 2023 has been marked down even more significantly, to 2.7 percent from 3.6 percent in April—if this projection materializes, it would be the weakest growth performance of recent decades outside the Global Financial Crisis and the COVID-19 Pandemic. Over the medium term, global growth is forecast to average just below 3½ percent.

The outlook for EMDEs is for a broad-based slowdown, although with some regional differentiation

The slowdown is broad based: advanced economies (AEs) are taking a significant part of the impact, with growth projected to slow from 5.2 percent in 2021 to 2.4 percent in 2022. However, EMDEs are also projected to expand at a much slower pace, with growth dropping to 3.7 percent in 2022 after 6.6 percent in 2021. The slowdown in EMDEs is most pronounced in Emerging Europe, where it reflects primarily the fallout from the war in Ukraine. However, growth projections for Emerging Asia and Latin America have also been marked down significantly. In Asia, China is at the core of the slowdown, reflecting the combined impact of COVID-19-related lockdowns and a worsening property market crisis—together these factors lower growth to 3.2 percent this year after 8.1 percent in 2021. At the other end of the spectrum, growth in Middle Eastern and Central Asian EMDEs is projected to strengthen to 5.0 percent from 4.5 percent in 2021, reflecting primarily favorable terms-of-trade developments.

In 2023, average growth in EMDEs is projected to remain at 3.7 percent. As the shocks of 2022 exacerbate already significant losses from the pandemic, output and employment in EMDEs are expected to remain below pre-pandemic trends for many years to come.

Growth in LIDCs is holding up somewhat better, although again with sizeable differences between regions

The impact on LIDCs is not uniform and depends inter alia on whether countries are net exporters or importers of commodities, and to what extent they are exposed to fiscal and debt vulnerabilities. Average growth in LIDCs—a subgroup of EMDEs—is projected to strengthen to 4.8 percent in 2022, from 4.1 percent in 2021. However, the improvement reflects mostly idiosyncratic developments in a couple of Southeast Asian economies with a large weight in the index (Vietnam and Myanmar). Outside Emerging Asia, LIDC growth is projected to moderate from 5.0 percent in 2021 to 3.8 percent in 2022. Many LIDCs suffer disproportionately from the global food crisis—while food prices have retreated from the highs reached earlier this year, they remain significantly above the levels in 2021 for most items.

Inflation has emerged as a major threat to economic welfare

Global inflation is expected to reach 8.8 percent in 2022—from 4.7 percent in 2021—the highest rate in decades. While the surge in inflation is broad based in AEs, developments are more differentiated for EMDEs. Relatively modest increases in Asia—reflecting, among other things, China's demand slowdown and receding price pressures for some food staples—contrast with sizeable inflationary surges in Latin America and Emerging Europe. On average, EMDE inflation is projected at 9.9 percent in 2022 before declining to 8.1 percent in 2023 and 5.3 percent in 2024. With this, disinflation in EMDEs is expected to be more drawn out than in AEs, reflecting, among other things, differences in the strength and credibility of monetary policy frameworks.

Downside risks are large

Risks to the outlook remain tilted to the downside. While global inflation is projected to peak in Q4 2022, pressures could persist for longer than currently foreseen, for example in case of further shocks to energy supply or extreme weather events. Getting the policy response to inflation right is key, as there is danger both in under- and over-tightening monetary policy: overtightening could sink many economies into prolonged recession,

but not tightening enough could be even costlier, by risking that inflation expectations become entrenched and forcing even larger interest increases in the future.

Divergent policy paths and a global flight to safety could provoke further dollar appreciation, triggering tensions surrounding competitiveness and forcing countries with dollar denominated liabilities to tighten monetary policy by more than would be warranted by domestic objectives alone. More generally, tight global financing conditions for a prolonged period could put debt sustainability at risk in many vulnerable EMDEs and LIDCs—more than half of LIDCs are assessed to at high risk of debt distress or in debt distress by the IMF's and the World Bank's joint debt sustainability analyses, often reflecting vulnerabilities exacerbated by fiscal burdens taken on during the pandemic. A broader EMDE debt crisis would weigh heavily on growth and could precipitate a global recession.

Finally, while the acute phase of the COVID-19 crisis appears to have passed, the risk of regional outbreaks with incipient economic disruptions persists, especially in countries and regions with relatively low vaccination rates.

POLICY PRIORITIES

The #1 economic priority is getting inflation under control

The primary macro-economic policy priority at this juncture is to bring inflation and inflation expectations under control. Without price stability, any benefits from a more accommodative monetary stance risk being eaten up by eroding real incomes. Taming inflation will come at a cost though in terms of slower growth and less employment in the near term. The appropriate path of anti-inflation policies is country specific and depends, inter alia, on the nature and intensity of underlying prices pressures, the degree to which inflation expectations have remained anchored, and the credibility of the monetary policy framework.

At the same time, a global tightening cycle can have severe repercussions for EMDEs, especially those with elevated external debt levels and other balance sheet vulnerabilities. Exchange rate flexibility helps adjust to the differential pace of monetary policy tightening across countries. In cases where exchange rate movements would generate financial stability risks, however, foreign exchange intervention can be deployed. Such interventions should be part of an integrated approach to addressing vulnerabilities as laid out in the IMF's Integrated Policy Framework.

Fiscal policy should focus squarely on the vulnerable

Fiscal policy should focus on protecting those most in need. Poorer households often spend relatively more on food and energy, expenditures that cannot be adapted easily to circumstance. Targeted cash transfers to those particularly exposed to higher energy and food prices are often called for. By contrast, broad price caps or food and energy subsidies should be avoided, as they remove incentives to adjust behavior and thus obliterate necessary adjustments to demand and supply. Moreover, in many cases new spending should be offset by savings elsewhere, to limit the fiscal impact on inflation and debt levels. Reforms that

increase revenue generating capacity—such as broadening tax bases and enforcing better compliance—are also key.

Strengthening debt resolution frameworks …

Stronger global debt resolution frameworks are necessary to prepare for a potential intensification of debt distress. The common debt resolution framework of the Group of Twenty (G20) should be improved to allow for a swifter and more efficient resolution for debt overhang cases, and with coverage that allow giving relief to a broader set of countries.

… and mitigating climate change are urgent priorities …

The world has only a few years left until the concentration of greenhouse gases in the atmosphere would reach a level that renders achieving the Paris temperature targets infeasible. Should this point be crossed, the global economy would enter unchartered territory, facing macro-financial risks of hitherto unknown quality and intensity. Decisive action is urgent and should, as a priority, include a fair and balanced climate mitigation accord among the world's largest emitters of greenhouse gases, encompassing both advanced and emerging economies.

… for which international cooperation is key

Many of the challenges the world economy faces are inherently global in nature: preserving global financial stability, working out debt overhangs, safeguarding the world's climate, combatting the global food crisis, facilitating trade, developing rules for digitalization that maximize benefits and minimize risks, and funding LIDCs to enable them address critical development challenges. Multilateral cooperation is therefore more important than ever, but it is acutely at risk from recent geopolitical developments and tensions.

IMF SUPPORT

Several reforms of the IMF's lending toolkit have been completed or are ongoing

As guardian of global financial stability, the IMF is constantly adapting its tools and instruments to address the macro-economic challenges its members face. The recently established Resilience and Sustainability Trust (RST) is a major reform to the Fund's lending toolkit, allowing the IMF to assist eligible members build resilience to external shocks and sustainable growth by focusing on longer-term challenges, including climate change and pandemic preparedness. Several RST-supported pilot programs will be brought to the IMF's Executive Board in the coming months. While funding from members with strong external positions has been encouraging, additional efforts are required to meet the RST's funding needs in full, including through additional pledges to channel SDRs or freely usable currencies to the trust.

The IMF has established a new Food Shock Window under its emergency financing toolkit to help countries facing urgent balance of payments pressures associated with the global food shock. The IMF is also enhancing the modalities for Staff Monitored Programs to allow for limited Executive Board involvement for countries that are experiencing particularly complex challenges. The funding gap of the Poverty Reduction and Growth Trust (PRGT) must be closed urgently to allow the IMF to continue its strong support for LIDCs and assist them with meeting external

funding needs. There is also a need to replenish depleted resources in the Catastrophe Containment and Relief Trust (CCRT).

Beyond these immediate steps, the IMF will continue in the coming months its work on its lending toolkit, including through a review of its precautionary facilities to ensure that members with strong fundamentals have adequate buffers to deal with shocks and uncertainties.

The IMF is contributing to strengthening the global debt resolution framework

The IMF will continue to work with its international partners on strengthening and accelerating the implementation of the G20 Common Framework (CF), building on recent important progress in the case of Zambia. It is also exploring ways to promote stronger creditor coordination for debt restructurings where the CF is not applicable. Together with the World Bank, the IMF continues work on collateralized financing practices. Moreover, as part of the Joint IMF-WB Multipronged Approach to Address Debt Vulnerabilities, the IMF is seeking to advance debt transparency, including by examining debtor creditor incentives, capacity, and governance issues. The roll-out of a new Sovereign Risk and Debt Sustainability Framework will help identify risks of sovereign distress and better align the Fund's debt sustainability and lending frameworks.

Surveillance and capacity development remain as important as ever

Impartial bilateral and multilateral surveillance that rests on strong analytical foundations is key for providing helpful real-time policy analysis to the IMF's membership. The Fund continues to deepen its engagement on macro-financial surveillance and advances the use of multiple policy tools, including by operationalizing the Integrated Policy Framework. Improved risk assessments aim at helping members to better prepare for shocks, in line with the recommendations of the recent Comprehensive Surveillance Review. The IMF is also moving ahead with implementing its strategies on climate, digitalization, fragile states, and gender and inclusion, which include broader and more in-depth coverage of these topics in Article IV consultations to the extent that they pertain to macro-financial stability. The framework for IMF engagement on governance issues is currently under review and will be discussed by the Executive Board in 2023.

The IMF's Capacity Development aims at building strong institutions that foster economic stability, resilience, and inclusive growth, while increasing support for topics like climate change, gender and fintech. To further advance the effectiveness and impact of its CD delivery, the IMF is working on modernizing CD management and administration.

Finally, a strong, quota-based and adequately resourced Fund remains critical. Progress toward governance reform and a timely and successful conclusion of the 16th General Review of Quotas are essential to enable the IMF deliver on its agenda, preserve its financial strength, and bolster its legitimacy.