Foreword

As the world enters the third year of the COVID-19 crisis, economic developments have been both encouraging and troubling, clouded by many risks and considerable uncertainty.

The good news is that output in many countries rebounded in 2021 after a sharp decline in 2020. Advanced economies and many middle-income countries have reached substantial vaccination rates. International trade has picked up, and high commodity prices are benefiting many developing countries. Domestic financial crises and foreign debt restructurings have been less frequent than might have been expected in a time of severe global shocks.

Yet, for many developing countries, progress toward recovery has been hampered by daunting challenges. This edition of *Global Economic Prospects* analyzes three of them.

Macroeconomic imbalances have reached unprecedented proportions. Government spending, deficits, and debt in several advanced economies have reached record highs relative to GDP. Central bank balance sheets have absorbed unprecedented amounts of long-term assets financed by bank reserves, resulting in an inequitable allocation of capital. Spending in developing countries surged to support economic activity during the crisis, but many countries are now facing record levels of external and domestic debt. Adding to these debt-related risks is the potential for higher interest rates: it is difficult to predict how rapidly interest rates will rise as advanced economies slow down their expansion in monetary policies. With fiscal and monetary policy in uncharted territory, the implications for exchange rates, inflation, debt sustainability, and economic growth are unlikely to be favorable for developing countries.

The world is facing growing income inequality across and within countries. The COVID-19 crisis wiped out years of progress in poverty reduction. As government's fiscal space has narrowed, many households in developing countries have suffered severe employment and earning losses—with women, the unskilled, and informal workers hit the hardest. School closures and sustained disruptions to healthcare services can do lasting damage to human capital, especially among children and the most vulnerable. At the other end of the income scale, booming asset prices are boosting the wealth of richer segments of the population, adding to inflation. This increasing divergence of fortunes is especially troubling given the possibility of social discontent in developing countries.

Compounding this rising inequality, the world is undergoing a phase of exceptional uncertainty. The emergence of the Omicron variant is a stark reminder that the COVID-19 pandemic is not over. New variants of the virus can put even highly vaccinated countries under pressure and threaten to wreak havoc in those with low vaccination rates—which are the poorest and most vulnerable of all. Supply bottlenecks have hit developing countries hard—these countries are often the last in the global supply line, outbid by countries with greater financial resources and larger orders. Ports operating below capacity, pandemic-related delays in orders for new vessels, and containers stranded in the "wrong" ports have increased shipping costs and supply constraints to unprecedented levels. Volatile commodity prices and extreme weather events driven by climate change are aggravating food insecurity risks, further burdening health and nutrition.

Progress in vaccination is key to restoring mobility and overcoming supply-chain disruptions. For most of 2021, the main obstacle was the limited access to vaccine doses, with low-income countries suffering the most. At the start of 2022 the supply of vaccines is increasing appreciably, but new variants and vaccine deployment bottlenecks remain major obstacles, causing the uncertainty over health to persist well into the future.

In response, this edition of *Global Economic Prospects* charts a policy agenda for the world to address these three major challenges.

To soften the increased global inequality, this report calls for a concerted effort to mobilize external resources and accelerate debt relief efforts. The recent $93 billion replenishment of the International Development Association (IDA)—the World Bank's fund for the poorest countries—is a key milestone in this respect. More progress, however, is needed on the implementation of the G20's Common Framework for debt restructuring for low-income countries under stress. In 2022 alone, around $35 billion in bilateral and private debt-service payments will become due on the public and publicly guaranteed debt of IDA countries. Given that burden, vulnerable countries will find it increasingly difficult to support recovery or direct resources to health, education, social protection, and climate.

Some of the most important steps to contain inequality can come from domestic growth and innovation. The digital revolution offers an opportunity to strengthen social protection systems and health and education services. It can enable access to finance and help create new jobs and economic opportunities. E-government initiatives can facilitate access to public services for the poor and encourage entrepreneurs. Greater access to continuous electricity supply will be a vital first step. In addition, policy measures to facilitate cross-border trade and investment—especially if combined with reforms in developing countries to improve business climates, human and physical capital—can help these countries generate the productivity growth needed to catch up to advanced-economy per capita incomes.

To enable social spending while investing more in infrastructure, climate adaptation and clean energy will require a careful review and prioritization of public spending, subsidies, and measures to expand the tax base. It will be equally important to strengthen financial systems, and to reprofile debt to spread out repayments and reduce exchange-rate risks.

Food-price inflation and supply shortages call for heightened attention to food security, particularly in fragile and conflict-affected countries. Access to clean water and better nutrition are vital to reduce stunting. Carbon taxes and the reduction of fossil-fuel subsidies are important steps in reducing greenhouse gas emissions, but high energy prices are making the implementation of these policies more challenging.

Against this mix of encouraging and troubling news, it is clear that challenging times lie ahead for the global economy—and particularly for developing countries—as economic stimulus slows and credit conditions tighten. Putting more countries on a favorable growth path will require concerted international action and a comprehensive set of national policy responses.

David Malpass
President
World Bank Group