Overview

- Following steady global growth in 2021Q3, survey data point to further stabilization in the fourth quarter.
- Growth has been solid in the United States and in some large EMDEs in November, and the effects of the pandemic-resurgence on activity appear limited in the euro area so far.
- Global financial conditions have tightened, and volatility has increased amid concerns related to the Omicron variant.

Chart of the Month

- Concerns that the Omicron variant might spread globally have prompted renewed travel bans in a number of countries.
- While data from South Africa point to a high transmissibility of the Omicron strain, it is too soon to assess whether it can cause severe illness or circumvent vaccines.
- Meanwhile, COVID-19 cases have continued to rise across Europe, with a growing number of governments re-introducing lockdown-measures.

Special Focus: The monetary policy stance in inflation-targeting EMDEs

- Rising inflation despite a lagging recovery has complicated the implementation of monetary policy in several EMDEs.
- Many EMDE central banks have hiked nominal policy rates in 2021 amid rising inflation and increasing inflation expectations.
- The monetary policy stance remains broadly accommodative in large EMDEs excluding China, as real interest rates stand below neutral interest rates.

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COVID-19 cases and hospitalizations in South Africa

Thousands of people

<table>
<thead>
<tr>
<th>Wave 1 (Beta variant)</th>
<th>Wave 2 (Delta variant)</th>
<th>Wave 3 (Delta variant)</th>
<th>Wave 4 (Omicron variant)</th>
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Sources: Our World in Data (database); World Bank.
Note: The chart shows weekly new COVID-19 cases and weekly hospital admissions in South Africa. Last observation is December 4, 2021 for hospital admissions and December 11, 2021 for new cases.
Monthly Highlights

Global activity: steady in 2021Q4. Global GDP growth edged up in 2021Q3, as a deceleration in activity in advanced economies—largely reflecting COVID-19 flareups, supply disruptions, and rising inflationary pressures—was more than offset by solid growth in EMDEs (figure 1.A). Recent survey data point to steady global growth in 2021Q4. The global composite PMI increased to 54.8 in November from 54.4 in October, reflecting growth in both the manufacturing and services sectors. Meanwhile, global inflationary pressures have continued to build in 2021Q4, with global headline inflation rising to 4.6 percent (y/y) in October. Headline CPI inflation rose to 3.6 percent (y/y) in advanced economies in October—the highest pace since November 2008. Inflation also increased in EMDEs, reaching a 13-year high (figure 1.B).

Global trade: firming at year’s end. Global goods trade declined 1.1 percent (q/q) in the third quarter, reflecting slowdowns across advanced economies and EMDEs. Nevertheless, it remains firmly above pre-pandemic levels. Services and travel trade continued to recover from their pandemic troughs in 2020 but remained subdued nonetheless, settling at 5 percent and 47 percent, respectively, below their 2019 levels in 2021Q3 (figure 1.C). Incoming data suggest that global trade bounced back in 2021Q4. The global manufacturing PMI new export orders rose to 51.4 in November, up from 50.6 in October. Supply strains appear to have eased somewhat in November, with the manufacturing PMI suppliers’ delivery time index declining from its all-time high in October.

Global financing conditions: renewed financial market volatility. In early December, news related to the spread of the Omicron variant triggered a sharp fall in equity valuations and a surge in volatility to its highest level since February, although some of the losses have been recouped (figure 2.A). Persistent inflationary pressures are contributing to uncertainty, also prompting some advanced-economy central banks to accelerate monetary policy normalization. EMDE financing conditions tightened further in November, as yields on government bonds increased and depreciation pressures reemerged across many economies. Credit spreads on EMDE government bonds remained elevated in December after increasing to their highest levels in about a year. Similarly, bond issuance cooled further alongside higher borrowing costs. Following sizable debt and equity outflows at the end of November, portfolio inflows to EMDEs saw only a modest rebound in early December as risk-off sentiment prevailed.

Sources: CPB Netherlands Bureau for Economic Policy Analysis; Haver Analytics; World Trade Organization; World Bank.
Note: EMDEs = emerging market and developing economies.
A. Quarterly growth rates are seasonally adjusted. Growth in 2021H1 is the average of 2021Q1 and 2021Q2.
B. Median of year-on-year headline consumer price index (CPI) inflation in a sample of 81 countries, of which 31 are advanced economies and 50 are EMDEs.
C. Goods trade is the average of imports and exports volumes, services trade is the average of imports and exports values. Goods trade data in 2021 relative to average of 2019, services and travel trade data relative to corresponding month in 2019. Total goods trade volumes for 38 advanced economies and 43 EMDEs, as reported in the CPB World Trade Monitor. Services trade and travel data from WTO statistics. Sample for services trade and travel includes 13 advanced economies and 16 EMDEs.
Commodity markets: sharp pullback in oil prices. After reaching a seven-year high of $86/bbl in October, Brent crude oil prices declined to around $73/bbl by mid-December (figure 2.B). The fall in prices reflected concerns about the impact of the Omicron variant on travel, which also prompted the IEA to reduce its forecast for oil demand by 100,000 barrels per day for 2021 and 2022. In December, OPEC+ members decided to increase monthly crude oil production by 400,000 barrels per day in January, although the group announced they would adjust production if required. Natural gas and coal prices have diverged further, with coal prices declining 32 percent in November (y/y) as coal production in China rose; whereas natural gas prices in Europe reached another record high by mid-December, owing to concerns over growing geopolitical risks. Metal prices dropped 6 percent (m/m) in November, led by falls in aluminum and zinc prices. In contrast, tin prices reached a new all-time high, reflecting global demand. Agricultural prices increased 1 percent (m/m) in November, primarily for wheat and corn.

United States: resilient momentum despite headwinds. Despite continued headwinds from supply bottlenecks and the pandemic, momentum remained resilient in the United States, supported by strong consumption and investment growth. In October, real personal consumption expenditure increased 0.7 percent (m/m) as the household savings rate fell to 7.3 percent—close to its pre-pandemic level. Core capital goods orders, a proxy for business investment, grew 0.7 percent (m/m) in October, while industrial production increased 0.5 percent (m/m) in November. The November ISM manufacturing index rose to 61.1 from 60.8, while the non-manufacturing index jumped to a record high of 69.1. The labor market has improved further in November, with unemployment falling to 4.2 percent and labor force participation increasing to 61.8 percent (figure 2.C). Headline inflation increased to 6.8 percent (y/y) in November, the highest rate since 1982, while core inflation rose to 4.9 percent (y/y). In December the FOMC announced it would double the pace of tapering, expecting to cease net asset purchases by 2022Q2. It also indicated a more hawkish outlook for the interest rates path, expecting three hikes in 2022 and a further three in 2023.

Other advanced economies: resilient growth despite a pandemic resurgence. In the euro area, the impact of the pandemic resurgence on economic activity appears generally limited so far, although mobility has edged down as several governments introduced new restrictions (figure 3.A). The composite PMI rose to 55.4 in November from 54.2 in the
previous month. Inflation rose to a 30-year high of 4.9 percent (y/y) and core inflation at a 20-year high of 2.6 percent (y/y) in November. Inflation exceeded expectations in the United Kingdom, where the Bank of England unexpectedly lifted the policy rate from 0.1 percent to 0.25 percent in December, despite a sharp resurgence of COVID-19 cases. In Japan, data signal a broad-based recovery in activity in the fourth quarter. The manufacturing and services PMIs rose to 54.5 and 53.0 in November and the Tankan confidence index rose to a 4-month high in December. In contrast to other advanced economies, inflation has remained low in Japan, slowing to 0.1 percent in October (y/y).

China: focus on economic stability. Activity indicators were mixed in November. Retail sales growth eased to 3.9 percent (y/y), reflecting localized COVID-19 outbreaks. Industrial production expanded, however, alongside easing power supply constraints. CPI inflation rose by 2.3 percent (y/y)—the highest since August 2020—but PPI eased to 12.9 percent from 13.5 percent in October. The People’s Bank of China has cut the reserve requirement ratio by 50 basis points and reaffirmed its prudent monetary policy stance, stable credit growth, and limits to easing (figure 3.B). Meanwhile, authorities have eased restrictions on mortgage loans. Evergrande announced the formation of a risk management committee which is expected to play a key role in the restructuring process.

Other EMDEs: mixed developments across regions. In contrast to advanced economies, the expansion in the EMDE composite PMI eased somewhat in November, reflecting softening in both manufacturing and services activity (figure 3.C). Despite this slight deceleration, growth remained robust in some large EMDEs. GDP in India expanded by a solid 8.4 percent (y/y) in 2021Q3, unwinding almost all the damage to economic activity that occurred in the second quarter. PMI indicators point to a further recovery of activity in November. Output in Turkey expanded 7.4 percent (y/y) in 2021Q3 on the back of strong consumption. Meanwhile, output contracted in Brazil for the second consecutive quarter in 20201Q3, amid falling investment and net exports. Services activity continued to expand while industrial and agriculture output stagnated. In Mexico, industrial production shrank by 1.4 percent (m/m) in September, as supply bottlenecks continued to hold back manufacturing and construction. GDP in South Africa fell 1.5 percent (q/q sa) in 2021Q3, reflecting disruptions from social unrest and a third pandemic wave. Activity in December is likely to be dented by a fourth COVID-19 wave.
Special Focus: The monetary policy stance in inflation-targeting EMDEs

Rising inflation despite a lagging recovery has complicated the implementation of monetary policy in EMDEs. Policymakers in EMDEs face a difficult trade-off at the current juncture. On the one hand, inflation is rising rapidly, and to levels not seen in half a decade. On the other hand, many EMDEs are still grappling with the fallout from the pandemic and a lagging recovery. In the seven largest emerging market economies excluding China (EM7 excluding China), inflation has increased to around 8 percent in October, on average (figure 4.A). Inflation is significantly above targets in four of the seven largest EMDEs (Brazil, Mexico, Russian Federation, Turkey). In India, inflation is effectively at the central bank’s target of 4 percent while in Indonesia inflation remains below the central bank’s target. Despite high inflation, almost all economies still face a negative output gap while stimulus measures in Turkey likely saw the output gap turning positive in early 2021.

Monetary policy has begun to tighten in a number of EMDEs. In response to the rapid rise in inflation, central banks in almost 40 percent of EMDEs—particularly in energy importers—have increased policy rates in 2021. Among large EMDEs, Brazil, Mexico, and Russia have all tightened policy rates; Brazil has tightened most, with the policy rate increasing 575 basis points since the beginning of the year. India and Indonesia have maintained low policy rates throughout 2021. In Turkey, policy rates have been lowered despite inflation being more than three times above the official inflation target. Due to the protracted nature of the pandemic, inflation forecasts—much like those for GDP growth—remain highly uncertain. The standard deviation of consumer price inflation during COVID-19 was almost six times its historical (2005-19) average (excluding the global financial crisis; figure 4.C). High uncertainty about the outlooks for output and inflation can complicate the conduct of monetary policy.

Rising nominal interest rates in the face of surging inflation do not necessarily imply that the monetary policy stance is countercyclical. To determine a country’s monetary policy stance, it is essential to assess whether the real interest rate, which is generally computed as the difference between the nominal policy rate and expected or forecast inflation, stands above or below the neutral rate. The latter, generally defined as the interest rate which stabilizes inflation at its target and keeps...
the economy growing at its potential (or at full employment), is unobservable and needs to be estimated. The deviation of policy rates from this neutral rate determines whether monetary policy is accommodative or restrictive.

Large EMDEs have seen a decline in the neutral rate over time, although estimates remain highly uncertain. Model-based estimates by Ruch (2021) suggest that the neutral real rate in EM7 excluding China has declined from around 6 percent in 2005 to around 2 percent in 2021 (figure 5.A). Despite this, it remains well above that in advanced economies. Neutral real rates have declined in all large EMDEs between 2005 and 2021. However, estimates of the neutral real rate tend to be highly uncertain, especially for EMDEs. In EM7 excluding China, the standard deviation around the neutral real interest rate estimate remains about 40 percent higher than that in the United States. (Ruch 2021, figure 5.B) Caution is needed in interpreting these results. The COVID-19 pandemic is likely to have had a pronounced impact on the structural factors that determine the neutral real rate including by leading to increased volatility of output and inflation and by lowering potential growth through changing labor, capital and productivity.

Real interest rates in large EMDEs are estimated to be below the neutral equilibrium rate at the current juncture. Increases in nominal policy rates in 2021 have significantly outpaced the surge in inflation expectations, allowing the average real interest rates to turn positive in late 2021 after being negative for much of 2020-21. Still, real interest rates in EM7 excluding China are assessed to stand below the neutral real rate. This suggests that despite the increase in nominal rates, the monetary policy stance remains broadly accommodative in these economies (figure 5.C).

A combination of factors stands behind the decline in the neutral real rate in large EMDEs. Economic theory suggests that changes in desired savings and investment drive changes in the neutral real interest rate. Factors that may explain these changes include demographics, income inequality, population growth, policy regimes (like social safety nets), risk preferences, profitability, and the relative price of capital. While there is yet to be agreement on which of these factors have mattered the most, the rise in life expectancy in EMDEs, the decline in potential growth, and the decline in the relative price of capital—which reduces the demand for investment—may have contributed to its decline.

Sources: Haver Analytics; Ruch (2021); World Bank.
Note: EM7 = the seven largest emerging market economies. “EM7 ex. China” reflects GDP-weighted average of Brazil, India, Indonesia, Mexico, Russia and Turkey. Forecasts are used for 2021Q4.
A. The neutral real interest rate estimates are based on the Laubach and Williams model implemented in Ruch (2021).
B. Standard deviations around estimates of the neutral real interest rates are shown for the United States and EM7 excluding China.
C. “Real interest rate gap” reflects the difference between the real interest rate and the neutral real interest rate. Positive values suggest a restrictive monetary policy stance while negative values suggest an accommodative stance.
Recent Prospects Group Publications

Global Economic Prospects - Forthcoming, January 2022
Commodity Markets Outlook - October 2021
What Has Been the Impact of COVID-19 on Debt? Turning a Wave into a Tsunami
The Aftermath of Debt Surges
One-Stop Source: A Global Database of Inflation
Neutral Real Interest Rates in Inflation Targeting Emerging and Developing Economies
Global Economic Prospects - June 2021
The Long Shadow of Informality: Challenges and Policies

Recent World Bank Working Papers

Nowcasting Global Poverty
Measuring Systemic Banking Resilience: A Simple Reverse Stress Testing Approach
Does Race and Gender Inequality Impact Income Growth
Estimating the Impact of Weather on Agriculture
Occupational Hazards: Why Migrants Faced Greater Economic and Health Risks during the COVID-19 Pandemic
Building State Capacity: What Is the Impact of Development Projects

Recent World Bank Reports

The State of the Global Education Crisis: A Path to Recovery
Green Public Procurement: An Overview of Green Reforms in Country Procurement Systems
Remote Learning During COVID-19: Lessons from Today Principles for Tomorrow
Industrialization in Sub-Saharan Africa: Seizing Opportunities in Global Value Chains
360° Resilience: A Guide to Prepare the Caribbean for a New Generation of Shocks

TABLE: Major Data Releases

(Percent change, y/y)

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<thead>
<tr>
<th>Country</th>
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<th>Indicator</th>
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