

Foreword

Just over two years after COVID-19 caused the deepest global recession since World War II, the world economy is again in danger. This time it is facing high inflation and slow growth at the same time. Even if a global recession is averted, the pain of stagflation could persist for several years—unless major supply increases are set in motion.

Amid the war in Ukraine, surging inflation, and rising interest rates, global economic growth is expected to slump in 2022. Several years of above-average inflation and below-average growth are now likely, with potentially destabilizing consequences for low- and middle-income economies. It's a phenomenon—stagflation—that the world has not seen since the 1970s.

Our forecasts reflect a sizable downgrade to the outlook: global growth is expected to slow sharply from 5.7 percent in 2021 to 2.9 percent this year. This also reflects a nearly one-third cut to our January 2022 forecast for this year of 4.1 percent. The surge in energy and food prices, along with the supply and trade disruptions triggered by the war in Ukraine and the necessary interest rate normalization now underway, account for most of the downgrade.

COVID-19 already dealt a major setback to income growth and poverty reduction in developing economies. The fallout from the war in Ukraine compounds the challenges for many of them. They are expected to grow 3.4 percent in 2022—barely half the rate in 2021 and well below the average from 2011 through 2019. Middle-income countries will see a sharp downgrade to growth in 2022, losing 1.3 percentage points relative to the January forecast. Because of the adverse shocks of the past two years, real income per capita in 2023 will remain below pre-COVID-19 levels in about 40 percent of developing economies. For many countries, recession will be hard to avoid. With the supply of natural gas constrained, especially for use in

fertilizer and electricity grids in poorer countries, announcements of major production increases worldwide will be essential for breaking out of stagflation and restoring noninflationary growth.

This edition of the *Global Economic Prospects* report offers the first systematic assessment of how current global economic conditions compare with the era of stagflation of the 1970s—with a particular emphasis on how stagflation could affect developing economies. The insights are sobering: the interest rate increases that were required to control inflation at the end of the 1970s were so steep that they touched off a global recession, along with a string of debt crises in developing economies, ushering in a “lost decade” in some of them.

The danger of stagflation is considerable today. Between 2021 and 2024, global growth is projected to have slowed by 2.7 percentage points—more than twice the deceleration between 1976 and 1979. Subdued growth will likely persist throughout the decade because of weak investment in most of the world. With inflation now running at multidecade highs in many countries and supply expected to grow slowly, there is a risk that inflation will remain higher for longer than currently anticipated.

External public debt in developing economies is at record levels today. Most of it is owed to private creditors, and much of it involves variable interest rates that could spike suddenly. As global financing conditions tighten and currencies depreciate, debt distress—previously confined to low-income economies—is spreading to middle-income countries.

The removal of monetary accommodation in the United States and other advanced economies, along with the ensuing increase in global borrowing costs, represents another significant headwind for the developing world. In addition, over the next two years, most of the fiscal support

provided in 2020 to fight the pandemic will have been unwound. Despite this consolidation, debt levels will remain elevated.

Yet the analysis shows that the current conditions differ from those in the 1970s in multiple dimensions. The dollar is strong, a sharp contrast with its severe weakness in the 1970s. Oil prices quadrupled in 1973-1974 and doubled in 1979-1980. Today, in inflation-adjusted terms, oil prices are only two-thirds of what they were in 1980. The balance sheets of major financial institutions were a risk in the 1970s; today, they are generally strong. Economies across the world are also more flexible than they were in the 1970s, with fewer structural rigidities involving wages and labor markets. Importantly, policy makers are in a better position today to stave off stagflationary headwinds. Monetary policy frameworks are more credible—with clear price stability mandates for central banks in advanced and many developing economies alike. Long-term inflation expectations are also better anchored. Existing technology and capital have the capacity to provide massive increases in supply, holding down price expectations.

Reducing the risk of stagflation will require targeted and impactful measures by policy makers across the world. This report spells out what they can do to avoid the worst outcomes—and why that work must begin immediately. In an extraordinary era of overlapping global crises, policy makers across the world will need to focus their efforts in five key areas:

- *First, limit the harm to people affected by the war in Ukraine* by coordinating the crisis response, including delivery of emergency food, medical, and financial aid to war-torn areas. It will also be necessary to share the burden of housing, supporting, and possibly relocating refugees and internally displaced people.
- *Second, counter the spike in oil and food prices.* It's essential to boost the supply of key food

and energy commodities. Markets look forward, so even mere *announcements* of future supply would help reduce prices and inflation expectations. In the poorest nations at greatest risk of a food crisis, social safety nets should be buttressed. It's also crucial to avoid export and import restrictions that magnify the rise in prices.

- *Third, step up debt relief efforts.* Debt vulnerabilities were acute for low-income countries even before the pandemic. As debt distress spreads to middle-income countries, the risk for the global economy is growing. Debt relief needs to be rapid, comprehensive, and sizable in order to minimize debt overhang and risks to future growth.
- *Fourth, strengthen health preparedness and efforts to contain COVID-19.* Expanding vaccination coverage in low-income countries, including that for COVID-19 vaccinations, must be a global priority.
- *Fifth, speed the transition to low-carbon energy sources.* Reducing dependency on fossil fuels will need more investments in electricity grids, cleaner energy sources, and greater energy efficiency. National policy makers should create climate-smart regulatory frameworks, adjust incentive structures, and strengthen land use regulations.

After multiple crises, long-term prosperity will depend on returning to faster growth and a more stable, rules-based policy environment. There is good reason to expect that, once the war in Ukraine stops, efforts will redouble—including by the World Bank Group—to rebuild the Ukrainian economy and revive global growth. In the meantime, policy makers everywhere must fight the world's other development crises: the catastrophe of higher food and energy prices, the threat of stagflation, the rise in inequality and instability, climate change, and the growing overhang of debt.

David Malpass
President
World Bank Group