FOREWORD

This April 2025 *World Economic Outlook* (WEO) was put together under exceptional circumstances, and I want to start by acknowledging the tremendous work of Petya Koeva Brooks, Deputy Director in the Research Department, and her team, as well as the staff of over 190 country teams within the IMF who worked tirelessly with us to revise their country projections until the very last minute. The April 2 Rose Garden announcement forced us to jettison our projections—nearly finalized at that point—and compress a production cycle that usually takes more than two months into less than 10 days.

Shortly after the January 2025 WEO *Update*, the United States announced multiple waves of tariffs on major trading partners and critical sectors, culminating on April 2 with a set of nearly universal tariffs. While many of the scheduled tariff increases are on hold for now, the combination of measures and countermeasures has hiked US and global tariff rates to centennial highs. However, the context for such increases is very different. Unlike in the previous century, the global economy is now characterized by a high degree of economic and financial integration, with supply chains and financial flows crisscrossing the world, whose potential unwinding could constitute a major source of economic upheaval.

For this reason, we expect that the sharp increase on April 2 in both tariffs and uncertainty will lead to a significant slowdown in global growth in the near term. While this is our central scenario—or "reference forecast"—many possible paths exist, reflecting the unpredictability surrounding future trade policy and the varied impact of tariffs across different countries through a diverse set of channels. These are discussed in detail in Chapter 1.

The common denominator, however, is that tariffs are a negative supply shock for the economy imposing them, as resources are reallocated toward the production of noncompetitive goods, with a resulting loss of aggregate productivity, lower activity, and higher production costs and prices. Moreover, in the medium term, by reducing competition, tariffs increase the market power of domestic producers, decrease incentives to innovate, and create multiple opportunities for rent seeking. For trading partners, tariffs constitute mostly a negative external demand shock, driving foreign customers away from their products, even if some countries could benefit from the rerouting of trade flows.

These effects are magnified in the presence of modern complex global supply chains. Most traded goods are intermediate inputs that traverse countries multiple times before their transformation into final products. Sectoral disruptions could propagate up and down the global input-output network in ways with potentially large multiplier effects, just as we saw during the pandemic. Anticipating such disruptions we have also revised down our projection for global trade growth by 1½ percentage points this year, with a slight recovery penciled in for 2026.

The uncertainty around trade policy is also a major factor depressing our outlook. Faced with increased uncertainty about access to markets—their own but also those of their suppliers and customers—many firms' initial reaction will be to pause, reduce investment, and cut purchases. Likewise, financial institutions will reevaluate their credit supply to businesses, until they can assess the latter's exposure to the new environment. The combined increased uncertainty and resulting tightening of financial conditions are a global negative demand shock and will weigh on activity. This could well dominate in the short term—as reflected in the sharp decline in oil prices.

The effect of tariffs on exchange rates is not straightforward. First, the US, as the tariffing economy, may see its currency appreciate, as happened in previous episodes. This reflects the reduced demand for foreign currency as the demand for imports declines, but also the likelihood that tariffed countries may ease their monetary policy stance to respond to the negative demand shock. However, greater policy uncertainty, lower growth prospects in the US, and an adjustment in the global demand for dollar assets—which has been orderly so far—can weigh on the dollar, as we saw in the immediate aftermath of the announcements. In the medium term, the dollar may depreciate in real terms if

tariffs translate into lower productivity in the US tradables sector, relative to its trading partners.

At this juncture, while the situation remains fluid, risks remain firmly tilted to the downside. The global economy showed surprising resilience during the severe shocks of the past four years and still bears significant scars. It is now being severely tested once again, especially in emerging market and developing economies with more limited buffers. More immediately, there is a risk that trade retaliation may further ratchet up—instead of dialing down—trade tensions, with negative consequences for global growth. Financial conditions may further tighten—perhaps abruptly—if markets react negatively to diminished growth prospects and increased uncertainty. While banks remain well capitalized overall, and market movements have been orderly so far, they may be tested in the case of a full-blown risk-off episode. The April 2025 *Global Financial Stability Report* reviews these market developments in detail. Yet herein lies also an upside: If countries deescalate from their current tariff stance, and coordinate to deliver clarity and stability on trade policy, the outlook could immediately brighten.

Our policy prescriptions call for prudence, clarity, and increased collaboration. First, on trade policy the message is clear: to bring back stability and find mutually beneficial trade arrangements. It is not clear yet what new architecture will emerge. But businesses need predictability going forward. And the global economy needs a well-functioning rules-based trading system that addresses long-standing gaps, such as the pervasive use of nontariff barriers and trade-distorting measures by some countries.

Second, monetary policy will need to remain ahead of the curve in the face of multiple challenges. Faced with tariffs and supply-chain disruptions, some countries may confront steeper trade-offs between inflation and output. Inflation expectations may become less well anchored with a new inflation shock following so close on the heels of the previous one. For these countries, forceful tightening will be needed. For others, the negative demand shock will dominate, and their economies may slump unless policy rates are lowered. In all cases, credibility of the monetary policy framework—and its cornerstone, central bank independence—will remain key.

Third, currency markets may experience strong volatility. This may be difficult to navigate, especially for emerging market economies. In line with our Integrated Policy Framework, it is important that countries let their currency adjust when the movements are driven by fundamental policy forces, as is the case now. That framework spells out the specific conditions under which it could be advisable for countries to intervene in currency markets.

Fourth, fiscal authorities face starker trade-offs on top of preexisting vulnerabilities associated with high debt, low growth, and rising financing costs. Heightened pressure on bond yields amid growing market nervousness could threaten fiscal stability. In addition, new spending pressures are further weighing on fiscal fragilities. Calls for support will increase for those at risk of severe dislocation from trade policy. Some support may be inevitable—and even desirable—but should remain narrowly targeted and incorporate automatic sunset clauses. The experience of the past four years suggests that it is easier to open the tap of fiscal support than to close it. Sunset clauses should also help frame expectations. Moreover, some countries, especially in Europe, face new and permanent increases in defense-related spending.

How should these new outlays be financed? For countries with little fiscal space, the answer is stark but simple: They have little choice but to stay within their budgetary envelope. Doing otherwise would jeopardize medium-term debt sustainability, with dire consequences. For countries with sufficient fiscal space, standard fiscal principles suggest that only the temporary part of the additional spending—for example, temporary support to help adapt to the new environment or an initial bulge in spending to rebuild defense capabilities—should be financed by debt. New permanent spending needs should be offset by spending cuts elsewhere or stronger domestic revenue mobilization. These points are further developed in the April 2025 *Fiscal Monitor*.

Fifth, we need to continue efforts to turn the tide on weak medium-term growth prospects. This means boosting total factor productivity, which can be raised by addressing existing deep-seated structural constraints that are holding back innovation, but also by exploiting technological breakthroughs. The recent progress of generative artificial intelligence offers such a promise, and countries should position themselves to harness it responsibly. This can be done by implementing policies to develop the necessary digital infrastructure and

acquire the skills necessary to benefit from the artificial intelligence transition.

In this direction, the analytical chapters of our report take a step back and explore how the nexus of labor supply and growth plays out over the medium term. They tackle interrelated themes of asynchronous aging and migration. Chapter 2—"The Rise of the Silver Economy"—focuses on the challenges from demographic headwinds for growth and public finances and shows that progress in "healthy aging"—people living not only longer, but living healthier—has been substantial. This, together with policies that help increase labor force participation and close gender gaps, can offset some of the negative effects of aging populations. Chapter 3—"Journeys and Junctions"—focuses on the spillover from migration policies in destination countries to origin, transit, and bordering economies. It highlights that emerging market and developing economies are increasingly on the receiving end of migration and refugee flows and that policies to improve the integration of migrants, minimizing skills mismatches, and alleviate pressures on local infrastructure can have large effects.

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