EXECUTIVE SUMMARY

The war in Ukraine has triggered a costly humanitarian crisis that demands a peaceful resolution. Economic damage from the conflict will contribute to a significant slowdown in global growth in 2022. A severe double-digit drop in GDP for Ukraine and a large contraction in Russia are more than likely, along with worldwide spillovers through commodity markets, trade, and financial channels. Even as the war reduces growth, it will add to inflation. Fuel and food prices have increased rapidly, with vulnerable populations—particularly in low-income countries—most affected. Elevated inflation will complicate the trade-offs central banks face between containing price pressures and safeguarding growth. Interest rates are expected to rise as central banks tighten policy, exerting pressure on emerging market and developing economies. Moreover, many countries have limited fiscal policy space to cushion the impact of the war on their economies. The invasion has contributed to economic fragmentation as a significant number of countries sever commercial ties with Russia and risks derailing the post-pandemic recovery. It also threatens the rules-based frameworks that have facilitated greater global economic integration and helped lift millions out of poverty. In addition, the conflict adds to the economic strains wrought by the pandemic. Although many parts of the world appear to be moving past the acute phase of the COVID-19 crisis, deaths remain high, especially among the unvaccinated. Moreover, recent lockdowns in key manufacturing and trade hubs in China will likely compound supply disruptions elsewhere.

Global growth is projected to slow from an estimated 6.1 percent in 2021 to 3.6 percent in 2022 and 2023. This is 0.8 and 0.2 percentage points lower for 2022 and 2023 than in the January *World Economic Outlook Update*. Beyond 2023, global growth is forecast to decline to about 3.3 percent over the medium term. Crucially, this forecast assumes that the conflict remains confined to Ukraine, further sanctions on Russia exempt the energy sector (although the impact of European countries' decisions to wean themselves off Russian energy and embargoes announced through March 31, 2022, are factored into the baseline), and the pandemic's health and economic impacts abate over the course of 2022. With a few exceptions, employment and output will typically remain below pre-pandemic trends through 2026. Scarring effects are expected to be much larger in emerging market and developing economies than in advanced economies—reflecting more limited policy support and generally slower vaccination—with output expected to remain below the pre-pandemic trend throughout the forecast horizon. Unusually high uncertainty surrounds this forecast, and downside risks to the global outlook dominate—including from a possible worsening of the war, escalation of sanctions on Russia, a sharper-than-anticipated deceleration in China as a strict zero-COVID strategy is tested by Omicron, and a renewed flare-up of the pandemic should a new, more virulent virus strain emerge. Moreover, the war in Ukraine has increased the probability of wider social tensions because of higher food and energy prices, which would further weigh on the outlook.

Inflation is expected to remain elevated for longer than in the previous forecast, driven by war-induced commodity price increases and broadening price pressures. For 2022, inflation is projected at 5.7 percent in advanced economies and 8.7 percent in emerging market and developing economies—1.8 and 2.8 percentage points higher than projected in January. Although a gradual resolution of supply-demand imbalances and a modest pickup in labor supply are expected in the baseline, easing price inflation eventually, uncertainty again surrounds the forecast. Conditions could significantly deteriorate. Worsening supply-demand imbalances—including those stemming from the war—and further increases in commodity prices could lead to persistently high inflation, rising inflation expectations, and stronger wage growth. If signs emerge that inflation will be high over the medium term, central banks will be forced to react faster than currently anticipated—raising interest rates and exposing debt vulnerabilities, particularly in emerging markets.

The war in Ukraine has exacerbated two difficult policy trade-offs: between tackling inflation and safeguarding the recovery; and between supporting the vulnerable and rebuilding fiscal buffers.

- *Tackling inflation:* Although the drivers of inflation are in many cases beyond the control of central banks (the war, sanctions, the pandemic, supply chain disruptions), price pressures are increasingly broad-based. The transmission of the war shock will vary across countries, depending on trade and financial linkages, exposure to commodity price increases, and the strength of the preexisting inflation surge. The appropriate monetary policy response will therefore differ across economies. In some places, including the United States, inflationary pressure had strengthened considerably and become more broad-based even before the Russian invasion of Ukraine—buoyed by strong policy support. In other countries, the prominence of fuel- and war-affected commodities in local consumption baskets could lead to broader and more persistent price pressures. In both cases, tighter monetary policy will be appropriate to check the cycle of higher prices driving up wages and inflation expectations, and wages and inflation expectations driving up prices. In countries where the harmful effects from the war are larger, the trade-off between safeguarding growth and containing inflation will be more challenging. Central banks should remain vigilant to the impact of price pressures on inflation expectations and continue to communicate clearly on the outlook for inflation and monetary policy. A well-telegraphed, data-dependent approach to adjusting forward guidance on the monetary stance—including the unwinding of record-high central bank balance sheets and the path for policy rates—is the key to maintaining the credibility of policy frameworks.
- *Fiscal policy amid rising interest rates and a cost-of-living squeeze:* Fiscal policies should depend on exposure to the war, the state of the pandemic, and the strength of the recovery. Following a huge and necessary fiscal expansion in many countries during the pandemic, debt levels are at all-time highs and governments are more exposed than ever to higher interest rates. The need for consolidation should not prevent governments from prioritizing spending with well-targeted support for the vulnerable—including refugees, those struggling because of commodity price spikes, and those affected by the pandemic. Where fiscal space permits and when monetary policy is constrained at the national level—for instance by the Effective Lower Bound or in a monetary union—broader fiscal support may be warranted, depending on the severity of the decline in aggregate demand. But this support should be deployed in ways that avoid exacerbating ongoing supply-demand imbalances and price pressures. Where fiscal space is more limited, governments will need to tread a difficult path between fiscal consolidation and prioritizing essential expenditures. Moreover, authorities should be vigilant regarding private sector vulnerabilities to rising interest rates, a topic explored in Chapter 2.
- *Preparing for tomorrow's economy:* Beyond the immediate challenges of the war and the pandemic, policymakers should not lose sight of longer-term goals. Pandemic disruptions have highlighted the productivity of novel ways of working. Governments should look to harness positive structural change wherever possible, embracing the digital transformation and retooling and reskilling workers to meet its challenges. Carbon pricing and fossil fuel subsidy reform can also help with the transition to a cleaner mode of production, less exposed to fossil fuel prices—more important than ever in light of the fallout of the war on the global energy market. The green energy transition will also entail labor market reallocation across occupations and sectors. Chapter 3 examines policies that can facilitate this labor market transformation.

Multilateral efforts to respond to the humanitarian crisis, prevent further economic fragmentation, maintain global liquidity, manage debt distress, tackle climate change, and end the pandemic remain essential. The adverse consequences from the current geopolitical conflict are a reminder of the importance of global cooperation. This extends from addressing the immediate needs of war refugees to the eventual great effort to rebuild Ukraine. As countries contend with higher volatility, spending pressures from humanitarian response needs, and tighter financial market conditions, the likelihood that some countries will become financially constrained increases. Multilateral institutions offer a critical safety net, providing emergency liquidity and preventing crises from spreading. Where liquidity support alone is insufficient, progress toward orderly debt restructuring is essential. On climate, advanced economies must make real progress toward their COP26 climate summit pledges. Emerging market and developing economies must extend their ambition to reduce emissions. And as the pandemic is not yet over, governments must use all tools at their disposal to combat the virus, both by meeting vaccination targets and by ensuring equitable access to tests and treatment.