



United
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2023

World Economic Situation and Prospects

MID-YEAR UPDATE



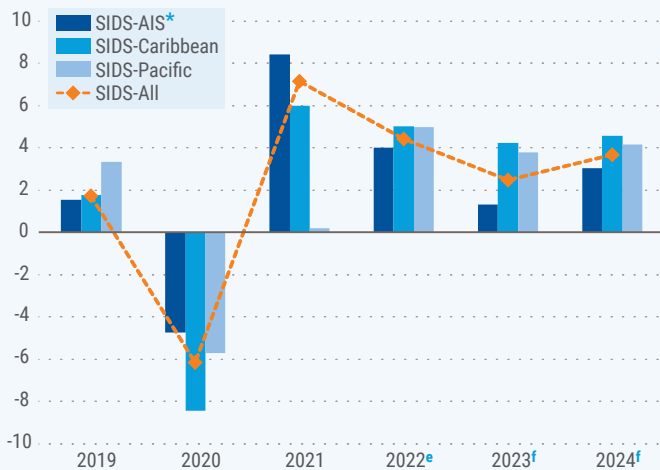
World Economic Situation and Prospects

MID-YEAR UPDATE

The *World Economic Situation and Prospects as of mid-2023* updates the *World Economic Situation and Prospects 2023* released on 25 January 2023. The report is prepared by the Global Economic Monitoring Branch in the Economic Analysis and Policy Division of the United Nations Department of Economic and Social Affairs.

GDP growth

Percentage change



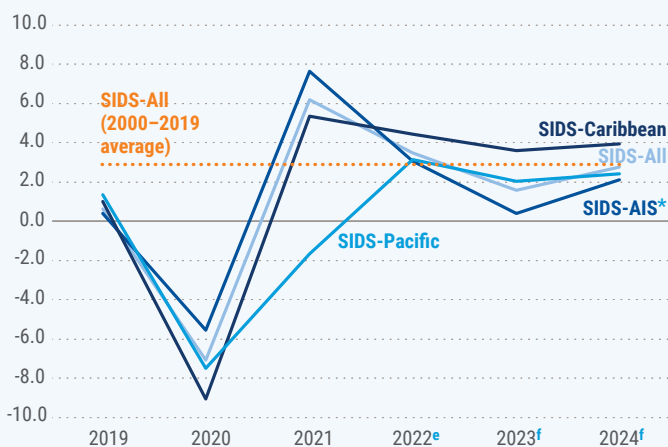
Source: UN DESA, based on estimates and forecasts produced with the World Economic Forecasting Model.

Growth prospects for small island developing States (SIDS) sharply deteriorated, with output projected to decelerate from an estimated 4.4 per cent in 2022 to 2.5 per cent in 2023 before increasing to 3.7 per cent in 2024 amid still-high inflation, tighter financial conditions, and rising debt sustainability concerns in some countries.

GDP per capita growth in the SIDS is expected to decelerate from an estimated 3.5 per cent in 2022 to 1.6 per cent in 2023 before increasing to 2.8 per cent in 2024. For the SIDS-AIS, the output per capita is projected to expand by only 0.4 per cent in 2023, well below the estimated 3.1 per cent in 2022. GDP per capita in the Caribbean SIDS is forecasted to expand by 3.6 per cent in 2023 and 3.9 per cent in 2024, slightly lower than the estimated 4.4 per cent in 2022, while in the Pacific SIDS the GDP per capita is projected to moderate to 2.1 per cent in 2023 and 2.4 per cent in 2024 from 3.1 per cent in 2022.

GDP per capita growth

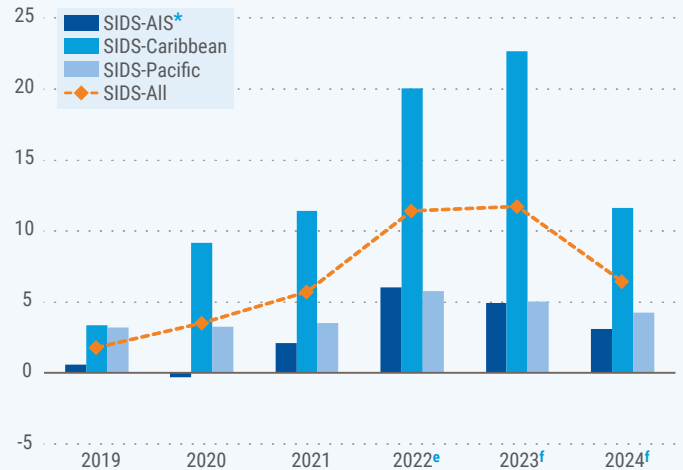
Percentage change



Source: UN DESA, based on estimates and forecasts produced with the World Economic Forecasting Model.

Inflation

Percentage



Source: UN DESA, based on estimates and forecasts produced with the World Economic Forecasting Model.

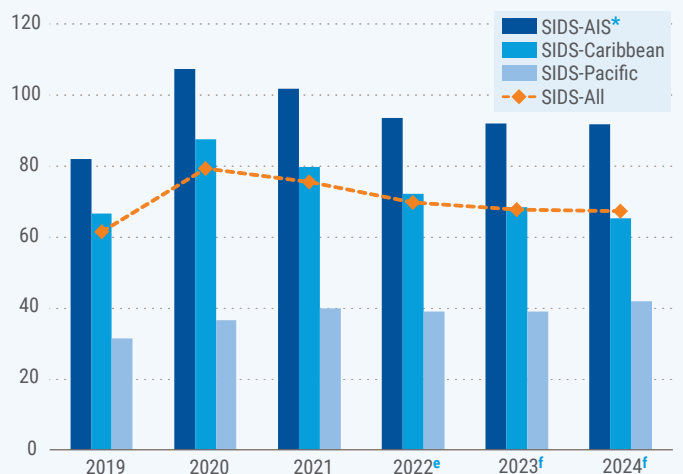
Annual inflation in the SIDS is projected to rise by 11.7 per cent in 2023, slightly above the estimated 11.4 per cent in 2022, before decreasing to 6.4 per cent in 2024. Inflation rates in the Pacific SIDS and the SIDS-AIS are projected to slow to about 5 per cent in both sub-regions in 2023 and they are expected to fall further in 2024. In contrast, annual inflation in the Caribbean SIDS is projected to remain above 20 per cent in 2023 before declining to 11.6 per cent in 2024.

ECONOMIC SITUATION AND PROSPECTS FOR SIDS

General government debt in the SIDS is expected to remain about 67 per cent of the GDP in 2023 and 2024, with differences across the subregions. The ratio public debt to GDP is expected to decrease slightly in the SIDS-AIS from 93.7 per cent in 2022 to 92 per cent in 2023, while in the Caribbean SIDS the ratio is projected to slow from 72.2 per cent in 2022 to 68.5 in 2023. General government debt in the Pacific SIDS is expected to remain at 39 per cent of the GDP in 2023.

Debt

General government gross debt as percentage of GDP



Source: UN DESA, based on data from the IMF World Economic Outlook database, April 2023.

World Economic Situation and Prospects as of mid-2023

Summary

The world economy is facing severe headwinds amid weak growth prospects, elevated inflation and heightened uncertainties. A confluence of factors – legacy effects of the COVID-19 pandemic, the lingering war in Ukraine, the ever-worsening impact of climate change and rapidly shifting macroeconomic conditions – are clouding the economic outlook, even as the global picture shows slight signs of improvement. Persistently high inflation has prompted the most aggressive interest rate hikes in decades, causing financial conditions to tighten sharply and exacerbating debt vulnerabilities.

While economic prospects remain subdued, the slowdown in global growth in 2023 is likely to be less severe than previously expected, mainly due to resilient household spending in developed economies and recovery in China. Global growth is now projected to slow from 3.1 per cent in 2022 to 2.3 per cent in 2023, an upward revision by 0.4 percentage points from the January forecast. Global inflation is projected to decline from 7.5 per cent in 2022 to 5.2 per cent in 2023, mainly due to lower food and energy prices and softening global demand. Amid easing

inflationary pressures, the global economy is expected to pick up some momentum in 2024, but at 2.5 per cent, growth is projected to remain well below the longer-term (2000-2019) average of 3.1 per cent.

Against a backdrop of multiple interconnected crises and heightened macroeconomic uncertainties, monetary and fiscal policy challenges have further intensified. The recent banking sector turmoil in the United States and Europe has illustrated fragilities in the financial system, complicating the trade-off for central banks between fighting inflation and preserving financial stability. After a decade of loose monetary policy with low interest rates and quantitative easing in developed countries, which encouraged excessive leverage in the financial sector and generated negative global spillovers, the prospect of high interest rates and quantitative tightening now poses a massive challenge for developing countries. Lack of access to affordable finance limits the ability of many governments to invest in education, health, sustainable infrastructure and the energy transition, while threatening to push a growing number of countries into debt default.

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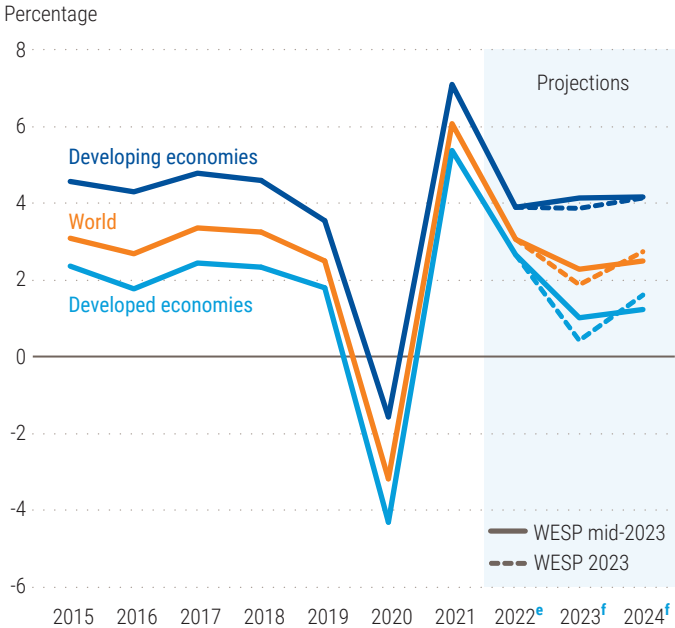
Global macroeconomic trends

Global overview

Uncertainties and poor growth prospects continue to bedevil the world economy. A confluence of factors – the long reach of the COVID-19 pandemic, the lingering war in Ukraine, the ever-worsening impacts of climate change, and growing policy challenges – has pushed many countries to the brink, even as the global picture shows slight improvement. Stubbornly high inflation in both developed and developing countries in the aftermath of the pandemic prompted the most aggressive interest rate hikes in decades. Despite rising rates, household spending and employment – especially in the developed economies – have remained resilient, making it harder for central banks to tame inflation.

Against this backdrop, the deceleration in global growth for 2023 – as projected earlier – is likely to be less severe than previously anticipated, mainly due to persistently robust household spending in the largest economies, especially in the United States and the European Union, as well as the recovery in China. Global growth is now projected to slow from 3.1 per cent in 2022 to 2.3 per cent in 2023 (up from 1.9 per cent forecast in January) (figure 1).

Figure 1
Growth of economic output in the world, developed and developing countries



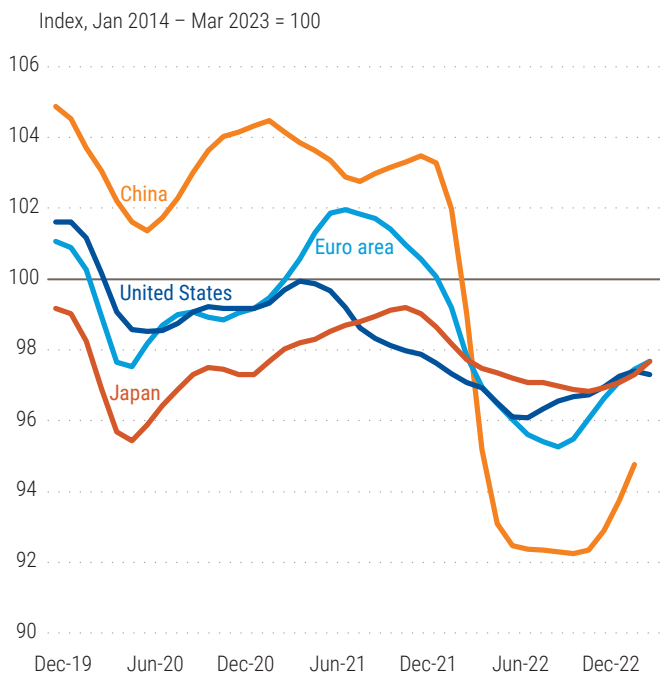
Source: UN DESA, based on estimates and forecasts produced with the World Economic Forecasting Model.
Note: e = estimates, f = forecasts.

The global economy is predicted to pick up some momentum, expanding by 2.5 per cent in 2024, with inflationary pressures easing during the second half of 2023. This rate is, however,

Figure 2

Consumer confidence and manufacturing Purchasing Managers' Index in selected economies

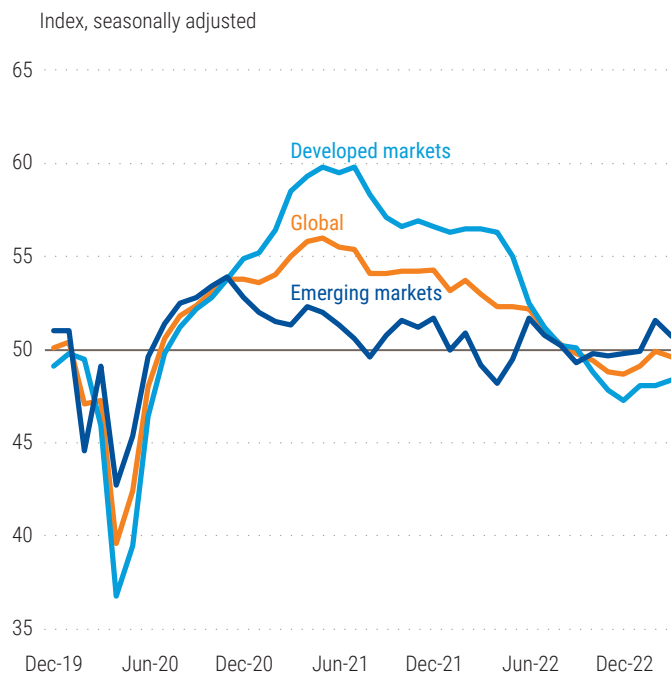
a) Consumer confidence



Source: UN DESA, based on data from the Organisation for Economic Co-operation and Development (OECD).

Note: The (long-term) average value from Jan 2014 until March 2023 equals 100.

b) Manufacturing Purchasing Managers' Index



Source: UN DESA, based on data from CEIC.

Note: The manufacturing Purchasing Managers' Index (PMI) is a weighted average of five subindices: new orders, output, employment, suppliers' delivery times and stocks of purchases. Country group data are weighted averages of individual country PMIs, produced by S&P Global. A value below 50 signals a contraction of activities compared to the previous month.

well below the world's longer-term (2000-2019) average growth rate of 3.1 per cent. As structural challenges including scarring from the pandemic, subdued investment, mounting debt vulnerabilities and funding shortages, remain unaddressed, the world economy is facing the risk of a prolonged period of subpar growth.¹ Slow income growth, in turn, would further undermine prospects for progress towards poverty eradication and other Sustainable Development Goals.

After declining steadily in 2022, consumer confidence slightly improved in recent months in most major economies, helped by lower international energy and food prices (figure 2a). However, consumer confidence levels remain far below their long-term averages. At the same

time, manufacturing activity, as measured by the Purchasing Managers' Index, which saw an uptick following China's reopening, appears to have bottomed out (figure 2b).

Meanwhile, global financial markets have remained largely resilient despite ongoing banking sector turmoil in the United States and Europe. In March 2023, the collapse of the Silicon Valley Bank, the 16th largest bank in the United States by total assets, and Signature Bank as well as the Swiss government-brokered takeover of Credit Suisse, a globally systemically important bank, rattled financial markets worldwide. In early May, the United States Government seized control of First Republic Bank, with total assets of \$212 billion and sold it to JPMorgan Chase. While governments and financial regulators managed

¹ United Nations (2023). *World Economic Situation and Prospects 2023*. New York: United Nations.

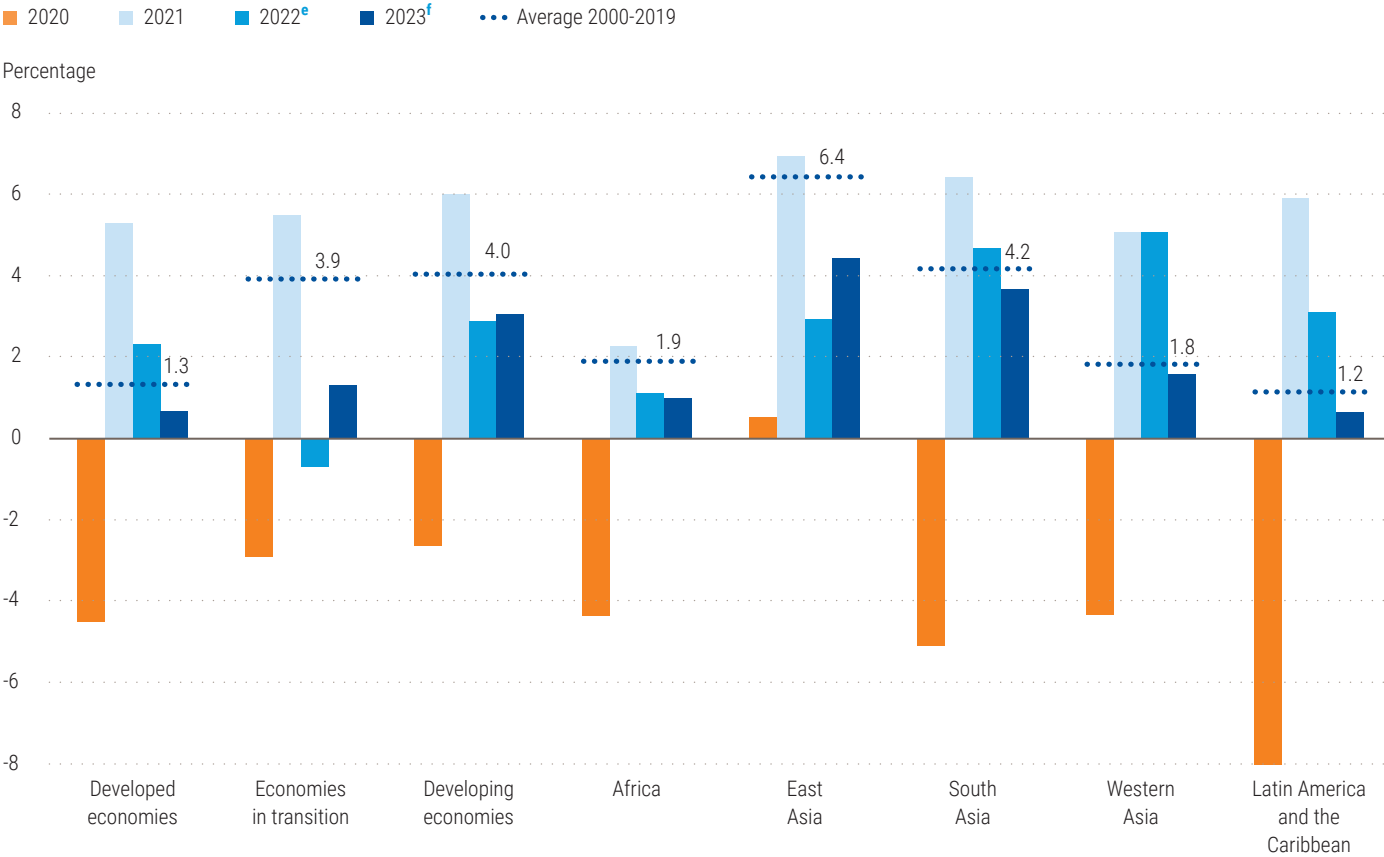
to contain the turmoil, these developments show the potential of more systemic financial stability risks. Despite the market turmoil, the Federal Reserve and other developed country central banks continued to raise policy rates as core inflation has remained high and more persistent than expected. While the major central banks have slowed the pace of monetary tightening, further rate hikes remain likely in 2023.

The slightly improved outlook for global growth in 2023 primarily reflects upward revisions in the major developed countries and China (table 1). In the United States, consumer spending and non-residential investment have proven more resilient than expected, prompting upward revision of the growth forecast to 1.1 per cent in 2023 (up from 0.4 per cent forecast in January). However, amid tightening financial conditions and further adjustments in house prices, consumer spending

is projected to soften, weighing on growth prospects. In Europe, lower gas prices and robust consumer spending, especially on services, have prevented the sharp slowdown that had been forecast in January. The European Union’s economy is now projected to grow by 0.9 per cent in 2023 (up from 0.2 per cent forecast in January). After lifting COVID-19-related restrictions in December 2022, China’s GDP expanded faster than expected in the first quarter of 2023. Annual growth this year is now forecast at 5.3 per cent (up from 4.8 per cent forecast in January).

Improved short-term prospects in the world’s three largest economies contrast with downward revisions to growth in many developing countries. GDP per capita is projected to grow only marginally in Africa and Latin America and the Caribbean in 2023, reinforcing a long-term trend of weak economic performance (figure 3).

Figure 3
Growth of gross domestic product per capita by region and country grouping



Source: UN DESA, based on estimates and forecasts produced with the World Economic Forecasting Model.
Note: e = estimates, f = forecasts. Data for Libya is excluded.

Table 1
Growth of world output, 2021–2024

Annual percentage change	2021	2022 ^a	2023 ^b	2024 ^b	Change from the <i>World Economic Situation and Prospects 2023</i>	
					2023	2024
World	6.1	3.1	2.3	2.5	0.4	-0.2
Developed economies	5.4	2.7	1.0	1.2	0.6	-0.4
United States of America	5.9	2.1	1.1	1.0	0.7	-0.7
Japan	2.1	1.1	1.2	1.0	-0.3	-0.3
European Union	5.4	3.5	0.9	1.5	0.7	-0.1
Euro area	5.4	3.5	0.9	1.4	0.8	-0.2
United Kingdom of Great Britain and Northern Ireland	7.6	4.0	-0.1	1.1	0.7	0.1
Other developed countries	4.9	3.2	1.3	1.4	0.1	-0.4
Economies in transition	5.5	-1.7	0.6	2.2
South-Eastern Europe	7.4	3.2	2.0	3.0	-0.3	0.2
Commonwealth of Independent States and Georgia	5.4	-1.9	0.6	2.2
Russian Federation	5.6	-2.1	-0.6	1.4	2.3	-0.1
Developing economies	7.1	3.9	4.1	4.2	0.2	0.1
Africa ^c	4.7	3.5	3.4	3.5	-0.4	-0.3
North Africa ^c	5.4	3.1	3.3	3.4	-0.8	-0.3
East Africa	5.5	5.1	5.0	4.9	-0.1	0.0
Central Africa	1.8	3.1	3.5	3.6	0.1	0.2
West Africa	4.3	3.8	3.8	3.9	0.0	-0.1
Southern Africa	4.3	2.7	1.9	2.3	-0.4	-0.4
East and South Asia	7.3	3.6	4.7	4.5	0.3	-0.1
East Asia	7.3	3.2	4.7	4.3	0.3	0.0
China	8.4	3.0	5.3	4.5	0.5	0.0
South Asia ^d	7.5	5.6	4.7	5.8	-0.1	-0.1
India ^d	8.9	6.8	5.8	6.7	0.0	0.0
Western Asia	6.3	6.6	3.1	3.3	-0.4	-0.1
Latin America and Caribbean	6.6	3.8	1.4	2.4	0.0	-0.1
South America	7.0	3.8	1.0	2.2	-0.1	-0.3
Brazil	4.6	2.9	1.0	2.1	0.1	0.1
Mexico and Central America	5.8	3.3	2.0	2.6	0.4	0.1
Caribbean	5.1	10.6	8.0	6.2	0.1	0.4
Least developed countries	2.8	4.3	4.1	5.2	-0.3	-0.2
<i>Memorandum items:</i>						
World trade ^e	10.6	5.0	2.3	3.6	2.7	1.1
World output growth with PPP weights ^f	6.2	3.3	2.7	3.0	0.4	-0.2

Source: UN DESA, based on estimates and forecasts produced with the World Economic Forecasting Model.

Notes: (a) Partially estimated, (b) forecast, (c) excludes Libya, (d) calendar year basis, (e) includes goods and services and (f) based on a 2015 benchmark.

Unsustainable debt servicing burdens, mounting balance-of-payments pressures, growing financing gaps and constrained fiscal space will continue to undermine near-term growth prospects of many developing countries.

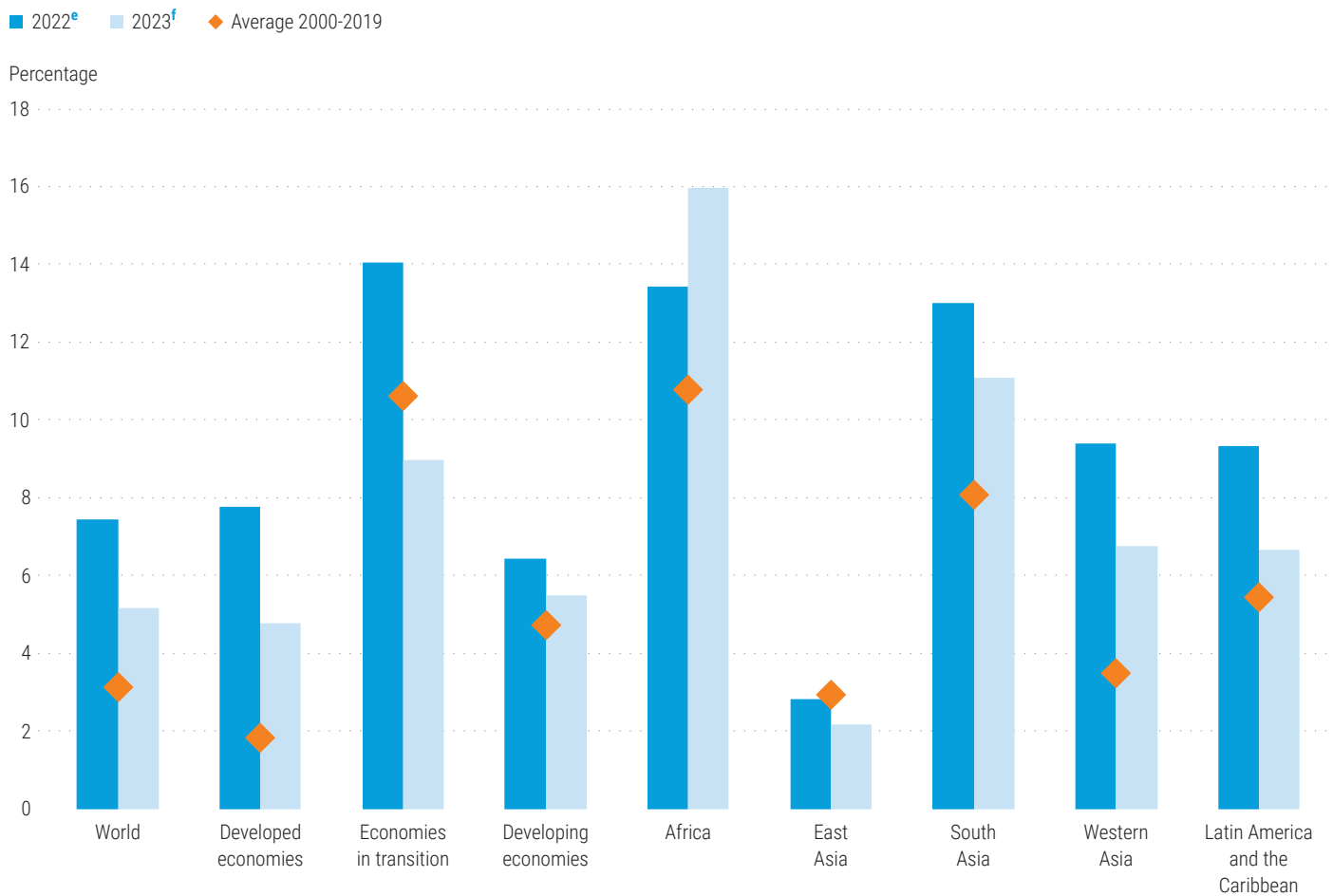
Inflation and commodity prices

While inflation has been easing in recent months, it is expected to remain above central bank targets in 2023. Global inflation is projected to decline from 7.5 per cent in 2022 to 5.2 per cent in 2023, mainly due to lower food and energy prices and softening global demand. Inflation will, however, remain well above the 2000-2019 average of 3.1 per cent (figure 4).

Global food prices have been falling since mid-2022 owing to several factors, including the resumption of exports from Ukrainian ports under the Black Sea Grain Initiative. The FAO Food Price Index declined by 20 per cent year-on-year in March 2023 to 126.9, the lowest value since July 2021. Although the unexpected OPEC+ production cut in April coupled with the European Union's ban on Russian crude exerted temporary upward pressures on prices, oil prices continued to drop. Between January and early May 2023, Brent crude oil prices fell 16 per cent to about \$75 per barrel, the lowest level since December 2021.

In developed countries, headline inflation is expected to decline gradually from 7.8 per cent

Figure 4
Annual inflation by region and country grouping



Source: UN DESA, based on estimates and forecasts produced with the World Economic Forecasting Model.

Note: e = estimates, f = forecasts. Regional averages are GDP-weighted. Data for Argentina, Sudan, Türkiye and the Bolivarian Republic of Venezuela are excluded.

in 2022 to 4.8 per cent in 2023 but will remain well above central bank targets, typically around 2 per cent. In the United States, headline inflation has been easing over the past year, falling to 5.0 per cent in March 2023, the lowest rate since May 2021. In the European Union, inflation declined to 8.3 per cent in March, ranging from about 3 per cent in Luxembourg and Spain to 25.6 per cent in Hungary. While headline inflation rates have been falling, core inflation in the United States and Europe remains high, mainly driven by rising service prices (e.g., housing, insurance, transport) and robust wage growth.

Inflation is also trending downward in most developing countries amid lower commodity prices and reduced global supply constraints and depreciation pressures. Annual inflation will, however, remain well above the long-term average, especially in Western Asia, South Asia, and Africa (figure 4). Although global food prices have been declining since mid-2022, domestic food inflation has often stayed elevated due to a number of factors, including still-high import costs, local supply disruptions, and market imperfections. According to the World Bank, food inflation in early 2023 remained above 5 per cent in about 90 per cent of developing countries.² Continuing high inflation in developing countries that are home to large numbers of people in poverty represents an additional barrier to poverty eradication. Emerging evidence from countries affected by the current episode of high food prices reconfirms earlier evidence that women and children are the worst affected by the resulting hunger and malnutrition.³

Labour markets

Labour markets in Europe, Japan and North America have remained tight, with low unemployment rates and recurrent worker

shortages. Post-pandemic mismatches between labour supply and labour demand in these countries – exerting upward pressures on wages – pose additional policy challenges to central banks striving to bring down inflation. Except for the United States and the United Kingdom, employment rates in developed economies were well above pre-pandemic levels at the end of 2022.

As shown in Figure 5, in many developed economies, employment rates increased more among women than men, narrowing the gender gap in employment rates. This is a result of a steeper decrease in the employment rate between 2019 and 2020 and a weaker recovery between 2020 and 2022 for men, which can be due to a combination of factors such as the gender differences in sector of employment, as well as policy responses, including telework and flexible working arrangements. However, even though the gender gap in employment rates has narrowed, women still cover a disproportionate share of unpaid work, and this discrepancy has prevailed during the pandemic.⁴

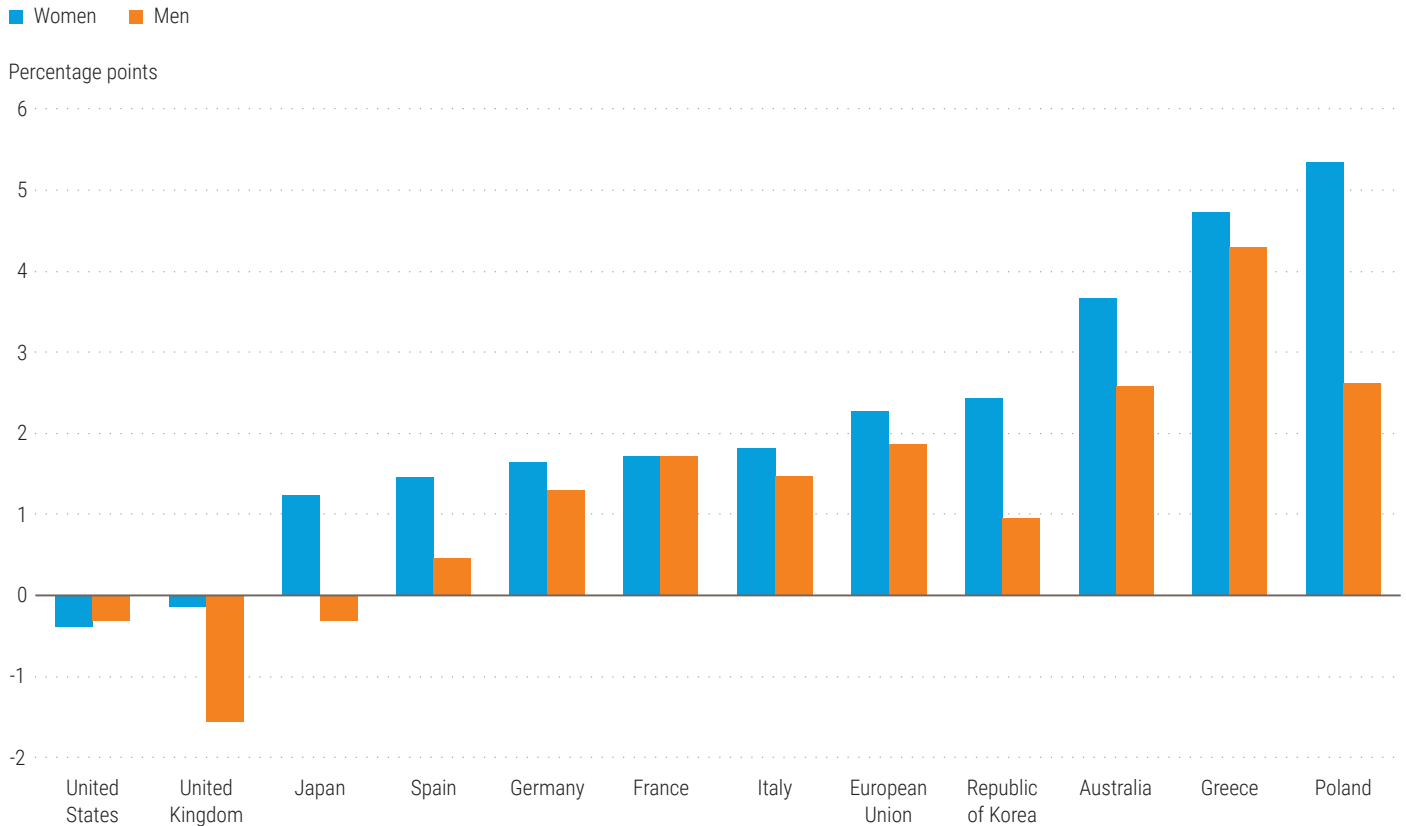
In the United States, the unemployment rate declined to 3.5 per cent in March 2023, despite a steady increase in labour force participation, which almost reached pre-COVID levels. Monetary tightening by the Federal Reserve, however, started to take a toll on employment in sectors – construction, manufacturing, and retail – that heavily rely on bank credit to finance their operations. As economic activity softens, the unemployment rate in the United States is projected to increase moderately during the forecast period but will remain low by historical standards. In Europe, unemployment has also fallen to record-low levels in many countries, averaging 6.5 per cent in the euro area in March 2023. Although some European economies may experience a mild recession in 2023, labour market conditions are expected to

² World Bank (2023). *Food Security Update*. April 6. Washington, DC: World Bank.

³ United Nations Entity for Gender Equality and the Empowerment of Women (UN Women) (2022). *Global Gendered Impacts of the Ukraine Crisis*. New York: UN Women.

⁴ European Foundation for the Improvement of Living and Working Conditions (Eurofound) (2022). *COVID-19 Pandemic and the Gender Divide at Work and Home*. Loughlinstown, Ireland: Eurofound.

Figure 5
Change in employment rates in selected economies, Q4 2019 vs Q4 2022



Source: UN DESA, based on data from the Organisation for Economic Co-operation and Development (OECD).

Note: The figure shows the change in the employment rate for the age group 15-64 between the fourth quarter of 2019 and the fourth quarter of 2022.

remain resilient, as businesses will likely retain workers amid significant labour shortages.⁵

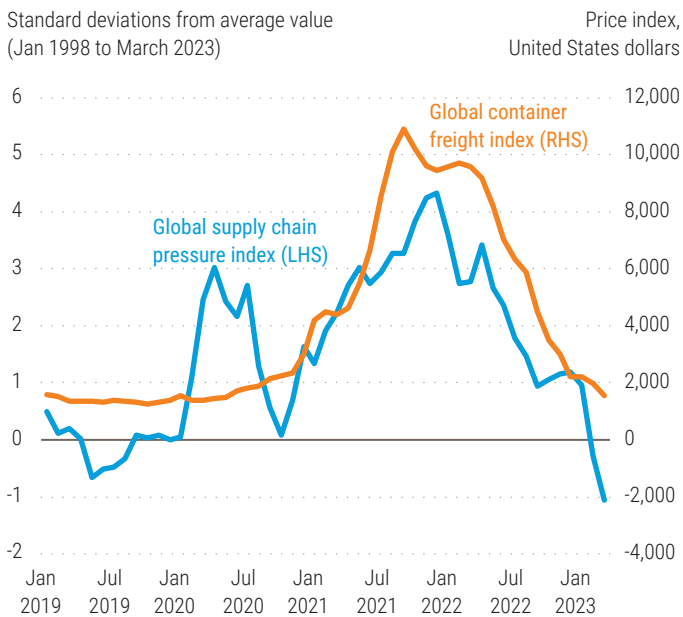
In China, the easing of pandemic-related restrictions has led to a marked decline in the urban unemployment rate to about 5.5 per cent in early 2023, which is, however, still above the pre-pandemic level of 4-5 per cent. Labour market conditions remain challenging in many parts of Africa, with high rates of informality, gender gaps and rising youth unemployment. On the positive side, the unemployment rate in South Africa declined for four consecutive quarters in 2022, reaching a two-year low.

International trade

Global trade is expected to remain under pressure in the forecast period. The baseline scenario projects that the volume of global trade in goods and services will grow by 2.3 per cent in 2023, slightly higher than the previous forecast of near zero growth. This reflects the upward revision to GDP growth projections. Furthermore, China’s reopening is expected to increase domestic demand and potentially boost global trade with increased imports of goods and services. However, the lingering effects of COVID-19, rising geopolitical tensions, and monetary tightening will continue to hold back global trade, although supply chain constraints

⁵ European Labour Authority (2023). *Report on Labour Shortages and Surpluses 2022*. Luxembourg: Publications Office of the European Union.

Figure 6
Global supply chain pressure index and global container freight index



Source: UN DESA, based on data from Federal Reserve Bank of New York and CEIC.

Note: LHS = left-hand scale, RHS = right-hand scale.

and high shipping costs have eased (figure 6). Trade in services experienced faster growth than trade in goods, supported by further recovery in travel and tourism sectors. International tourism is set to consolidate its recovery in 2023, backed by pent-up demand, particularly from Asia and the Pacific as destinations and markets open up. United Nations World Tourism Organization (UNWTO) estimates that international tourism arrivals could reach 80 to 95 per cent of pre-pandemic levels in 2023.⁶

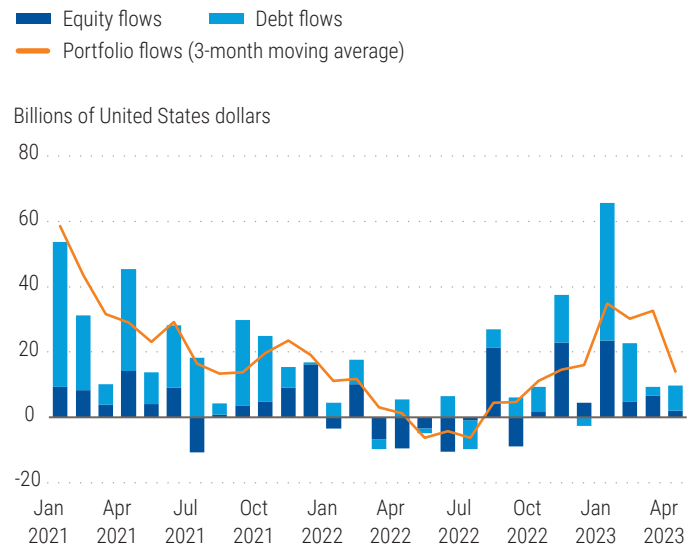
International financial markets

With energy prices and inflation gradually softening, international capital markets have been expecting a pause or even a reversal of monetary tightening in the developed economies. While this has remained elusive, prospects of slowing inflation have reduced

investors' risk aversion as well as long-term interest rates. Capital flows to developing countries recovered (figure 7), albeit with significant volatility, reversing the decline in the first half of 2022. New sovereign bond issuances from emerging economies totalled \$39.8 billion in January 2023, the second highest level on record.⁷ Many developing country currencies also recouped some of the losses suffered throughout most of 2022. Between October 2022 and March 2023, the nominal U.S. dollar index against emerging market currencies fell by 6 per cent, but it still remains about 5 per cent above the level of January 2021. However, as major central banks further increased interest rates in recent months, global financial conditions have continued to tighten.

In March 2023, the collapse of Silicon Valley Bank (SVB) and Signature Bank in the United States and the near-failure of Credit Suisse sent shock waves through the global financial

Figure 7
Non-resident portfolio flows to emerging economies



Source: UN DESA, based on data from the Institute of International Finance (IIF).

Note: A list of the countries classified as emerging economies is available on the IIF website.

⁶ UNWTO (2023). *Tourism Set to Return to Pre-Pandemic Levels in Some Regions in 2023*. 17 January 2023.

⁷ IMF (2023). *Emerging and Frontier Markets Issuance*. *Global Markets Analysis*, 7 February 2023. Washington, DC: IMF.

sector. Rapidly rising interest rates exacerbated the asset-liability mismatches and exposed balance sheet vulnerabilities and failures in risk management in the failed banks. The fear of contagion prompted swift and decisive actions by regulators, which minimized any threats to financial stability. In the United States, the Federal Deposit Insurance Corporation expanded deposit protection to all depositors at the failed banks instead of only those below \$250,000.⁸ The Federal Reserve also briefly reversed its balance sheet shrinking under the quantitative tightening programme, which had been started in April 2022. After reducing its balance sheet by \$623 billion between April 11, 2022 and March 6, 2023, the Federal Reserve expanded the balance sheet by \$364 billion during March 10-27 2023⁹ – following the failure of SVB - to provide liquidity and stabilize the financial sector. The banking sector, especially in the United States, has, however, remained under pressure as evidenced by the failure of First Republic Bank in early May 2023. The turmoil in regional banks does not present any systemic risks as balance sheets of the country’s largest banks have remained strong, but will likely further constrain credit growth in the near term.

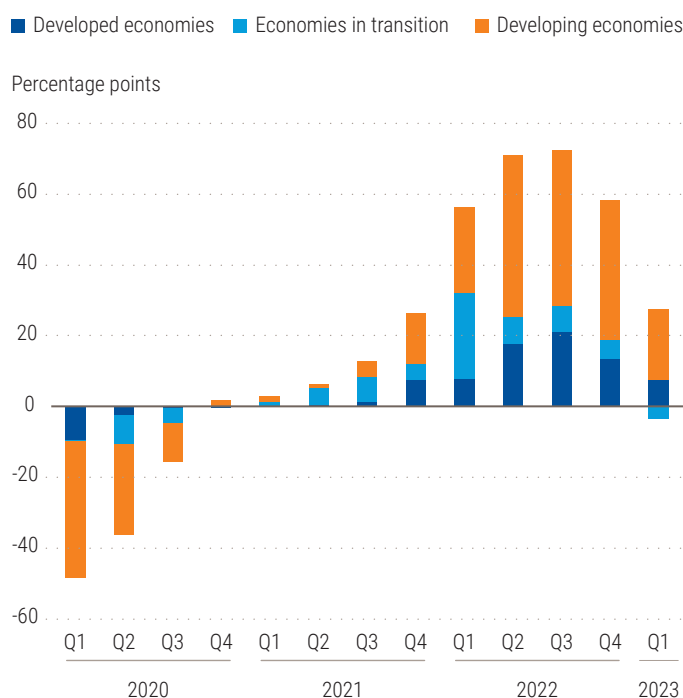
Financial conditions in emerging economies with good credit ratings have generally remained relatively stable in the aftermath of such turbulence. However, some economies experienced a rise in credit spreads, further limiting their access to finance. In March, credit spreads in “frontier markets” widened by 120 basis points.¹⁰ Several developing economies, for example Nigeria and Kenya, decided to postpone plans to issue new sovereign bonds, amid a significant increase in credit spreads.¹¹ According to the IMF, there are currently 12 sovereign bonds trading at distressed spreads of more than 1,000 basis points and an additional 20 bonds trading at spreads of more than 700 basis points.¹² The reverberations from the banking

sector turmoil in the developed economies have thus further impaired financing conditions in many developing economies.

Monetary and fiscal policy: trends and challenges

Central banks in developed and developing countries have continued to tighten monetary policy in 2023 to anchor inflation expectations and maintain credibility. However, most central banks have reduced the pace of their interest rate hikes as headline inflation figures have gradually eased (figure 8). In the United States, the Federal Reserve raised interest rates by only 25 basis points in January, March and May, after several earlier rate hikes of 75 basis points in

Figure 8
Policy rate changes by central banks



Source: UN DESA, based on data from CEIC.

Note: The policy rate changes refer to the net sum of all central banks’ policy changes in each period and country category. The figure covers a total of 78 central banks.

8 Such an expansion arguably increased the prospects of moral hazard and excessive risk-taking going forward.

9 Data source: Board of Governors of the Federal Reserve System, *Credit and Liquidity Programs and the Balance Sheet, Recent Balance Sheet Trends*.

10 IMF (2023). Emerging and Frontier Markets Issuance. *Global Markets Analysis*, 5 April 2023. Washington, DC: IMF.

11 Muir, M. (2023). Quarter of Emerging Countries Lose Effective Access to Debt Markets. *Financial Times*, 31 March 2023.

12 IMF (2023). *Global Financial Stability Report 2023*. 11 April 2023. Washington, DC: IMF.

2022, and hinted at a pause in the tightening cycle. The European Central Bank also shifted to a smaller 25 basis points hike in May, following three consecutive hikes of 50 basis points. Several developing country central banks have also adopted a more cautious approach, while others - especially in Latin America - have paused rate hikes.

The recent banking sector turmoil in the United States and Europe has exposed the trade-offs between raising policy rates and preserving financial stability. A decade of ultra-loose monetary policy and near-zero policy rates has encouraged excessive leverage in the financial sector. The sudden shift to monetary tightening and rising interest rates has exposed asset-liability mismatches and exposed the financial sector to significant duration risks.¹³

Over the forecast period, monetary policy stances are expected to diverge. In the major developed economies, the tightening cycle is well advanced: the Federal Reserve is projected to implement one or two more rate hikes this year while in the euro area, interest rates may peak in the third quarter of 2023. An end to monetary tightening in developed economies would allow some developing country central banks to recalibrate their monetary stances to support economic growth while others will continue to raise interest rates amid stubbornly high inflation.

In 2022, fiscal trends across the world were driven by continued economic recovery from the COVID-19 crisis, the impact of unexpected inflation on debt dynamics (which particularly

benefitted developed economies), and tighter fiscal stances as pandemic-related support measures were phased out. Average fiscal deficits and public debt levels as a share of GDP declined for a second consecutive year in both developed and developing countries. Commodity producers, especially oil-rich countries, experienced particularly large improvements in fiscal performance. Global public debt stood at an estimated 92.1 per cent of GDP in 2022, 7.6 percentage points below the 2020 level, but still notably higher than the pre-pandemic level of 84.3 per cent.

These aggregate short-term trends should not obscure an increasingly challenging fiscal outlook, especially for developing countries facing weak and diminished growth prospects. The aggressive tightening of global monetary policy since early 2022 has significantly exacerbated fiscal and debt vulnerabilities and further constrained fiscal space in many countries, especially in sub-Saharan Africa, South Asia, and Latin America and the Caribbean. Borrowing costs have risen sharply and the strong dollar – despite some softening in recent months – has pushed up the debt-servicing burden of dollar-denominated debt. In Africa, external debt service as a share of government revenue has risen sharply, while access to development assistance and private finance has diminished. Financing constraints will limit the ability of governments to invest in education, health, sustainable infrastructure and energy transition and accelerate progress towards sustainable development, while threatening to push a growing number of countries into debt default.

¹³ Duration risk measures how much bond prices are likely to change if and when interest rates move.

Spillover effects of unconventional monetary policy

After decades of quiescence, high inflation made a comeback in 2022. Major developed country central banks began to raise interest rates and also reduce liquidity in the financial market, by selling off assets on their balance sheets, pursuing a process known as quantitative tightening (QT). However, QT has proved to be challenging given the years of ultra-loose monetary policy of quantitative easing (QE), undertaken through programmes that injected trillions of dollars of liquidity since the global financial crisis (GFC) in 2008. The transition from QE to QT in the developed economies will likely be particularly challenging for many developing countries as it will significantly tighten global financial conditions, increase their borrowing costs and exacerbate debt sustainability risks.

Developed country central banks first resorted to unconventional monetary policy measures when policy rates reached or approached the zero lower bound. By purchasing government bonds or other financial assets, QE aimed to increase liquidity and stimulate economic activity. Notably, in response to a prolonged period of economic stagnation and deflation, the Bank of Japan (BoJ) first implemented QE in 2001.

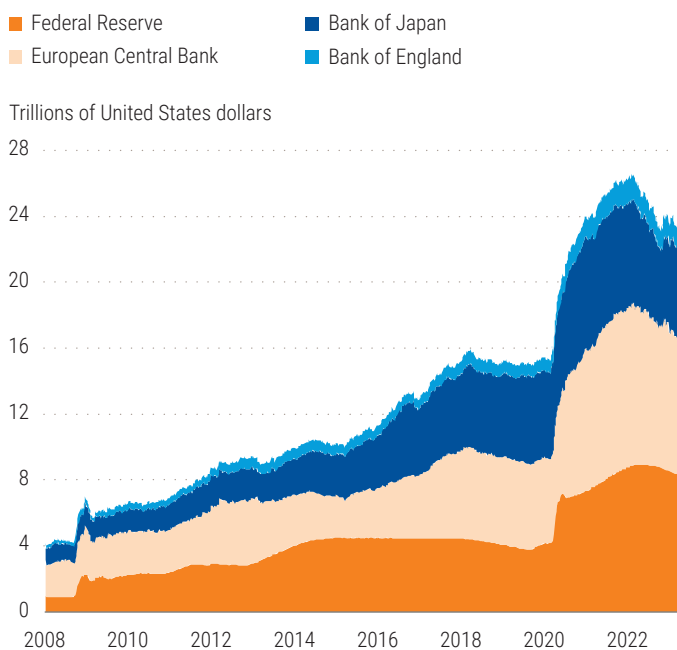
During the GFC, QE - through asset purchases by central banks - became the monetary policy tool of choice. In the United States, the Federal

Reserve needed to restore the balance sheets of the too-big-to-fail banks, as many of them held trillions of dollars of mortgage-backed securities (MBS) that lost value before the crisis. It recognized that lowering policy interest rates, though necessary, alone would not solve the balance sheet challenges of the banks that held these securities. There was limited liquidity in the market to support the prices of these MBS. With sharply falling MBS prices, long-term interest rates surged. The Federal Reserve began to buy these MBS - securities that no market participant wanted to buy and hold - to shore up the balance sheets of the banks and reduce long-term interest rates. Other developed country central banks - notably the European Central Bank (ECB) and the Bank of England (BoE) - followed the lead of the Federal Reserve to support their financial sector during the crisis in 2008.

In the aftermath of the GFC, QE has remained a key monetary policy tool for developed country central banks, with some changes in strategy, including announcement to taper asset purchases in 2013, and balance sheet normalisation in 2017 by the Federal Reserve. During the pandemic, with record-low policy rates, many central banks implemented massive QE as a way to provide economic stimulus, even

though the balance sheets of commercial banks remained strong. Between January 2020 and December 2021, the Federal Reserve, ECB and BoE doubled or nearly doubled the assets on their balance sheets. As of end 2021, the total assets of the Federal Reserve, ECB, BoE and BoJ reached about \$8.8 trillion, \$9.6 trillion, \$1.5 trillion and \$6.3 trillion, respectively (figure 9), collectively representing about a quarter of world GDP. Facing deteriorating global financial conditions, large capital outflows and rising borrowing costs during the pandemic, 27 developing countries introduced QE for the first time during the pandemic in 2020.¹⁴

Figure 9
Total assets of major developed country central banks



Source: UN DESA, based on data from Federal Reserve, European Central Bank, Bank of England, Bank of Japan, CEIC and Trading Economics.

Note: All assets are converted into United States dollars by using the exchange rate of the corresponding period.

Developed countries: transmission channels and impacts of quantitative easing

With QE, the central banks pursued two objectives in the aftermath of the global financial crisis: a. restore financial stability and b. boost investment and economic growth by lowering long-term borrowing costs. The QE interacted with the real economy through multiple channels: First, the liquidity channel, increasing money supply and liquidity with a view to easing financial market stress and preventing liquidity shortages particularly during the immediate crisis phase. Second, the portfolio rebalancing channel, changing the relative prices of financial assets and encouraging investors to hold long-term assets by lowering their yields. Third, the signalling channel, conveying the central bank's commitment to stabilizing financial markets and supporting the economy.

QE has been proven to be an important monetary policy tool to address financial distress particularly during crisis times. Between 2007 and 2021, broad money as a percentage of GDP increased from 79.5 per cent to 117 per cent in the United States, and from 90 per cent to 124 per cent in the euro area.¹⁵ Various studies find that QE can improve market liquidity by relaxing bank funding constraints, increasing risk appetite, lowering liquidity premium among others.¹⁶

QE had a large impact on bond yields. Research by Krishnamurthy and Vissing-Jorgensen illustrates that the first and third QE by the Federal Reserve decreased MBS and Treasury yields.¹⁷ Moreover, in the United States, banks that owned more MBS prior to QE had faster growth in loans to the private sector than those

¹⁴ United Nations (2022). *World Economic Situation and Prospects 2022*. New York: United Nations.

¹⁵ Data source: CEIC.

¹⁶ Christensen, J. H. E. and Gillan, J. M. (2019). *Does Quantitative Easing Affect Market Liquidity?* Federal Reserve Bank of San Francisco Working Paper.

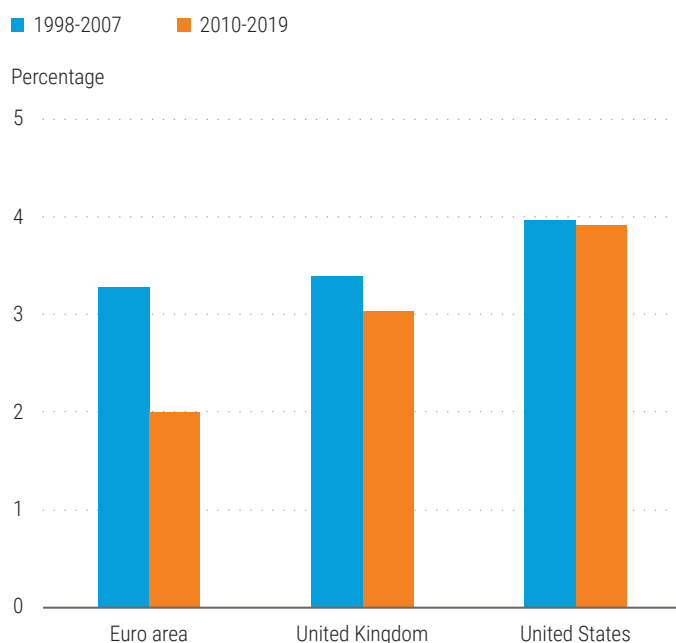
Han, F. and Seneviratne, D. (2018). *Scarcity Effects of Quantitative Easing on Market Liquidity: Evidence from the Japanese Government Bond Market*. IMF Working Paper 18/96. The paper also finds that QE may reduce market liquidity when the increase in a central bank's holdings of certain securities leads to a scarcity of those securities and hence higher search costs in the market.

¹⁷ Krishnamurthy, A. and Vissing-Jorgensen, A. (2011). *The Effects of Quantitative Easing on Interest Rates: Channels and Implications for Policy*. *Brookings Papers on Economic Activity*, Fall 2011.

Krishnamurthy, A. and Vissing-Jorgensen, A. (2013). *The Ins and Outs of Large Scale Asset Purchases*. Kansas City Federal Reserve Symposium on Global Dimensions of Unconventional Monetary Policy, 2013.

that had little or no MBS holdings, indicating that QE was able to stimulate additional credit provision.¹⁸ However, lower yields and additional credit may not necessarily support productive investments in the medium to long term when many other factors also come into play. During the QE episodes of the past 15 years, growth of fixed capital formation in major economies decreased compared to the pre-crisis period (figure 10).

Figure 10
Growth of fixed capital formation in selected developed economies



Source: UN DESA.

Note: The figure shows average annual growth rates (using geometric average).

Over this period, as investors searched for stronger returns and rebalanced their portfolios with riskier assets, additional liquidity flowed into financial sectors and real estate markets, contributing to pushing up asset prices. In the 10 years after the first round of QE, the S&P 500 rose by over 200 per cent and the Dow Jones Euro Stoxx Index nearly doubled. Between the

last QE introduced during the pandemic and the end of 2021, the S&P 500 nearly doubled and the Dow Jones Euro Stoxx Index increased by about 50 per cent. Similar movements were also seen in real estate prices in the United States and Europe, with additional liquidity chasing available housing stocks.

Developing countries: spillovers of quantitative easing

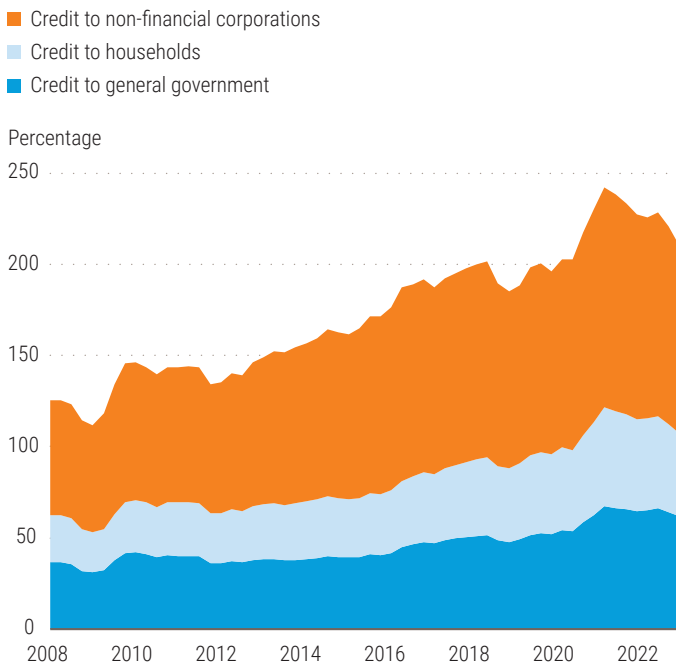
QE boosted global liquidity. As long-term interest rates remained near zero in the developed economies, investors' search for higher yields contributed to higher asset prices in the developing countries.¹⁹ Many developing country governments and corporates began to borrow in the international capital market. Increased external borrowing and inflow of foreign portfolio capital often led to exchange rate appreciation, making imports cheaper and exports more expensive and adversely affecting the balance-of-payments of many developing countries.

In principle, increased global liquidity could lower borrowing costs for some developing countries, especially those with access to international financial markets and strong macroeconomic fundamentals. Yet, while such inflows helped to bridge financing gaps in the short run, they also contributed to increases in external debt. Between 2007 and 2020, total debt of governments, firms and households increased from 125 per cent of GDP to 243 per cent of GDP (figure 11). During the same period, the stock of international bonds of the developing countries increased by over 200 per cent to about \$7.5 trillion (figure 12).

Many developing countries continued to pay high and rising risk premia during QE, even though interest rates in the developed

¹⁸ Darmouni, A. and Rodnyansky, O. M. (2017). The Effects of Quantitative Easing on Bank Lending Behavior. *The Review of Financial Studies*, Vol. 30, Iss. 11, pp. 3858-3887.

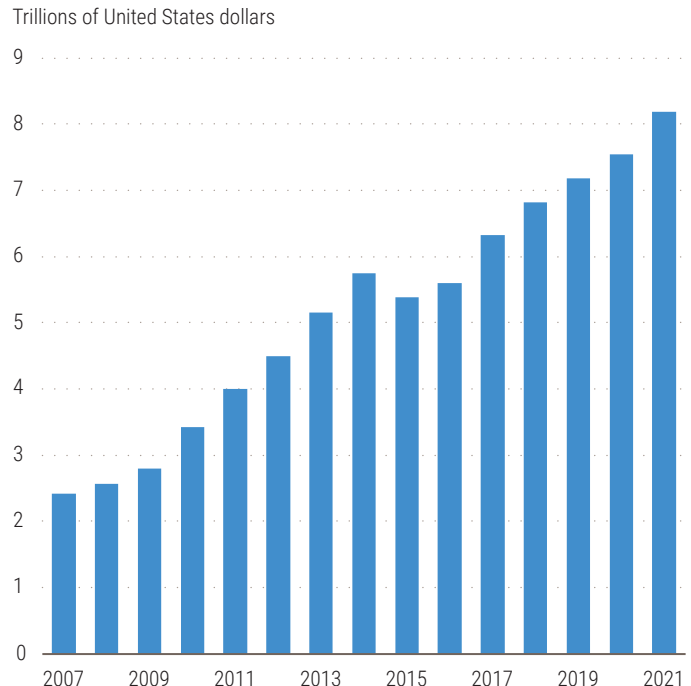
¹⁹ For instance, the MSCI Emerging Markets Index, which traces stock market performance in 25 developing countries, doubled in the decade after the QE was implemented in the developed economies during the GFC.

Figure 11**Credit to non-financial sectors as a share of GDP in emerging economies**

Source: UN DESA, based on data from the Bank for International Settlements (BIS).

Note: The countries classified as emerging economies can be found on the BIS website.

economies remained near zero during the decade before the pandemic. For instance, in 2007 before QE, Ghana issued a sovereign bond that paid 8.5 per cent interest, while in 2015 it issued a bond in the international capital market that paid 10.75 per cent interest. Other countries in sub-Saharan Africa – for example Angola, Senegal and Zambia – experienced higher external borrowing cost during the QE period. These countries faced even higher borrowing costs during crises. For instance, the yield on Zambia’s sovereign bonds remained between 14 per cent and 28 per cent between 2007 and 2019 and surged to about 35 per cent during the pandemic.²⁰ Persistently high borrowing costs have exacerbated the debt sustainability risks of many developing countries. As of February 2023, 36 out of 69 countries covered by the Debt

Figure 12**External debt stock in developing economies**

Source: UN DESA, based on data from the World Bank World Development Indicators database.

Note: External debt stock estimates cover 94 developing economies.

Sustainability Framework for Low-Income Countries were in debt distress or at high risk of experiencing debt distress.²¹

From QE to QT: a bumpy road

The Federal Reserve attempted to wean the financial sector from QE in 2013, but it triggered the so-called “taper tantrum”. In 2017, the Federal Reserve started balance sheet normalisation and managed to reduce its total assets by about \$700 billion from nearly \$4.5 trillion in October 2017 to \$3.8 trillion in August 2019 (figure 9). After a massive expansion of its balance sheet during the pandemic, the Federal Reserve began its new round of QT in April 2022. It announced plans to reduce its asset holdings by about \$95 billion a month,²² roughly double

²⁰ Data source: CEIC.

²¹ IMF (2023). *List of LIC DSAs for PRGT-Eligible Countries, as of February 28, 2023*.

²² Including \$60 billion of Treasuries and \$35 billion of MBS.

the maximum pace of \$50 billion a month²³ it had targeted during 2017-2019. BoE and ECB also began QT for the first time in late 2022 and early 2023, respectively.

Unwinding of QE has however proved to be challenging, and will take monetary authorities into uncharted territory. As QE had lowered yields and increased prices of riskier assets, QT may be expected to do the opposite. Abrupt asset price corrections may trigger financial instability and force central banks to pause or even reverse QT. Between 2017 and 2019, quick interest rate hikes and QT in the United States were accompanied by significant volatility and uncertainty in the stock market. In late 2018, a sharp sell-off in the global equity markets led to significant declines in equity prices. Concerns of financial market instability partly forced the Federal Reserve to abandon QT in 2019. More recently, the collapse of Silicon Valley Bank in March 2023 disrupted the Federal Reserve's efforts to shrink its balance sheet.

Abrupt asset price corrections could trigger a spiral of credit defaults and increase financial risks.²⁴ Such a scenario could be especially disquieting in conditions like those in the United States where, despite interest rate hikes for about a year, credit card debt hit a record high - in early April 2023, consumer loans by credit cards totalled just under \$1 trillion, compared with \$850 billion a year ago.²⁵ Near zero interest rates and abundant liquidity during QE could also have made monetary policy responses – based on the Taylor Rule²⁶ – less effective in reducing consumption demand and bringing down inflation. Transitioning from QE to QT may require a careful recalibration of all monetary policy tools, including the Taylor Rule.

It is also unclear whether QT can boost long-term interest rates since many transmission

channels are involved.²⁷ Although both short-term and long-term government bond yields increased during the policy rate hikes in the United States, long-term government bond yields rose at a slower pace, generating an inverted yield curve. The inverted yield curve and the persistence of compressed term premiums reflect investors' preference for holding safe "shorter" duration sovereign bonds amid a still uncertain economic outlook.²⁸

The collapse of Silicon Valley Bank in the United States has also exposed significant duration risks in the financial sector. Rising short-term rates are reducing the price of long-term bonds held by banks and other investors. This will lead to balance sheet losses and may trigger financial turmoil, especially if the financial intermediaries are forced to sell their long-term bond holdings. These risks will weigh on long-term economic growth, with investors shying away from holding long-term assets.

Policy challenges for the developing countries

QE in developed economies was associated with large capital inflows to developing countries, leading to currency appreciation and lower export competitiveness. Developing country central banks – aiming to keep capital flowing into the country – were often unable to take appropriate prudential measures to prevent excessive borrowing and consequent exchange rate appreciations. Instead, many central banks maintained tight monetary policy stances to prevent inflation and signal central banks' commitment to maintaining financial stability. This often required central banks to maintain higher than necessary interest rates to ensure a strong exchange rate and secure international investors' confidence in the economy. It also

23 Including \$30 billion of Treasuries and \$20 billion of MBS.

24 Valckx, N. (2017). *Rising Household Debt: What It Means for Growth and Stability*. IMF blog.

25 Inflation could have also contributed to higher credit card debt in the United States.

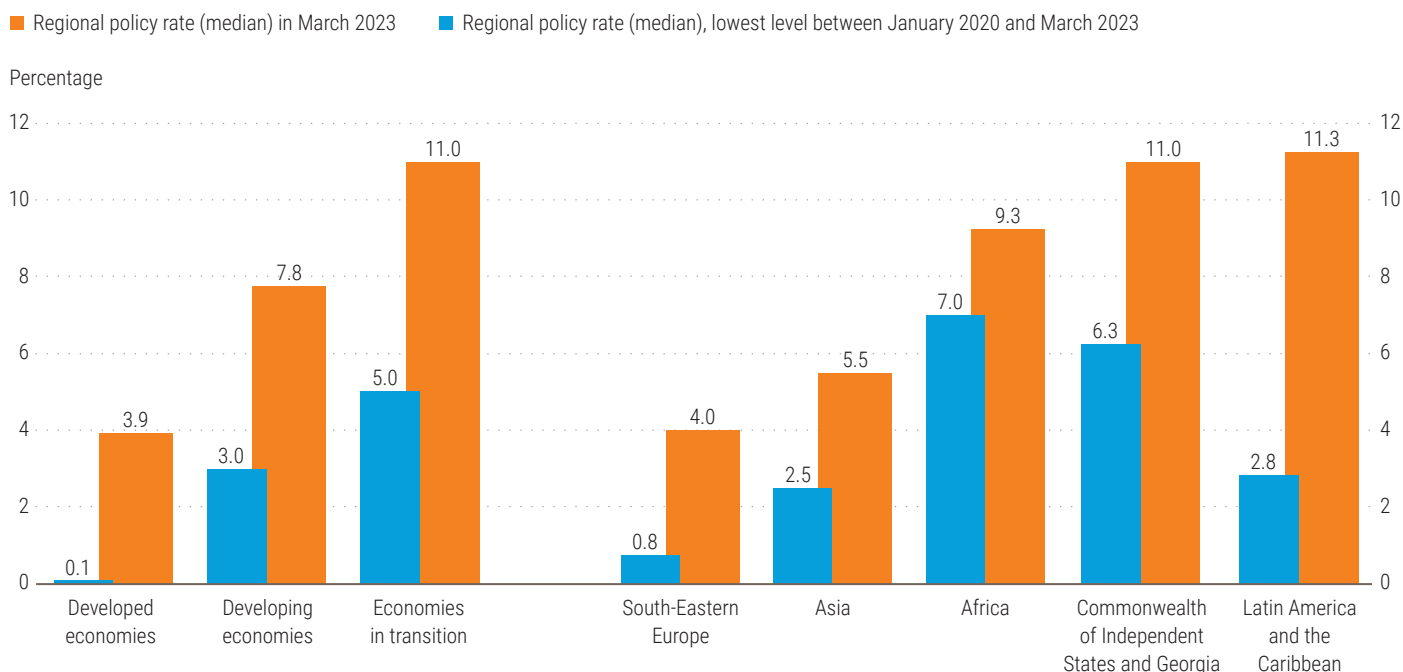
26 The Taylor Rule, created by American economist John Taylor in 1993, prescribes how policymakers should set and adjust the short-term policy rate in response to the values of a few key economic variables. It suggests that the target nominal policy rate should be dependent on the level of the real neutral interest rate, expected inflation, and deviations of inflation and output from their respective target levels.

27 Ono, N. and Pina, A. (2022). *Quantitative Tightening: Another Driver of Higher Interest Rates?* OECD Ecoscope blog.

28 IMF (2023). *Global Financial Stability Report 2023*. 11 April 2023. Washington, DC: IMF.

Figure 13

Policy rate changes in selected regions and country groupings



Source: UN DESA, based on data from CEIC.

meant that actual output in the economy often remained below potential output during periods of large capital inflows and both domestic investments and exports suffered setbacks.

The prospect of QT is now posing an even greater challenge for the developing country central banks. With monetary tightening, the dollar has appreciated against most developing countries' currencies during the past year, making imports more expensive and further fuelling inflation. This has compelled many developing country central banks to pursue faster rate increases than in the developed economies (figure 13). Moreover, as developed country monetary

authorities increased policy rates and began to implement QT, many developing countries began to experience quick reversal of capital flows, higher borrowing costs and increasing rollover and debt sustainability risks. However, developing countries, especially many low-income countries, have not yet recovered from the pandemic. Rapid interest rate hikes and tighter global liquidity conditions – in tandem with rising pressures for fiscal consolidation to improve debt sustainability – will further delay their recovery and push them towards a low growth path in the medium term, making it ever more difficult for them to accelerate progress towards sustainable development.

Regional economic outlook

Developed economies

United States

The economy of the United States is forecast to grow by 1.1 per cent in 2023, marking an upward revision of 0.7 percentage points from the forecast released in January 2023. This is largely due to better than expected household spending and economic resilience during the first half of 2023.

Underneath the apparent resilience, there are significant fragilities. The recent banking sector turmoil, while quickly contained by regulators, has exposed underlying financial vulnerabilities as interest rates rise rapidly, and remains a source of concern. In the product and services market, supply has not kept up with strong consumer demand, resulting in sustained upward price pressures and complicated monetary policy choices. High prices usually encourage more supply of goods and services, contributing to easing price pressures, but this has not been the case so far, partly reflecting labour market constraints. Furthermore, higher interest rates and tighter credit market conditions will continue to constrain supply of goods and services.

A similar mismatch in the housing market has prevented adjustment in housing prices and sustained high household net worth, which, in turn, has supported strong household spending. High housing prices and very low inventory

should boost housing supply. But high interest rates – translating to higher mortgage rates – have impaired both housing affordability and investment in new construction. A correction of housing prices – reducing household net worth and spending via the wealth effect – will remain critical in restoring equilibrium in the housing market. In the credit market too, credit demand – especially demand for consumer credit – remains strong despite sharp increases in interest rates. Restoring equilibrium in the credit market will require credit demand to fall amid tighter credit conditions, leading to reduced spending and investment.

These adjustments in prices will weaken economic activities during the second half of the year and contribute to pushing the economy towards a contraction in late 2023 and early 2024.

Europe

Europe's economies have proven more resilient than previously expected. While high energy costs, persistent inflation and aggressive monetary tightening have weighed heavily on economic growth, most countries have so far escaped recession and the short-term outlook has improved. In the European Union, GDP is projected to expand by 0.9 per cent in 2023 (up from 0.2 per cent forecast in January) and 1.5 per cent in 2024. The recession in the United Kingdom will also likely be milder than previously predicted, with GDP growth projected

at -0.1 per cent in 2023 (up from -0.8 per cent forecast in January) and 1.1 per cent in 2024.

The broad-based upward revisions in growth reflect several positive developments in recent months. Europe averted gas shortages during the winter, with wholesale natural gas prices falling below their pre-war levels due to unusually warm weather, demand restraint and diversification of energy supply sources. The re-opening of China's economy and further easing of supply bottlenecks have boosted manufacturing output, while service sector output has benefited from strong demand for leisure activities.

Average annual inflation in the European Union is projected to decline from 8.8 per cent in 2022 to 6.0 per cent in 2023 and 2.8 per cent in 2024; the pace of disinflation may be slower in East European countries. Despite economic slowdown, labour markets across Europe remain exceptionally strong. The unemployment rate in the European Union stood at a record low of 6 per cent in February 2023. The employment rate among persons aged 20-64 reached an all-time high of 74.9 per cent in the fourth quarter of 2022, 2 percentage points higher than before the COVID-19 crisis and more than 8 percentage higher than a decade ago.

The region's baseline outlook, however, faces significant downside risks. International energy markets remain highly vulnerable to a further deterioration in geopolitical conditions. At the same time, tighter financial conditions could expose vulnerabilities, especially in the region's commercial and residential real estate markets.

Developed Asia and the Pacific

Economic growth of developed Asia and the Pacific countries is forecast to slow to 1.4 per cent in 2023 and 1.3 per cent in 2024. Significant monetary tightening in Australia and New Zealand is expected to weigh on domestic demand, while falling disposable income will slow household spending. In Japan, pent-up household spending – after lifting of COVID-19 restrictions – appears to be dissipating,

weakening near-term growth to 1.2 per cent in 2023 (from 1.5 per cent projected earlier). The Republic of Korea's economy will face significant headwinds in 2023 amid cumulative transmission effects of monetary tightening and reduced fiscal support. The region faces weakening external demand, although China's re-opening could alleviate some pressures.

Risks to the outlook in developed Asia and the Pacific are largely tilted to the downside. The full impact of higher interest rates is yet to be felt, due to the lagged effects of monetary policy. Moreover, although inflation may have peaked in Australia and New Zealand, wage increases could feed into headline inflation, forcing more interest rate hikes. In Japan, more persistent than expected inflation may prompt a shift in the expansionary monetary policy stance. Furthermore, the risk of a sharp housing market correction has been rising in Australia, the Republic of Korea and New Zealand.

Economies in transition

The war in Ukraine and the associated economic disruptions, including those due to sanctions against the Russian Federation, continue to influence economic prospects of the Commonwealth of Independent State (CIS) and Georgia. Following the officially reported contraction of 2.1 per cent in 2022, the Russian economy is projected to marginally shrink in 2023, before returning to a low medium-term growth path in 2024. Russian export revenues plummeted in the first quarter of 2023, with oil flows reoriented from Europe mostly to Asia. Consumer confidence remains low despite tight labour market conditions. Although fiscal support to the economy, including military spending, is expected to continue in 2023, stronger enforcement of restrictions on the import of sanctioned technologies through third countries may constrain productive investment.

The economy of Ukraine lost a large share of its industrial capacity and energy infrastructure to the war and contracted by 29.1 per cent in 2022. Despite the external financial assistance,

including an IMF loan and budget support from the European Union and the United States, the economy is likely to stagnate in 2023. The longer-term outlook for Ukraine will depend on the duration and intensity of the war and its ability to finance reconstruction, with reconstruction cost estimates raised to \$411 billion.²⁹ Energy exporters of the region – including Azerbaijan and Kazakhstan – are set to benefit from the higher oil prices resulting from the OPEC+ agreement.

Following a contraction by 1.9 per cent in 2022, the aggregate GDP of the CIS and Georgia is expected to expand by only 0.6 per cent in 2023. Growth is forecast to accelerate to 2.2 per cent in 2024.

For the countries of South-Eastern Europe, amid a sluggish European Union economy, GDP growth is projected to slow from 3.2 per cent in 2022 to 2.0 per cent in 2023, with a rebound to 3.0 per cent forecast for 2024.

Developing economies

Africa

Africa's growth is projected to decelerate slightly from 3.5 per cent in 2022 to 3.4 per cent in 2023 before returning to 3.5 per cent in 2024.³⁰ The latest forecasts reflect downward revisions of 0.4 percentage points for 2023 and 0.3 percentage points for 2024 from the forecasts released in January, accounting for weaker growth prospects in Egypt and South Africa. Egypt is now projected to face more pronounced balance-of-payments constraints throughout 2023 despite recent monetary tightening measures and currency devaluations. The power crisis in South Africa, including daily rolling power cuts, is projected to hamper economic activities much longer than expected.

Several factors are influencing near-term growth prospects in Africa. First, as monetary stances

are projected to remain mostly tight, credit conditions will further tighten. The cost of external funding through international capital markets is expected to stay prohibitively high. For countries with substantial financing gaps and high external debt burdens, space for domestic demand expansion is very limited in 2023. Second, mining sector and mining-related investments will support growth in several African economies. The mining sector was the main driver of recent growth, particularly when tourism and other services sectors' growth plunged during the pandemic. The expected completion of new investments, such as the Niger–Benin oil pipeline and a liquefied natural gas project offshore of Mauritania and Senegal, improves near-term growth prospects of several African countries. Meanwhile, many countries in the region will face growing food insecurity. Despite declining international grain prices, a significant fraction of the population in Africa remains food insecure. In West and Central Africa, the level of food insecurity and malnutrition reached a 10-year high.³¹

East Asia

Recovery in East Asian developing economies is expected to continue but will likely lose some steam amid global monetary tightening and weakening external demand. In 2023, East Asia's growth is forecast to moderately improve to 4.7 per cent, compared to 3.2 per cent in 2022. The improvement mainly reflects China's recovery. The Chinese economy is predicted to grow by 5.3 per cent in 2023, up from 3 per cent in 2022. After lifting the COVID-19 related restrictions in late 2022, consumer spending and fixed asset investment quickly recovered, thanks to pro-growth policy measures. Both manufacturing and services Purchasing Managers' Indexes (PMIs) moved to the "expansionary zone" in early 2023. However, uncertainties persist in the property sector, which may negatively impact household

29 World Bank, Government of Ukraine, European Union, United Nations (2023). *Ukraine Rapid Damage and Needs Assessment February 2022 – February 2023*.

30 Africa's average growth excludes Libya, which experiences large fluctuations in GDP due to geopolitical factors.

31 World Food Programme (2023). *Food Insecurity and Malnutrition in West and Central Africa at 10-Year High as Crisis Spreads to Coastal Countries*. News Release.

spending and growth during the second half of 2023.

Several export-driven East Asian economies have been hit by weakening external demand. Exports and industrial production in Malaysia, Singapore, Taiwan Province of China, Thailand and Viet Nam have slowed or contracted since late 2022. Although strong recovery in China could provide some impetus, especially for commodity- and tourism-dependent economies, it is unlikely to fully offset the sluggish demand in the developed economies. At the same time, policy rate hikes to curb inflationary pressures and maintain financial stability have weakened domestic demand in many East Asian economies. Sharp increases in public spending during the pandemic have constrained fiscal space, and limited the scope for further fiscal support in the near term.

While the region's average inflation is expected to ease to 2.2 per cent in 2023 from 2.8 per cent in 2022, it is predicted to remain elevated in Indonesia, the Philippines and Singapore, among others.

Several economies in the region – especially Fiji and Lao People's Democratic Republic³² – have experienced a rapid increase in the debt-to-GDP ratio since the onset of the pandemic. Further tightening of global financial conditions could push up their debt distress levels. Some East Asian economies face idiosyncratic downside risks, including civil conflict in Myanmar and natural disasters in the Pacific small island developing states (SIDS). Geopolitical tensions, weak external demand and tighter global financial conditions will negatively impact the region's near-term outlook.

South Asia

South Asia's economy is projected to grow by 4.7 per cent in 2023 and 5.8 per cent in 2024, a slight downward revision of 0.1 percentage

points for both years from the forecasts in January. High inflation, tighter financial conditions, weaker private consumption, and external imbalances will continue to impact growth in 2023. As the region is highly vulnerable to extreme climate conditions, potential droughts and floods also pose a significant risk to the economic outlook. India's economy – the largest in the region – is expected to expand by 5.8 per cent in 2023 and 6.7 per cent in 2024 (calendar year basis), supported by resilient domestic demand. However, higher interest rates and weaker external demand will continue to weigh on investment and exports in 2023.

Regional consumer price inflation is projected to average 11.0 per cent in 2023 and 9.4 per cent in 2024, slightly lower than the 12.9 per cent recorded in 2022. Inflation in India is expected to decelerate to 5.5 per cent in 2023 as global commodity prices moderate and slower currency depreciation reduces imported inflation. Inflation rates in Pakistan and Sri Lanka are expected to remain in double digits in the coming months owing to weakening local currencies and supply-side constraints. Domestic food inflation remains elevated due to country-specific factors, challenging food security across the region, particularly in Afghanistan, Bangladesh, and Pakistan.³³

Central banks in the region continued their interest rates hikes in early 2023 to tackle inflation and stabilize exchange rates. However, the Reserve Bank of India kept the policy rate unchanged at 6.5 per cent in April 2023, after a cumulative increase of 250 basis points since May 2022.

Western Asia

Western Asia's growth is projected to decelerate from 6.6 per cent in 2022 to 3.1 per cent in 2023 before increasing to 3.3 per cent in 2024. The projection has been revised down by 0.4 percentage points for 2023 and 0.1 percentage

³² According to the IMF's World Economic Outlook database (April 2023 version), the debt-to-GDP ratio rose from 49 per cent in 2019 to an estimated 92 per cent in 2022 in Fiji, and from 69 per cent in 2019 to an estimated 128 per cent in 2022 in Lao People's Democratic Republic.

³³ World Bank (2023). *Food Security Update*. April 6. Washington, DC: World Bank.

points for 2024 from the forecast released in January. The growth impacts of increased crude oil production and recovery of international tourism in 2022 have dissipated. Furthermore, the decision by the OPEC and other major oil producers to reduce crude oil production from May 2023 will weigh on real GDP growth in the Gulf Cooperation Council (GCC) member countries.

Monetary tightening measures by the central banks in the GCC countries, Israel and Jordan have weakened domestic demand growth. Tighter monetary stances and stabilizing global grain prices have also contributed to lower inflationary pressures. However, Lebanon, the Syrian Arab Republic, Türkiye, and Yemen – facing severe balance-of-payments constraints – have continued to experience high inflation due to weakening exchange rates. Fiscal stances have become more expansionary in the region, except in Jordan, Lebanon, the Syrian Arab Republic, and Yemen, where fiscal consolidation measures continue. In Türkiye and the Syrian Arab Republic, recovery efforts after the devastating earthquake in February 2023 have required additional fiscal measures, with international cooperation. The region faces the downside risks of unstable oil prices and uncertain geopolitical situations.

Latin America and the Caribbean

After a robust growth performance in 2022, the economic outlook in Latin America and the Caribbean is deteriorating sharply. Subdued global growth, still-elevated inflation, and

structural vulnerabilities are adversely affecting the region's economic performance. Also, higher borrowing costs are impacting consumer spending and investment. Fiscal space remains constrained and unable to support economic activity in most countries. Regional GDP growth is projected to slow significantly from 3.8 per cent in 2022 to only 1.4 per cent in 2023, recovering moderately to 2.4 per cent in 2024. The slowdown in 2023 is broad-based across the region, particularly affecting Argentina, Brazil, Chile, and Colombia. After an expansion of 2.9 per cent in 2022, Brazil's GDP is projected to expand by only 1 per cent in 2023.

Regional average inflation is forecast to decline from 9.3 per cent in 2022 to 6.7 per cent in 2023, but this masks significant differences across countries.³⁴ Headline inflation is softening visibly in Brazil, Costa Rica and Uruguay, among others. As a result, the central banks that hiked interest rates early and aggressively may pivot and recalibrate their monetary stances in the second half of 2023. In other countries, however, price pressures remain elevated and central banks will likely continue to raise interest rates in the near term. Meanwhile, the labour market prospects are challenging, as slower growth hampers job creation and inflation continues to impact real incomes. Consequently, socioeconomic conditions in the region are unlikely to improve in the near term. The pandemic crisis and the war in Ukraine left many economies grappling with higher levels of poverty, informality, and food insecurity. A move towards fiscal consolidation or prolonged monetary tightening could further worsen regional economic prospects.

³⁴ Regional inflation figures exclude Argentina and the Bolivarian Republic of Venezuela.

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