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ON THE WORLD ECONOMIC SITUATION AND PROSPECTS

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Prospects for a robust global recovery remain dim

GLOBAL GROWTH REMAINS SUBDUED

The world economy is facing severe headwinds amid weak growth prospects, elevated inflation and heightened uncertainties. A confluence of factors, including legacy effects of the COVID-19 pandemic, the protracted war in Ukraine, the ever-worsening impacts of climate change, and rapidly shifting macroeconomic conditions, are weighing on the global outlook. Stubbornly high inflation in both developed and developing countries has prompted the most aggressive interest rate hike cycle in decades, causing financial conditions to tighten and exacerbating debt vulnerabilities.

While economic prospects remain subdued, the global growth slowdown in 2023 will likely be less severe than previously anticipated, mainly due to improved household spending in the United States and the European Union, the recovery in China, and no reversals to the earlier forecast for India. 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).

The world economy is predicted to pick up some momentum, expanding by 2.5 per cent in 2024, with inflationary pressures gradually easing. This rate is, however, well below the longer-term (2000–2019) average growth rate of 3.1 per cent. As structural challenges such as 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 would further undermine prospects for progress towards poverty eradication and other Sustainable Development Goals.

Consumer and business sentiment slightly improved in recent months in most major economies, helped by lower international food and energy prices (figure 2a). But confidence levels remain far below their long-term averages. Manufacturing activity, as measured by the Purchasing Managers' Index, 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.

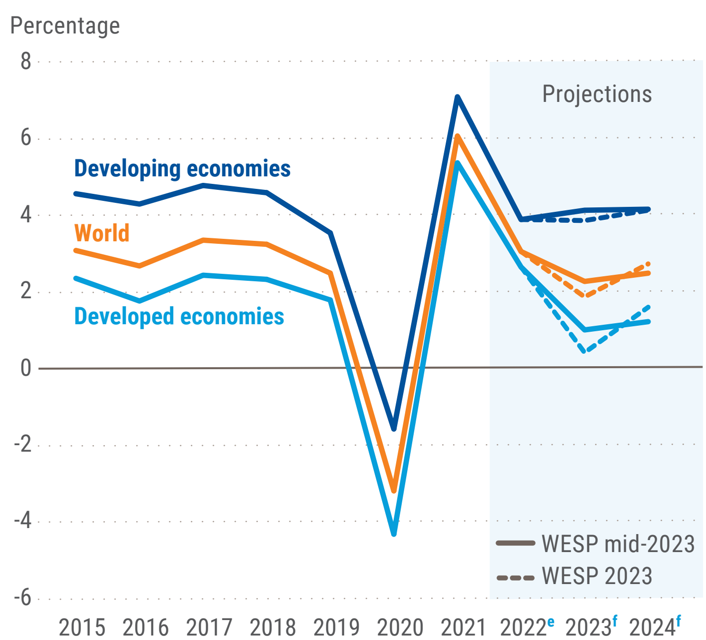
1 United Nations (2023), *World Economic Situation and Prospects 2023*, New York.

KEY MESSAGES

- » Prospects for a robust recovery of the world economy remain dim amid stubborn inflation, rising interest rates and heightened economic and geopolitical uncertainties.
- » The global growth projection for 2023 has been upgraded due to more-resilient-than expected consumer spending in developed economies, the recovery in China and a continuation of the growth momentum in India. But the outlook for many developing countries is even bleaker than predicted in January.
- » Medium-term growth prospects are clouded by scarring from the pandemic, the ever-worsening impact of climate change, and structural macroeconomic challenges, such as anaemic investment and mounting debt vulnerabilities.

Figure 1

Growth of economic output in the world, developed and developing economies



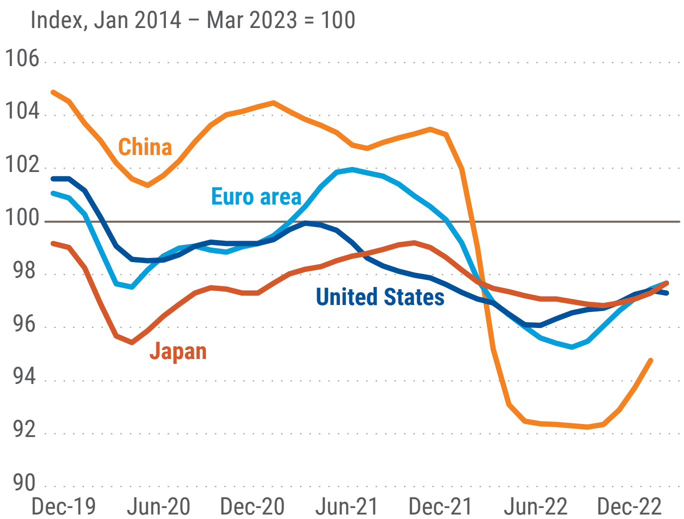
Source: UN DESA, based on estimates and forecasts produced with the World Economic Forecasting Model.

Note: **e** = estimates, **f** = forecasts.

Figure 2

Consumer confidence and manufacturing Purchasing Managers' Index in selected economies

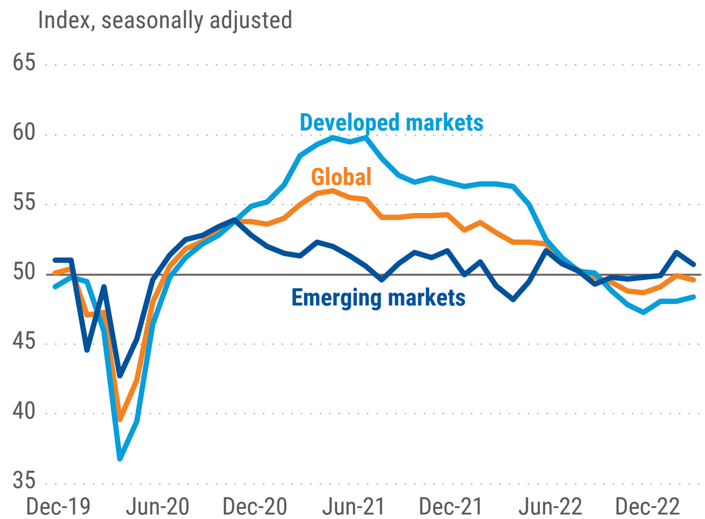
a) Consumer confidence



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.

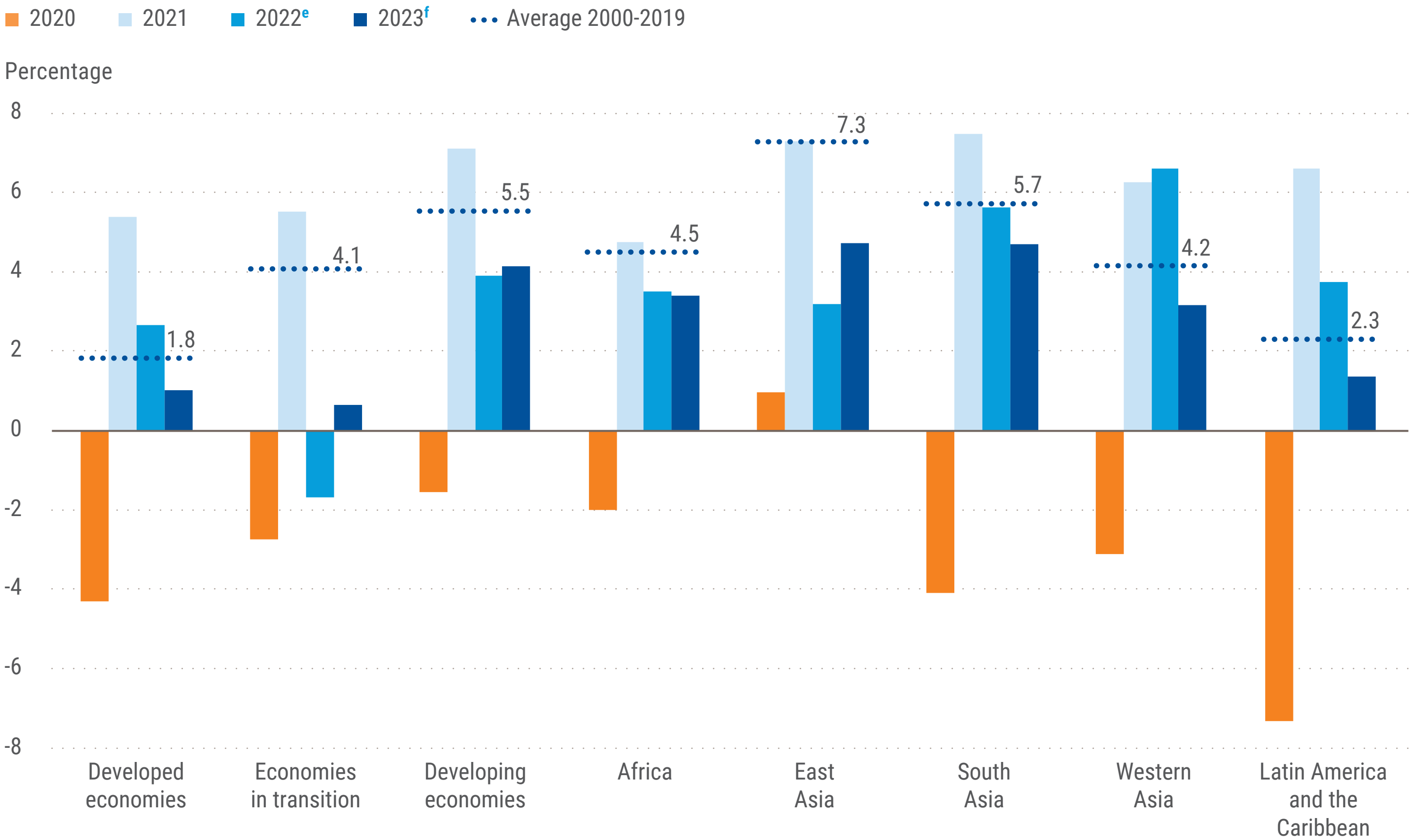
Note: The manufacturing Purchasing Managers' Index (PMI) is produced by S&P Global. A value below 50 signals a contraction of activities compared to the previous month.

In March 2023, the collapse of 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 and sold it to JPMorgan Chase. While governments and financial regulators managed 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 have continued to raise policy rates as core inflation remains high and more persistent than expected.

The slightly improved global growth outlook for 2023 primarily reflects upward revisions in the major developed countries and China (figure 3). In the United States, consumer spending and non-residential investment have held up better than expected, prompting an 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 2024. In Europe, lower gas prices and resilient 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 most developing countries. In Africa, GDP growth is projected to decelerate slightly from 3.5 per cent in 2022 to 3.4 per cent in 2023, a downward revision of 0.4 percentage points from the forecasts released in January. Several of the region's economies are experiencing a funding squeeze amid rising borrowing costs and tightening credit conditions. In Western Asia, growth is projected to slow sharply from 6.6 per cent in 2022 to 3.1 per cent in 2023 as the positive effects of increased crude oil production and recovery of international tourism dissipate. In Latin America and the Caribbean, still-elevated inflation, higher borrowing costs and lack of fiscal space are adversely affecting short-term prospects, with average growth projected to slow from 3.8 per cent in 2022 to 1.4 per cent in 2023. South Asia's economy is forecast to grow by 4.7 per cent in 2023, down from 5.6 per cent in 2022. India will remain one of the world's fastest-growing economies even as higher interest rates and weaker external demand weigh on growth this year. East Asia is expected to benefit from China's recovery, with regional growth projected to accelerate from 3.2 per cent in 2022 to 4.7 per cent in 2023. Monetary policy tightening will, however, dampen domestic demand in many

Figure 3
Growth of gross domestic product 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.

of the region's economies. Growth in the least developed countries is projected to remain subdued at 4.1 per cent in 2023 (down from 4.3 per cent in 2022), falling well short of the 7 per cent SDG target.

INFLATION IS PROJECTED TO SLOW GRADUALLY

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).

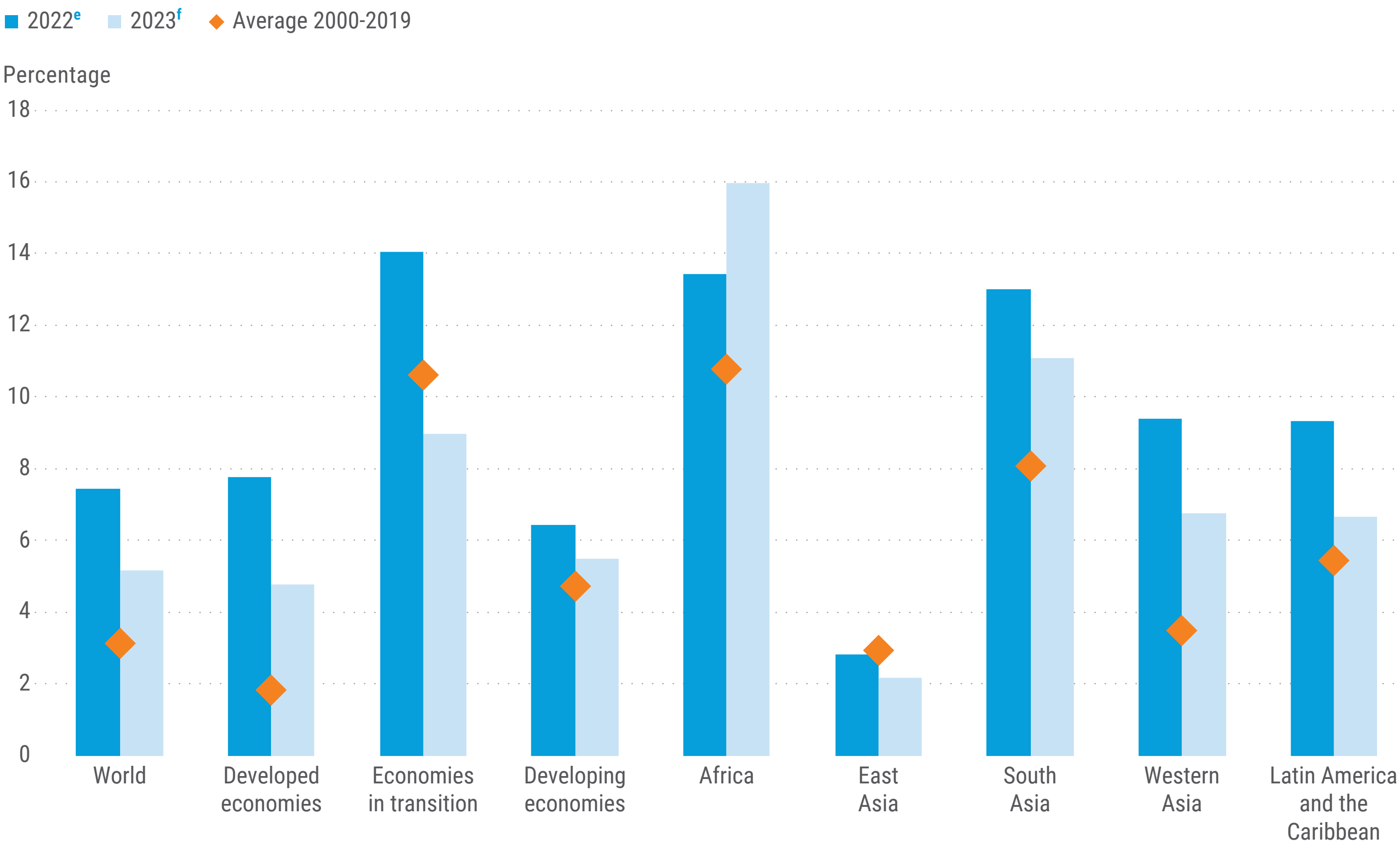
Global food prices have been falling since mid-2022 owing to several factors, including the resumption of exports from Ukrainian ports under the Black Sea Grain Initiative. The FAO Food Price Index declined by 19.7 per cent year-on-year in April 2023 to 127.2. Despite the unexpected OPEC+ production cut in April and the European Union's embargo on seaborne Russian crude, oil prices have continued to drop. Between January and mid-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 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 4.9 per cent in April 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

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.

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 IN DEVELOPED ECONOMIES REMAIN TIGHT

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 – exerting upward pressure on wages – pose additional policy challenges for central banks. 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. Employment rates in most developed economies have increased more among women than men, narrowing the gender gap (figure 5). This trend is due to various factors, including gender differences in employment sectors and increased use of telework and other flexible working arrangements.

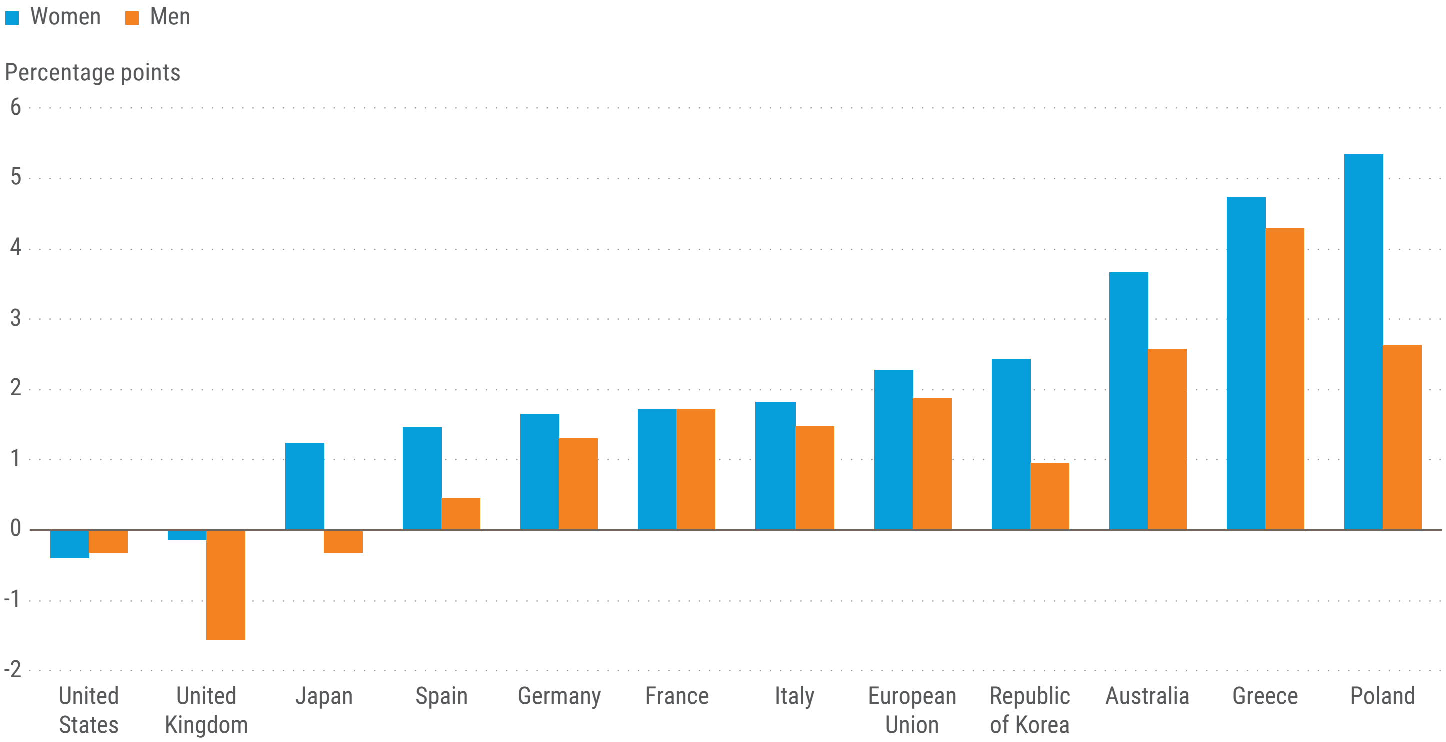
In the United States, the unemployment rate declined to 3.4 per cent in April 2023, despite a steady increase in labour force participation, which almost reached

2 World Bank (2023), *Food Security Update*, April 6, Washington, D. C.

3 UN Women (2022), *Global Gendered Impacts of the Ukraine Crisis*, New York.

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.

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

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. In Latin America and the Caribbean, the rapid deterioration in growth prospects is projected to hamper job creation in the near term.

INTERNATIONAL TRADE IS EXPECTED TO GROW AT A MODEST PACE

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 upward revision reflects improved GDP growth projections for the world's largest economies. However, the lingering effects of COVID-19, rising geopolitical tensions, and monetary tightening will continue to hold back global trade, although supply chain constraints and high shipping costs have eased. 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. The World Tourism Organization (UNWTO) estimates that international tourism arrivals could reach 80 to 95 per cent of pre-pandemic levels in 2023.[4]

4 UNWTO (2023), *Tourism Set to Return to Pre-Pandemic Levels in Some Regions in 2023*, 7 January.

RECENT BANKING SECTOR TURMOIL IS UNLIKELY TO POSE SYSTEMIC RISKS

With energy prices and inflation gradually softening, international capital markets have been anticipating 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 in recent months, albeit with significant volatility, reversing the decline in the first half of 2022. 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 about 5 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 and Signature Bank in the United States and the near-failure of Credit Suisse sent shock waves through the global financial 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. The Federal Reserve also briefly reversed its balance sheet shrinking under the quantitative tightening programme, which had been started in April 2022. 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 these turbulences. 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.[5] Several developing economies, for example Nigeria and Kenya, decided to postpone plans to issue new sovereign bonds, amid a significant increase in credit spreads.[6] 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.[7] The reverberations from the banking sector turmoil in the developed economies have thus further impaired financing conditions in several developing economies.

CENTRAL BANKS HAVE SLOWED THE PACE OF RATE HIKES

Central banks have continued to tighten monetary policy in 2023 to anchor inflation expectations and maintain credibility. However, many have reduced the pace of interest rate hikes as headline inflation rates started to decline (figure 6). 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 2022. 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 higher interest rates has revealed asset-liability mismatches and exposed the financial sector to significant duration risks.[8]

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.

MEDIUM-TERM FISCAL OUTLOOK REMAINS CHALLENGING

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

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

6 Ibid.

7 IMF (2023), *Global Financial Stability Report 2023*, 11 April, Washington, D. C.

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

Figure 6

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.

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 has pushed up the costs 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 default.