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Secretary-General

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Written Statement to the International Monetary Fund Committee

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The Global Economic Outlook

1. **The world is paying a heavy price for Russia's unprovoked, unjustifiable and illegal war of aggression against Ukraine.** After global activity bounced back strongly from the COVID-19 pandemic, a return to a more normal economic situation appeared to be in prospect in early 2022. Instead, the effects of the war, coupled with the continuing impacts of COVID-19 outbreaks in parts of the world, have dented growth and put additional upward pressure on prices, particularly for energy and food, at a time when the cost of living was already rising rapidly around the world.

2. **Given the large and prolonged overshooting of inflation targets over the past year, monetary policy has been tightened substantially in many economies.** In addition, the erosion of real disposable household incomes, low consumer confidence and high prices for some energy products, especially natural gas in Europe, are negatively affecting both private consumption and business investment. Global GDP stagnated in the second quarter of 2022, and while it is likely that positive growth resumed in the third quarter, the economic outlook has darkened.

3. **According to the OECD's September 2022 Interim Economic Outlook, global growth is projected at a modest 3.0% in 2022 and an even weaker 2.2% in 2023, well below the pace foreseen prior to the war.** In 2023, real global incomes could be around USD 2.8 trillion lower than expected a year ago (a shortfall of just over 2% of GDP in Purchasing Power Parity terms).

    - For the United States, growth is projected to be 0.5% in 2023, well below potential and down from the 1.5% growth rate projected for 2022.

    - In Europe, many economies are likely to have at best weak growth in the second half of 2022 and the first quarter of 2023 before some improvement comes through in the remainder of 2023. Given the drag exerted by falling real incomes and the disruptions in energy markets, consecutive quarters of decreasing output are likely in several European economies.

    - Japan, Korea and Australia currently have somewhat stronger growth momentum than Europe and the United States. However, this momentum is projected to wane over the coming quarters, in part due to weaker external demand.

    - In China, policy measures worth up to 2% of Gross Domestic Product to strengthen infrastructure investment, and a rebound effect from COVID-related restrictions earlier this year, are expected to help growth recover to 4.7% in 2023 from an unusually weak 3.2% in 2022.

- Softer external demand is a factor in India's projected slowdown from 8.7% annual growth in the 2021-22 Financial Year to 6.9% in the 2022-23 Financial Year and 5.7% in the 2023-24 Financial Year, but this still represents rapid growth in the context of a weak global economy.

- Indonesia is expected to experience a slowdown in the second part of 2022 as higher inflation erodes the growth of private consumption, but Gross Domestic Product is projected to expand by 5.0% in 2022 and 4.8% in 2023.

- Annual growth in 2023 in Brazil, Mexico and South Africa, countries relatively exposed to the global economic cycle and demand in the advanced economies, is projected to slow to a range of 0.4-1.5%.

4. **One factor cushioning the growth slowdown but adding to inflationary pressures is the almost universal tightness of labour market conditions.** In many OECD economies, unemployment rates are at their lowest levels in the past 20 years, while the ratio of jobseekers to vacancies remains historically low. In a few economies, including the United States, a reduction in labour force participation relative to the pre-pandemic period is also contributing to current labour market tightness. Nonetheless, the pace of job growth in North America and Europe has slowed, while in some countries vacancies have begun to fall and the reduction in the unemployment rate appears to have bottomed out or even reversed.

5. **Inflation has become broad-based in many economies.** Tighter monetary policy and easing supply bottlenecks should moderate inflation pressures next year, but elevated energy prices and higher labour costs are likely to slow the pace of decline. With the global economic cycle turning, energy price inflation subsiding and monetary tightening by most of the major central banks increasingly taking effect, consumer price inflation is expected to moderate through 2023 in most major countries. Even so, annual inflation in 2023 will remain well above central banks' targets almost everywhere.

6. **Headline inflation is projected to ease from 8.2% in 2022 to 6.6% per cent in 2023 in the G20 economies, and decline in the G20 advanced economies from 6.2% this year to 4.1% in 2023.** In the United States, where inflation may have already peaked and where the tightening of monetary policy began earlier than in other large advanced economies, relatively rapid progress in bringing inflation down is expected. By contrast, with the recent spike in energy costs working its way through the economy and with monetary policy tightening having begun later than in the United States, inflation is projected to remain elevated in the euro area and the United Kingdom through 2023. Inflation is set to remain moderate in Japan, although at a higher rate than in recent years.

7. **The inflation outlook in major emerging-market economies varies widely.** China continues to have relatively low and stable inflation, despite the upward pressures coming from food and energy prices. Inflation in India and Indonesia is currently above the objective of their respective central banks, but monetary policy tightening and weaker global demand are projected to help bring inflation close to target by late 2023. In the largest Latin American economies, Brazil and Mexico, central banks have raised interest rates sharply already, which – combined with an easing of energy price inflation – is expected to bring inflation down substantially in 2023.

8. **The OECD's growth and inflation projections are surrounded by great uncertainty and sensitive to a number of key assumptions, including the absence of further waves of COVID-19 infections, no escalation or broadening of Russia's war of aggression against Ukraine, and the gradual dissipation of energy market pressures in Europe.** In particular, there are substantial downside risks in energy markets that could make the costs of the war for the global economy even higher than in the OECD's baseline projections.

9. **A key risk is that the impact of the reductions in energy supplies from Russia to the European Union proves to be greater than assumed.** Gas shortages in Europe over the winter months would push up energy costs, hit confidence and lead to temporary shutdowns in some sectors. Such shocks could reduce growth in Europe by a further 1.3 percentage points in 2023, with global growth lowered by 0.4 percentage points, and raise inflation in OECD-Europe by 1.4 percentage points.

10. **A related risk is that the forthcoming EU sanctions against Russian seaborne oil exports prove more disruptive than anticipated.** If the result is the withdrawal from global markets of these flows (close to 2% of global supply), international prices for some products could rise sharply. The recent OPEC+ decision to cut oil production by 2 million barrels a day (also equivalent to around 2% of global supply), together with the forthcoming EU ban on the provision of maritime insurance for Russian oil shipments to non-EU destinations, increases the chances of such disruptions. Shortages of types of fuels hitherto supplied by Russia could emerge, including diesel in some parts of Europe. An additional 20% rise in oil prices for one year, with a spike at the start of 2023 that then fades, could add a further 0.6 percentage point to global consumer price inflation in 2023 and reduce global growth by 0.1-0.2 percentage points.

11. **Another key risk to the outlook relates to the evolution of food prices.** The initial spike in the prices of key agricultural commodities like wheat and corn following Russia's large-scale invasion of Ukraine was unwound by July, but those prices have risen again subsequently, in part owing to fears about renewed blockages to grain exports, and the effects of the war and a succession of extreme weather events have left markets for some foodstuffs vulnerable to further shocks. The sharp rise in fertiliser prices this year may have a negative impact on harvests next year, hurting food security, especially in emerging-market and developing countries. With extreme weather events becoming increasingly frequent and severe owing to climate change, and droughts in Europe and China, there is a clear risk of further spikes in food prices that would place additional upward pressure on inflation and increase poverty and hunger.

12. **The difficulties being experienced by China's property sector also remain a significant global concern.** China faces significant challenges in dealing with its ongoing real estate downturn amidst elevated levels of corporate debt. If successful, solid economic growth can resume, as projected in the second half of 2022 and into 2023. However, risks remain of a sustained downturn driven by significantly weaker private domestic demand. This would be associated with much slower global growth than in our baseline projections.

Policy Requirements

13. **Elevated uncertainty, slowing growth, acute inflationary pressures and disruption in energy markets leave policymakers facing difficult choices.** The challenge is to bring down inflation, cushion households and firms from the worst effects of high energy prices and avoid a severe recession, while maintaining efforts to mitigate climate change and achieve other longer-term goals including enhancing productivity, reducing inequalities of opportunity and strengthening resilience.

14. **While most major central banks have raised interest rates in recent months, further policy rate increases are generally needed to durably reduce inflation pressures.** This is likely to involve a period of below-trend growth to help lower resource pressures. The OECD sees policy rates rising to 4.5-4.75% in the United States and Canada and 4.25% in the United Kingdom in 2023, reflecting the marked labour market pressures in these countries. The environment is especially challenging for the European Central Bank, as the impact of Russia's war of aggression against Ukraine on growth is most severe in Europe, while at the same time inflationary pressures continue to build and spread to a wider range of goods and services. The European Central Bank's main refinancing rate is projected to rise to 4% in 2023, with use being made of all margins of flexibility when reinvesting the proceeds of maturing bonds held by the European Central Bank to limit financial fragmentation in the euro area. In Japan, where underlying price pressures remain mild, the Bank of Japan is projected to maintain its current policy stance focused on yield curve control, with policy rates remaining unchanged.

15. **The calibration of monetary policy tightening is particularly challenging given uncertainty about the economic outlook, the balance of the different channels through which higher interest rates impact the economy, and the potential spillovers from tightening in other countries.** In many economies it is two decades or more since a sustained policy tightening last occurred. With tightening being unusually synchronised around the world, careful monitoring will be required to guard against the risk that policy rates could be tightened more than necessary to bring down inflation.

16. **Fiscal measures are being used in many countries, especially in Europe, to cushion the immediate impact of higher food and energy costs for households and businesses.** While there is a valid case for such temporary measures, the need to extend support should be balanced against the priorities of limiting further demand stimulus at a time of high inflation, ensuring debt sustainability and reducing energy consumption. Windfall taxes on the exceptional profits of some energy producers and suppliers, or similar measures such as the proposed EU-level cap on the prices paid to lower-cost electricity producers (renewables and nuclear), could limit the budgetary cost. Credible fiscal frameworks would help provide clear guidance about the medium-term trajectory of public finances and mitigate concerns about debt sustainability.

17. **Fiscal policy action to help cushion the impact of higher energy prices should ideally be targeted on the most vulnerable, not outlast the period of exceptional price pressures and preserve incentives to reduce energy consumption.** This generally militates in favour of means-tested transfers to households while high prices persist. However, given that such transfers are more administratively complex, often take longer to put in place and may miss out some of those hardest-hit by high energy prices, countries are increasingly tending to introduce broad-based but more costly price caps for consumers and businesses. Careful design of these different policies is necessary to ensure that consumers and businesses clearly face a higher relative price of energy, and to avoid preserving energy-intensive activities that are not sustainable in the medium-term. Governments also need to consider the risk that the energy crisis could continue for several years.

18. **For European countries, a number of policy responses are needed to counter the risk of squeezed energy supply and higher prices over the coming winter.** Additional gas supplies, diversification of energy sources and sizeable demand-reduction measures are required. There is an urgent need to coordinate among EU members on supply diversification and the reduction in energy consumption, improve gas and electricity interconnections and reinforce intra-EU solidarity to prevent energy hardship this winter in the countries most affected by the disruption of energy imports from Russia.

19. **More broadly, closer international co-operation is needed for both near-term energy security and an effective approach to climate change.** Greater cross-border co-operation on climate policies would help mitigate leakage, lower the cost of emission reductions and improve worldwide access to low emission technologies. In that context, building on the success of our Inclusive Framework on Base Erosion and Profit Shifting, the OECD has launched an Inclusive Forum on Carbon Mitigation Approaches to enhance the effectiveness of combined actions on climate issues. This multilateral approach will help to improve data and information sharing about the comparative effectiveness of different carbon mitigation approaches. Work will begin shortly with Module One (on inventory and the mapping of mitigation policies) and Module Two (on the estimation of impacts on emissions).