Executive Summary

The world economy is experiencing an exceptionally strong but highly uneven recovery. Global growth is set to reach 5.6 percent in 2021—its strongest post-recession pace in 80 years—in part underpinned by steady but highly unequal vaccine access. Growth is concentrated in a few major economies, with most emerging market and developing economies (EMDEs) lagging behind: while about 90 percent of advanced economies are expected to regain their pre-pandemic per capita income levels by 2022, only about one-third of EMDEs are expected to do so. In low-income countries, the effects of the pandemic are reversing earlier gains in poverty reduction and compounding food insecurity and other long-standing challenges. The global outlook remains highly uncertain, with major risks around the path of the pandemic and the possibility of financial stress amid large debt loads. Controlling the pandemic at the global level will require more equitable vaccine distribution, especially for low-income countries. In addition to the necessary efforts to pursue widespread vaccination, policy makers face a difficult balancing act as they seek to nurture the recovery through efficiently allocated fiscal support while safeguarding price stability and fiscal sustainability. Policy makers can also help entrench a lasting recovery by undertaking growth enhancing reforms and steering their economies onto a green, resilient, and inclusive development path. Prominently among the necessary policies are efforts to lower trade costs so that trade can once again become a robust engine of growth.

Global outlook. The global economy is set to expand 5.6 percent in 2021—its strongest post-recession pace in 80 years. This recovery is uneven and largely reflects sharp rebounds in some major economies—most notably the United States, owing to substantial fiscal support—amid highly unequal vaccine access. In many emerging market and developing economies (EMDEs), elevated COVID-19 caseloads, obstacles to vaccination, and a partial withdrawal of macroeconomic support are offsetting some of the benefits of strengthening external demand and elevated commodity prices. By 2022, global output will remain about 2 percent below pre-pandemic projections, and per capita income losses incurred last year will not be fully unwound in about two-thirds of EMDEs. The global outlook remains subject to significant downside risks, which include the possibility of large COVID-19 waves in the context of new virus variants and financial stress amid high EMDE debt levels. Controlling the pandemic at the global level will require more equitable vaccine distribution, especially for low-income countries. The legacies of the pandemic exacerbate the challenges facing policy makers as they balance the need to support the recovery while safeguarding price stability and fiscal sustainability. As the recovery becomes more entrenched, policy makers also need to continue efforts toward promoting growth-enhancing reforms and steering their economies onto a green, resilient, and inclusive development path.

Regional Prospects. The recovery in all EMDE regions is expected to be insufficient to reverse the damage from the pandemic. By 2022, output in all regions is expected to remain below pre-pandemic projections, weighed down by the ongoing pandemic and its legacies, which include higher debt loads and damage to many of the drivers of potential output. The recovery in small, tourism-dependent economies is expected to be particularly weak as some travel restrictions will remain in place until the pandemic is brought under control. The pace of vaccine rollout varies across countries, with low-income countries lagging considerably. The recovery is expected to be strongest in East Asia and the Pacific, primarily due to strength in China. In South Asia, India's recovery is being hampered by the largest outbreak of any country since the beginning of the pandemic. In the Middle East and North Africa and Latin America and the Caribbean, the pace of growth in 2021 is expected to be less than the magnitude of the contraction in 2020, while the tepid recovery in Sub-Saharan Africa will make little progress in reversing the increase in extreme poverty caused by the pandemic. In most regions, risks to the outlook are tilted to the downside. All regions remain vulnerable to renewed outbreaks of COVID-19, which could feature variant strains of the virus; financial stress amplified by elevated debt levels; deeper-than-expected scarring from the pandemic; and rising social unrest, potentially triggered by rising food prices.

This edition of *Global Economic Prospects* also includes analytical chapters on policy options for reducing trade costs, so that trade can once again become an engine of growth, and on prospects for inflation as an exceptionally fast global rebound is associated with growing price pressures.

High Trade Costs: Causes and Remedies. As the global economy rebounds from the COVID-19-induced global recession, the accompanying strength in global trade offers an opportunity to jumpstart the recovery in EMDEs. Lowering cross-border trade costs could help revive trade growth. Trade costs are high: on average, they double the cost of internationally traded goods over domestic goods. Tariffs account for only one-fourteenth of average trade costs; the bulk of trade costs are incurred in shipping and logistics as well as cumbersome trade procedures and processes at and behind the border. Despite a decline since 1995, trade costs remain almost one-half higher in EMDEs than in advanced economies; about one-third of the gap may be accounted for by higher shipping and logistics costs and another one-third by trade policy. A comprehensive reform package to lower trade costs would include trade facilitation measures; deeper trade liberalization; efforts to streamline trade processes and clearance requirements; better transport infrastructure; more competition in domestic logistics, retail, and wholesale trade; and less corruption. Some of these measures could yield large dividends: Among the worst-performing EMDEs, a hypothetical reform package to improve logistics performance, maritime connectivity, and border processes to those of the best-performing EMDEs is estimated to halve trade costs.

Emerging Inflation Pressures: Cause for Alarm? After declining in the first half of 2020, global inflation has rebounded quickly on recovering activity. While global inflation is likely to continue rising in the remainder of this year, inflation is expected to remain within target bands in most inflation-targeting countries. Among EMDEs where recent price pressures may raise inflation above their target ranges, they may not warrant a monetary policy response—provided they are temporary and inflation expectations remain well-anchored. However, higher inflation may complicate the policy choices of EMDEs that are in danger of persistently breaching their inflation targets while also relying on expansionary policies to ensure a durable recovery. Measures to strengthen central bank credibility can help anchor inflation expectations in these economies. Unless risks from record-high debt are addressed, EMDEs remain vulnerable to financial market stress should investor risk sentiment deteriorate as a result of actual or perceived inflation pressures in advanced economies. Low-income countries are likely to experience rising aggregate and food price inflation in the remainder of this year, exacerbating food insecurity and threating to increase poverty. Attempts to control food prices through price subsidies in many countries, or the re-emergence of protectionist policies could drive global prices higher and prove to be self-defeating.