Editorial

A Long Unwinding Road

The global economy is turning a corner but faces a long road ahead to attain strong and sustainable growth. Global GDP growth slowed substantially throughout 2022, but several of the factors weighing negatively are now unwinding. Falling energy prices and headline inflation, easing supply bottlenecks and the reopening of China's economy, coupled with strong employment and relatively resilient household finances, all contribute to a projected recovery. Nevertheless, the recovery will be weak by past standards. We project global growth to be 2.7% in 2023, with a modest pick-up to 2.9% in 2024 – both well below the average growth rate in the decade preceding the COVID-19 pandemic.

Policymakers need to act decisively on macroeconomic and structural policy to deliver stronger and more sustainable growth. This is hard. Core inflation remains too persistent. Debt levels are too high. And potential output is too low.

Monetary policymakers need to navigate a difficult road. Although headline inflation is declining thanks to lower energy prices, core inflation remains stubbornly high, more so than previously expected. Central banks need to maintain restrictive monetary policies until there are clear signs that underlying inflationary pressures are abating. Some economies grappling with stubbornly high core inflation may require additional interest rate increases. However, policymakers must keep a watchful eye, given the uncertainties around the exact impact of the rapid and globally synchronised monetary policy tightening following an extended period of low interest rates. The tightening has already revealed some vulnerabilities in financial markets. Should further financial market stress arise, central banks should deploy financial policy instruments to enhance liquidity and minimise contagion risks. Clear communication will be crucial to avoid confusion about the potential conflict between pursuing price stability and financial stability mandates.

The choices for fiscal policymakers are clearer but no easier to implement given the inherent political sensitivity of policy choices with direct redistributive effects. Fiscal policy played a vital role in supporting the global economy through the shocks of the COVID-19 pandemic and Russia's war in Ukraine. However, in the aftermath, most countries are grappling with higher budget deficits and higher public debt. The burden of debt servicing is increasing and spending pressures related to ageing and the climate transition are building.

As the recovery takes hold, fiscal support should be scaled back and better targeted. Energy price support should be withdrawn as energy prices fall. Vulnerable households inadequately covered by existing social protection systems, will continue to need support, as still high food and energy prices particularly burden the most disadvantaged. Limited resources should be targeted only to those who really need it and to high-priority productivity-enhancing investments, including those driving the green transition and improving labour supply and skills. Gradually unwinding fiscal support will help reduce the burden on monetary policy, strengthen buffers against future crises and prepare for longer-term challenges.

Emerging-market economies face challenges from tight global financial conditions: higher debt servicing costs, capital outflows, and reduced credit availability from foreign lenders. Moreover, rising geopolitical tensions and concerns about supply chain security have prompted several countries to implement trade and investment restrictions. Increasingly restrictive trade policies risk curtailing the gains from global trade and harming the development prospects of low-income countries.

Ultimately only ambitious structural policy reforms can sustainably raise long-term economic growth and people's quality of life around the world. Revitalising labour and product markets; removing barriers to cross-border trade; promoting competition and adapting competition policies to the digital era; and enhancing skill development are essential elements of the structural reform agenda.

Private and public investment is needed in human, tangible and intangible capital to enable people to make the most of their skills and capabilities, and to harness the ever-increasing opportunities from technological transformation. Investment in education and skills is critical to enable people to flourish in the future economy and reap the benefits of increased productivity.

Policymakers need to unwind the impact of a sequence of negative shocks to the global economy and face a complex set of challenges in doing so. They need to calibrate monetary and fiscal policies to curtail inflation and rebuild fiscal buffers without overly reducing growth. Delivering sustainably higher rates of growth will need bold and forward-thinking structural policy reforms allowing us to harness the opportunities of rapid technological advances, demographic shifts, and the climate transition.

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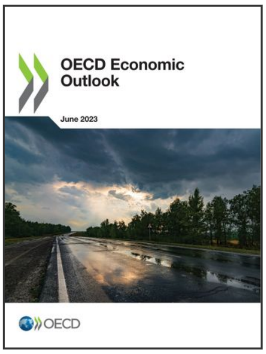

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