

Executive Summary

Global growth is projected to decelerate sharply this year, to its third weakest pace in nearly three decades, overshadowed only by the 2009 and 2020 global recessions. This reflects synchronous policy tightening aimed at containing very high inflation, worsening financial conditions, and continued disruptions from the Russian Federation's invasion of Ukraine. Investment growth in emerging market and developing economies (EMDEs) is expected to remain below its average rate of the past two decades. Further adverse shocks could push the global economy into yet another recession. Small states are especially vulnerable to such shocks because of their reliance on external trade and financing, limited economic diversification, elevated debt, and susceptibility to natural disasters. Urgent global action is needed to mitigate the risks of global recession and debt distress in EMDEs. Given limited policy space, it is critical that national policy makers ensure that any fiscal support is focused on vulnerable groups, that inflation expectations remain well anchored, and that financial systems continue to be resilient. Policies are also needed to support a major increase in EMDE investment, including new financing from the international community and from the repurposing of existing spending, such as inefficient agricultural and fuel subsidies.

Global outlook. Global growth is expected to decelerate sharply to 1.7 percent in 2023—the third weakest pace of growth in nearly three decades, overshadowed only by the global recessions caused by the pandemic and the global financial crisis. This is 1.3 percentage points below previous forecasts, reflecting synchronous policy tightening aimed at containing very high inflation, worsening financial conditions, and continued disruptions from Russia's invasion of Ukraine. The United States, the euro area, and China are all undergoing a period of pronounced weakness, and the resulting spillovers are exacerbating other headwinds faced by emerging market and developing economies (EMDEs). The combination of slow growth, tightening financial conditions, and heavy indebtedness is likely to weaken investment and trigger corporate defaults. Further negative shocks—such as higher inflation, even tighter policy, financial stress, deeper weakness in major economies, or rising geopolitical tensions—could push the global economy into recession. In the near term, urgent global efforts are needed to mitigate the risks of global recession and debt distress in EMDEs. Given limited policy space, it is critical that national policy makers ensure that any fiscal support is focused on vulnerable groups, that inflation expectations remain well anchored, and that financial systems continue to be resilient. Policies are also needed to support a major

increase in EMDE investment, which can help reverse the slowdown in long-term growth exacerbated by the overlapping shocks of the pandemic, the invasion of Ukraine, and the rapid tightening of global monetary policy. This will require new financing from the international community and from the repurposing of existing spending, such as inefficient agricultural and fuel subsidies.

Regional prospects. The forecast for growth in 2023 and 2024 combined has been downgraded for every EMDE region. Monetary policy tightening, and restrictive global financial conditions are slowing growth, especially in LAC, SAR and SSA. Persistently elevated energy prices are expected to dampen outlooks for energy-importers in all regions, while falling metals prices will weigh on terms of trade in LAC and SSA. The projected slowdown in advanced economy import demand is expected to especially impact EAP and ECA. Added to the pandemic-recession and incomplete recovery, the outlook implies feeble per capita income growth in LAC, MNA and SSA in the half decade to 2024. Risks to the baseline forecasts are skewed to the downside in all regions. They include the possibility of financial stress and greater spillovers from major advanced economy weakness (especially in EAP, ECA, LAC and SSA), commodity price shocks (especially in ECA, EAP and SAR), conflict (particularly in ECA, MNA, and SSA),

and natural disasters (with elevated risk in sub-regions in EAP, LAC and SAR).

This edition of *Global Economic Prospects* also includes analytical pieces on prospects for investment after the pandemic and the multiple challenges faced by small states.

Investment growth after the pandemic. Investment growth in EMDEs is expected to remain below its average rate of the past two decades through the medium term. This subdued outlook follows a geographically widespread investment growth slowdown in the decade before the COVID-19 pandemic. During the past two decades, investment growth was associated with strong real output growth, robust real credit growth, terms of trade improvements, growth in capital inflows, and investment environment reform spurts. All of these factors have seen a declining trend since the 2007-09 global financial crisis. Weak investment growth is a concern because it dampens potential growth, is associated with weak trade, and makes achieving development and climate-related goals more difficult. Policies to boost investment growth need to be tailored to country circumstances but include comprehensive fiscal and structural reforms, including repurposing of expenditure on inefficient subsidies. Given EMDEs' limited fiscal space, the international community will need to signifi-

cantly scale up international cooperation and official financing and grants as well as help leverage private sector financing for sufficient investment to materialize.

Small States: Overlapping crises, multiple challenges. Small states' economies were hit particularly hard by COVID-19, largely due to prolonged disruptions to global tourism. Now facing spillovers from Russia's invasion of Ukraine and the global monetary tightening cycle, small states are expected to have weak recoveries with large and possibly permanent losses to the level of output. Small states are diverse in their economic features, but they share attributes that make them especially vulnerable to shocks, including dependence on imports of essential goods, highly concentrated economies, elevated levels of debt, reliance on external financing, and susceptibility to natural disasters and climate change. Policy makers in small states can improve long-term growth prospects by building fiscal space, fostering effective economic diversification, and improving resilience to climate change. There is a need for intensified international cooperation to support small states in addressing their challenges. The global community can assist small states in these efforts by maintaining the flow of official assistance, helping restore and preserve debt sustainability, facilitating trade, and supporting climate change adaptation.