GROUP OF TWENTY

G-20 REPORT ON STRONG, SUSTAINABLE, BALANCED, AND INCLUSIVE GROWTH

2023

Prepared by Staff of the

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*Does not necessarily reflect the views of the IMF Executive Board

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EXECUTIVE SUMMARY

Global growth momentum is slowing amid widening growth divergences across regions. Despite an upside surprise relative to the April WEO projections in the first half of 2023, global growth remains modest due to a combination of cyclical—including tighter macroeconomic policy, withdrawal of fiscal support, and high debt—and non-cyclical factors, such as the war in *Ukraine* and increasing geoeconomic fragmentation. At the same time, global headline inflation has eased owing to tighter monetary policy and declining commodity prices. However, core inflation is proving more persistent, staying above target in most economies, and headline inflation is not expected to return to target until at least 2025 in most cases. Such persistence raises the prospect of higher-for-longer rates. The cost-of-living crisis has receded on the back of moderating food and energy prices but remains pressing in the poorest economies. Amid rising debt servicing costs and the strong dollar, debt vulnerabilities are mounting in some emerging market economies.

Near-term risks are more balanced than they were but remain skewed to the downside. The likelihood of a hard landing moderated following the resolution of the *US* debt ceiling standoff in early June and receding banking sector risks earlier this year. But the balance of risks remains tilted to the downside. Further adverse inflation shocks could trigger more restrictive monetary policies, weighing on economic activity and leading to disruptive repricing in financial markets and tighter global financial conditions, which could eventually trigger sovereign debt distress in a wider group of economies. *China*'s growth momentum could weaken further should the property sector crisis deepen, with negative cross-border spillovers. Climate and geopolitical shocks could cause additional food and energy price spikes. Broader geoeconomic fragmentation risks greater distortions and policy uncertainty. On the upside, inflation could fall faster than expected and domestic demand could prove more resilient, while labor markets could ease through fewer vacancies rather than more unemployment.

G-20 policymakers should remain focused on achieving inflation goals, while striving to restore growth prospects. The growth path has become more divergent across countries. The stance of monetary policy should reflect a country-specific pace of economic recovery and disinflationary processes. More ambitious fiscal consolidation efforts are needed in some economies, while financial stability must be safeguarded. Such policies would help improve the effectiveness of monetary policy by ensuring financial stability and debt sustainability, providing fiscal room for investments and reforms to support growth.

Multilateral efforts by G-20 policymakers are required to solve global challenges. The main medium-term risks threatening the global economy—supporting vulnerable economies, resisting further geoeconomic fragmentation, fighting climate change—are global in nature and therefore must be tackled in a collaborative manner. More efficient coordination on debt resolution, including through the G-20 Common Framework supported by the Global Sovereign Debt Roundtable, is needed. Countries should reduce trade tensions, strengthen the multilateral trading system, and address food and energy security. Net-zero carbon emissions require coordination on carbon pricing or equivalent policies.

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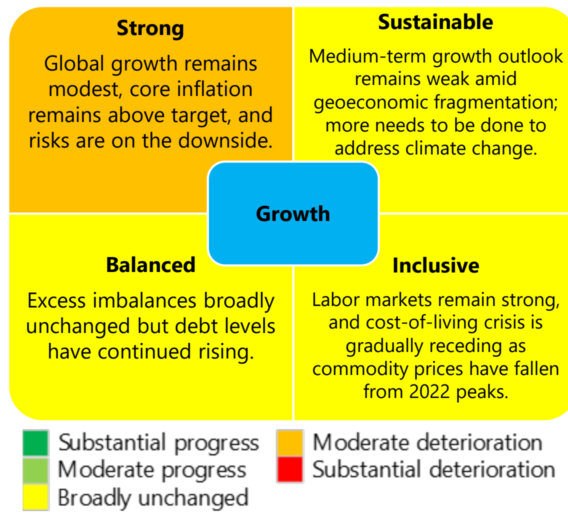
GLOBAL GROWTH IS SUBDUED

Despite signs of resilience in the first half of 2023 and easing headline inflation, it is too early to celebrate. The recovery is being held back by the legacies of past shocks and by more cyclical factors. Meanwhile, core inflation in most G-20 economies remains above central banks' targets and the balance of risks to growth remains tilted to the downside.

1. **Since 2022, there have been slippages with limited progress by the G-20 economies towards strong, sustainable, balanced, and inclusive growth (Figure 1).** The global recovery from the COVID-19 pandemic and *Russia*'s invasion of *Ukraine* remains slow and uneven. Economic activity still falls short of its pre-pandemic path, held back in part by synchronous monetary policy tightening to tame inflation. The result is widening divergences between regions. Notwithstanding recent volatility in oil prices, the stabilization of global commodity prices had brought headline inflation back to early-2021 levels in most countries—helping to alleviate the cost-of-living crisis. However, core inflation has proved more persistent, particularly in the services sector where consumer demand is strong. Despite further widening in global imbalances for the third consecutive year in 2022, excess imbalances are unchanged since 2021, while debt vulnerabilities are expected to grow amid higher-for-longer rates. Given headwinds, global growth forecasts over the medium term are at their lowest in decades, and prospects for countries to catch up to higher living standards are weak. At the same time, geoeconomic fragmentation risks have begun to materialize with cross-border capital flows realigning and investment slowing.

Figure 1. Progress Toward Strong, Sustainable, Balanced, And Inclusive Growth



Source: IMF staff estimates.
Note: The assessment is relative to IMF, 2022, G-20 Report on Strong, Sustainable, Balanced, and Inclusive Growth.

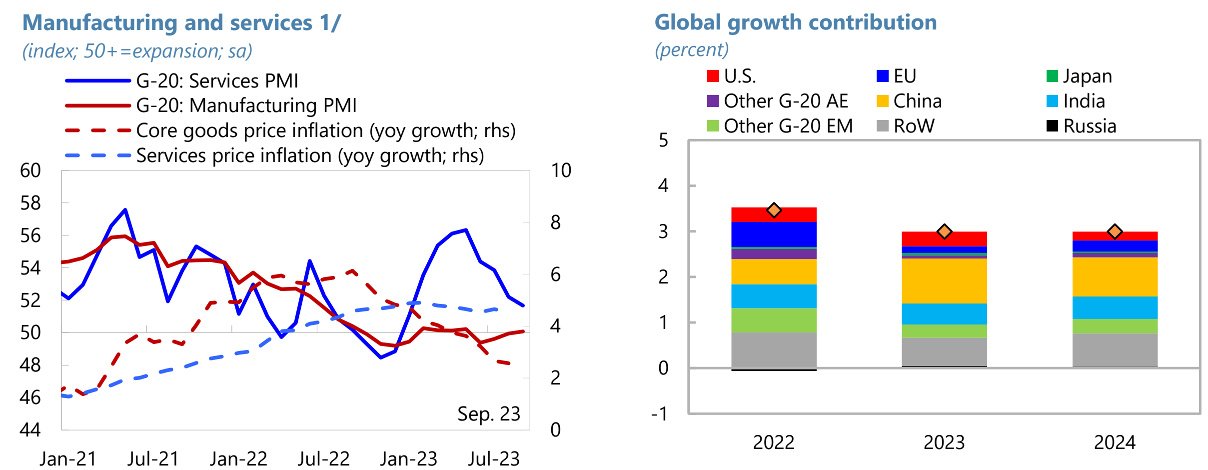
A. A Modest Growth Outlook, Sticky Inflation, and Financial Vulnerabilities are Testing Policy Trade-offs

2. **The resilient start to 2023 appears to be fading.** The near-term outlook is marginally stronger than previously forecast—a 0.2 percentage point upgrade for 2023 from the April WEO projections—, with services holding up in the first half of 2023 (Figure 2, left panel). But, while supply chains disrupted by the pandemic have largely recovered, the manufacturing sector has shown weakness given weak productivity growth, the unwinding of crisis support measures, and challenging financial conditions. Moreover, the post-pandemic rotation of demand toward services as well as heightened uncertainties regarding the future geoeconomic landscape has led to muted investment and international trade. There are signs that the boost from *China*'s reopening was short-lived and momentum has decelerated, including from the real estate sector downturn. High-frequency

indicators through the third quarter highlight heterogeneity, with growth momentum in the *United States* contrasting with weakening activity in the *euro area* and *China*.

3. As a result, the growth outlook remains modest for most countries with growing divergences. Global growth is projected to slow to 3.0 percent in 2023 and 2.9 percent in 2024 (from 3.5 percent in 2022) (Table 1).[1] The outlook largely reflects a fading post-pandemic recovery, *Russia*'s invasion of *Ukraine*, and tighter monetary policy and financial conditions. Beneath the headline figures, there are also widening divergences between regions. The slowdown is particularly pronounced in the *European Union* where growth is projected to decline from 3.6 percent in 2022 to 0.7 percent this year (Figure 2, right panel). Most G-20 emerging market economies other than *Brazil, China,* and *Russia* are also expected to experience a slowdown this year. While economic activity in the *United States* is estimated to exceed its pre-recovery path in 2023, other economies have recovered less strongly—with output still significantly below pre-pandemic projections.

Figure 2. Economic Activity



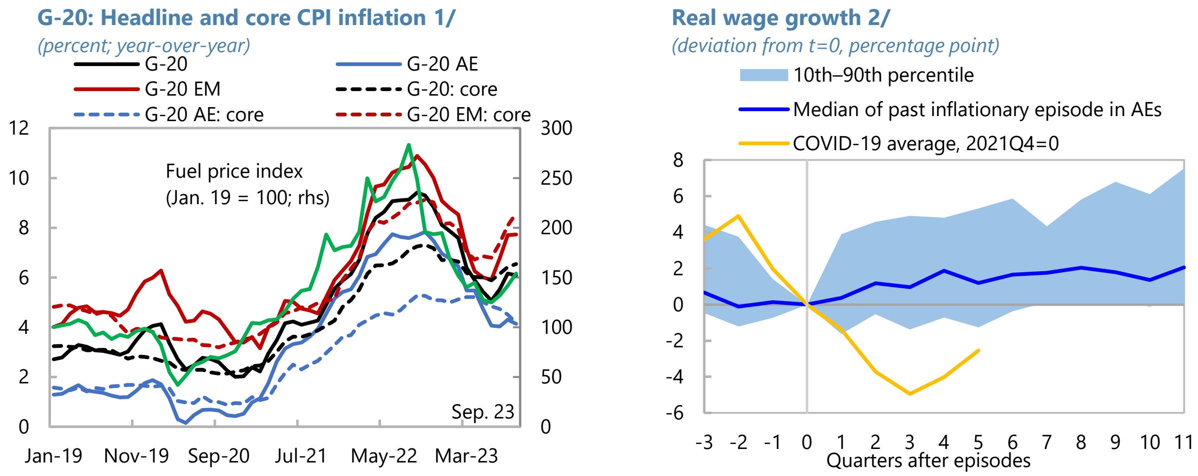
Sources: Haver Analytics; IMF, *World Economic Outlook;* S&P Global; and IMF staff calculations.
1/ For manufacturing PMI, ARG, SAU and ZAF are excluded due to data limitations. For services PMI, CAN, IDN, KOR, MEX, TUR, ARG, SAU and ZAF are excluded due to data limitations. Core goods and services price inflation based on 22 economies accounting for 70.8 percent of global GDP (PPP-weighted), including USA, EA, GBR, JPN, KOR, TWN, CAN, AUS, SWE, NOR, CZE, CHN, MYS, BRA, MEX, COL, CHL, RUS, ZAF, TUR, HUN, and POL; for China consumer goods inflation is used due to data limitations.

4. Headline inflation has moderated but core inflation remains above target for most G-20 economies. As energy prices moderated, year-on-year headline inflation has declined rapidly in most G-20 economies, e.g., to under 4 percent in the *United States* and below 4.5 percent in the *euro area* (Figure 3, left panel). Recent energy price volatility has halted some of this decline, particularly in emerging market economies. Core inflation declined more slowly, remaining above central banks' targets. Stickier core inflation partly reflects ongoing pass-through of past price shocks to headline inflation into core inflation and strong economic activity in the services sector with high corporate profits. Elevated core inflation may persist due to tight labor markets in many G-20 economies, with unemployment rates below pre-pandemic levels. With real wages well below pre-pandemic levels in many G-20 advanced economies (Figure 3, right panel), there may be scope for real incomes to recover where labor markets are tight. If this were to occur, it would place upward pressure on inflation unless

[1] IMF, 2023, World Economic Outlook, Chapter 1, October.

margins compress. However, to date, wage-price spirals do not appear to have taken hold in the average advanced economy, and longer-term inflation expectations remain anchored.[2]

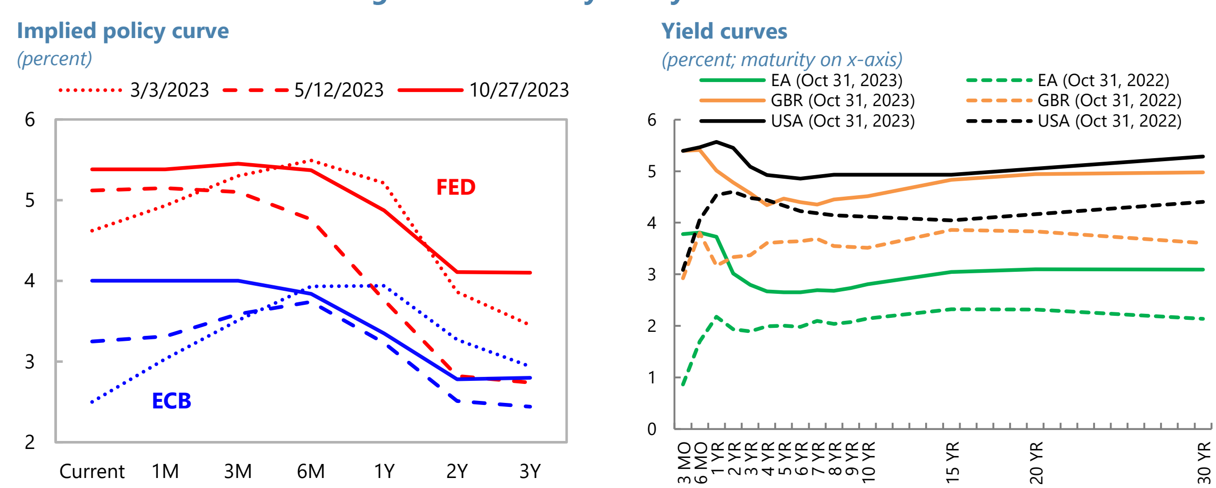
Figure 3. Inflation And Wage Dynamics



Sources: Haver Analytics; IMF, *Primary Commodity Price System;* IMF, *World Economic Outlook;* OECD; and IMF staff calculations.
1/ G-20 EM core CPI inflation excludes SAU.
2/ Percentile range shows episodes in which at least three of the preceding four quarters have (a) accelerating prices/rising price inflation, (b) positive nominal wage growth, (c) falling or constant real wages, and (d) a declining or flat unemployment rate. Twenty-three such episodes are identified within a sample of 30 advanced economies, the earliest going back to 1960.

5. **There are signs that tighter monetary policy is slowing activity.** Uncertainty surrounding inflation prospects has amplified volatility of market expectations for the policy rate path in both *euro area* and *United States* (Figure 4, left panel). However, with inflation expected to remain above target until 2025 in most cases, many G-20 central banks have continued to tighten monetary policy, and rates are likely to remain elevated for some time (Figure 4, right panel). Although full transmission of

Figure 4. Monetary Policy Interest Rates

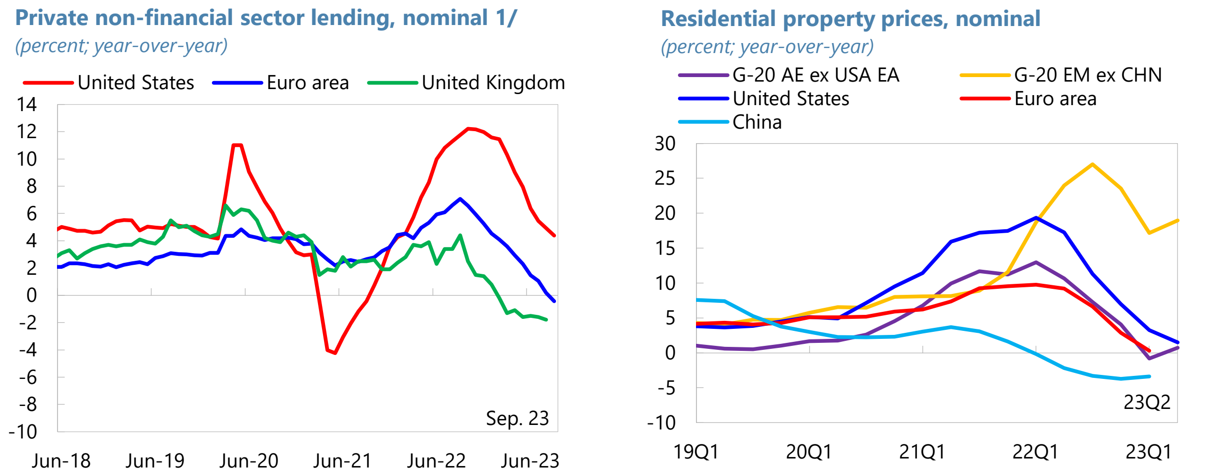


Sources: Bloomberg Finance, L.P.; Haver Analytics; and IMF staff calculations.
Note: Market-implied policy rate paths are futures on the US federal funds mid target rate and the ECB deposit facility rate. The European Central Bank conducts monetary policy for the euro area as a whole, incl. for DEU, ESP, FRA, and ITA.
On the right chart, dotted lines denote one year ago.

[2] Alvarez and others, 2022, "Wage-Price Spirals: What is the Historical Evidence?", IMF Working Paper No.2022/221.

tightening takes time, bank credit growth has slowed (Figure 5, left panel) and some housing markets are cooling (Figure 5, right panel). Looking forward, the loan officer surveys in some advanced economies point to significantly slower demand for credit and tightening lending standards (*euro area, United Kingdom,* and *United States*).[3] The rapid tightening of monetary policy also resulted in temporary market turbulence in some advanced economies (e.g., *Switzerland, United States*). Swift action by the authorities contained turmoil, but financial sector vulnerabilities remain in many G-20 economies with elevated exposures to credit, liquidity, and interest rate risks, including via residential and commercial real estate sectors.

Figure 5. Financial And Property Sector Developments



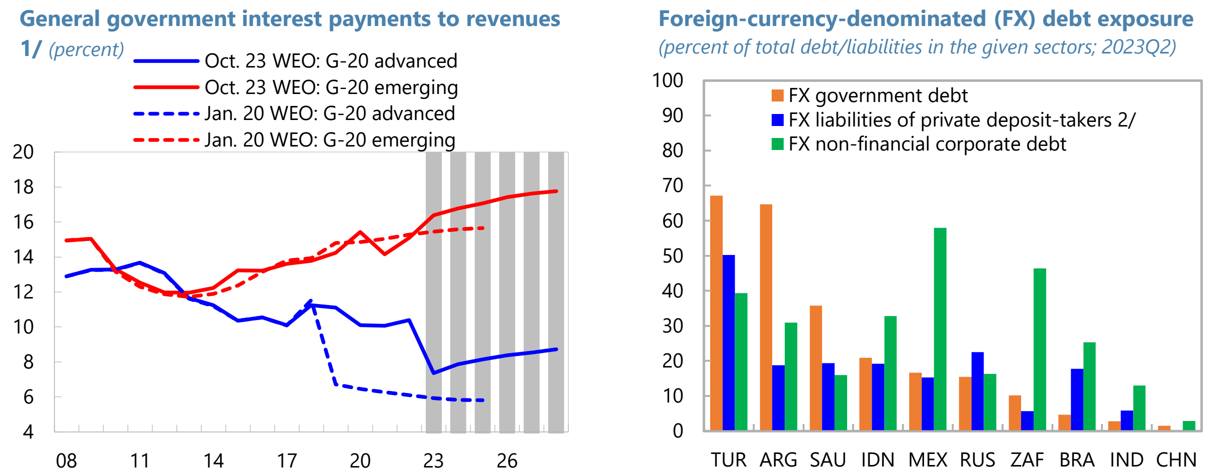
Sources: Bank of International Settlements; Haver Analytics; and IMF staff calculations.
Note: G-20 advanced ex USA and AE: AUS, CAN, GBR, JPN, and KOR; G-20 emerging ex CHN: ARG, BRA, IDN, IND, MEX, RUS, SAU, TUR, and ZAF.
1/ U.S.: loans and leases in bank credit, all commercial banks; EA: MFI loans to private sector; UK: M4 lending excl. intermediate OFCs.

6. Emerging market economies have so far weathered tighter global financial conditions, but debt vulnerabilities are expected to grow amid higher-for-longer rates and the strong *US* dollar. Debt servicing costs are likely to rise sharply (Figure 6, left panel). At the same time, some G-20 emerging market economies rely substantially on foreign currency denominated borrowing (Figure 6, right panel) heightening vulnerabilities to currency movements. While the *US* dollar has depreciated broadly since the last SSBIG report, currency movements have become more differentiated. Some (e.g., *Argentina*, *Türkiye*) have depreciated–supporting competitiveness, but potentially exacerbating external debt vulnerabilities–while lower-than-expected *US*. CPI inflation outturns and policy rate differentials have supported an appreciation against the *US* dollar for others (e.g., *Brazil, Indonesia, Mexico*).[4]

[3] Adrian and others, 2023, "Inflation remains risk confronting Financial Markets," IMF Blog, July 27.

[4] The recent realignment of the exchange rate in *Argentina* was a part of the authorities' IMF-supported program policy package to help support reserve accumulation and safeguard stability (IMF, 2023, Press Release NO.23/290).

Figure 6. Public And Foreign Currency Debt



Sources: IIF; IMF, *Financial Soundness Indicators;* IMF, *World Economic Outlook,* October 2023 update and January 2020 update; and IMF staff calculations.
Note: G-20 advanced: AUS, CAN, DEU, ESP, FRA, GBR, ITA, JPN, KOR, and USA. G-20 emerging: ARG, BRA, CHN, IDN, IND, MEX, RUS, SAU, TUR, and ZAF.
1/ Grey area denotes projections from 2023.
2/ IND data as of 2023Q1. ZAF data as of 2022Q3. ARG, BRA, RUS, and SAU data as of 2021Q3. MEX data as of 2021Q1. No data availability for CHN.

7. **The energy and food crisis has become less acute, although food prices remain elevated.** After increasing to record highs following supply disruptions caused by COVID-19, *Russia*'s invasion of *Ukraine*, and bouts of extreme weather, food and energy prices have dropped substantially this year. However, they remain elevated, endangering welfare for the world's most vulnerable populations and economies and the potential for further volatility implies sustained macroeconomic risks.[5] For instance, the World Food Program estimates that about 345 million people will be food insecure in 2023—almost 200 million more than in early 2020. High energy prices, particularly natural gas, have contributed to higher food prices and have driven an increased reliance on higher-emission fuels, such as coal, setting back the green transition. To support their vulnerable populations, most governments, including almost half of the G-20, have also extended extraordinary support measures, with potentially adverse implications for fiscal sustainability and the green transition. Moreover, some commodity-exporting G-20 countries have instituted food and fertilizer export restrictions, adding to trade distortions from increasing geoeconomic fragmentation. While some of these have been reversed as commodity prices have come down, export restrictions remain in place for about 7 percent of annual traded calories as of June 2023, including in several G-20 economies (e.g., *Argentina, Russia, Türkiye, China, India*).[6,7]

[5] G-20 Frame Working Group, 2023, "G-20 Report on Macroeconomic Impacts of Food and Energy Insecurity and their Implications for the Global Economy."

[6] IMF, 2023, "G-20 Background Note on the Macroeconomic Impact of Food and Energy Insecurity."

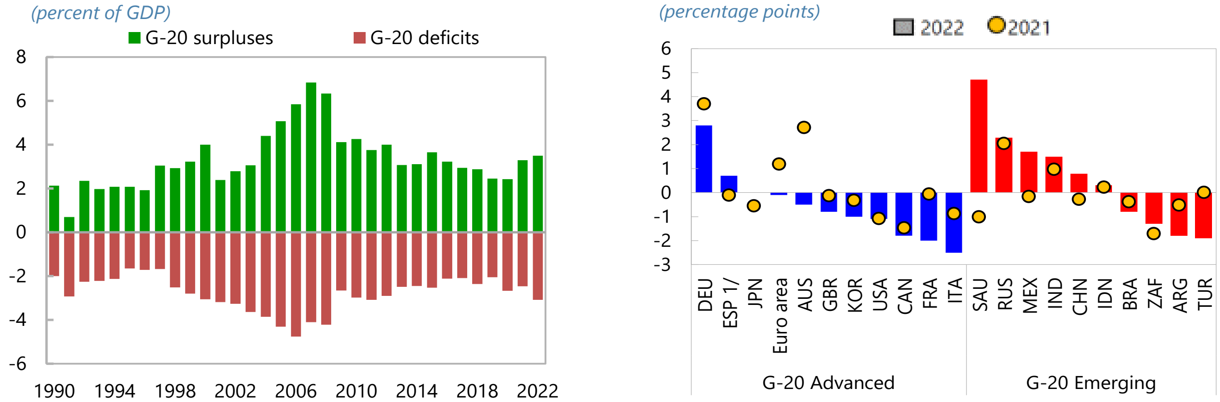
[7] IFPRI Food Security Portal.

8. **Despite further widening in global imbalances for the third consecutive year, *excess* imbalances are unchanged since 2021.**[8] Current account balances among G-20 economies increased in 2022 on the back of the spike in commodity prices triggered by *Russia*'s invasion of *Ukraine* and the uneven recovery from the pandemic across countries (Figure 7, left panel). Wider global current account balances are not necessarily a negative development, but *excess* balances, beyond what can be accounted for by fundamentals, can fuel trade tensions and protectionist measures or increase the risk of disruptive currency and capital flow movements. In its latest assessment of economies' external positions and the appropriateness of current account balances, the IMF reports that excess global current account balances have remained unchanged in 2022 at 0.9 percent of GDP, after being on a declining trend for several years. Among G-20 economies, *Saudi Arabia* and *Germany* recorded the largest excess surpluses among G-20 economies partly on weaker-than-required public investment to achieve domestic climate and structural reform goals (*Germany*) and significant oil price movements (*Saudi Arabia*), while *France, Italy*, and *Türkiye* recorded the largest excess current account deficits with significant increases since 2021, reflecting competitiveness challenges (Figure 7, right panel).

Figure 7. External Developments

G-20: Current account balance
(percent of GDP)

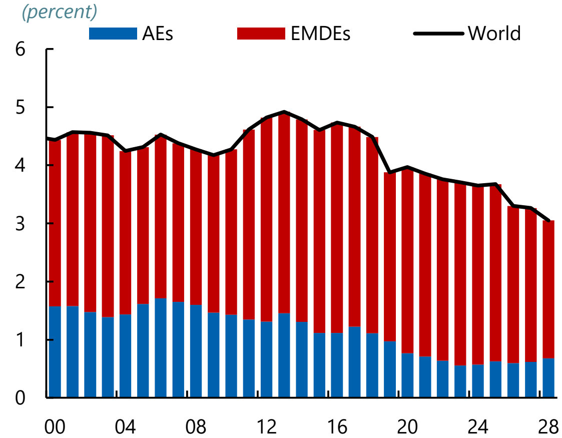
Current account gap
(percentage points)



Source: IMF, External Sector Report, 2023 and 2022; IMF, *World Economic Outlook*; and IMF staff calculations.
Note: G-20 surpluses and defects are the sum of the current account balances among G-20 economies with current account surpluses and deficits, respectively. Current account gaps are relative to IMF staff assessed current account norms.
1/ ESP: permanent invitee.

Figure 8. Medium-Term Global Growth

Five-year-ahead growth projections
(percent)



Sources: IMF, *World Economic Outlook;* and IMF staff calculations.
Note: The predicted variable is real GDP growth. The years on the horizonal axis refer to the forecasted year using the Spring vintage such that the 2028 forecast is based on the Spring 2023 vintage, and so on.

[8] IMF, 2023, External Sector Report, Chapter 1.

9. The medium-term outlook for global growth is at its lowest in decades. The IMF's five-year ahead global growth projections have steadily declined from a peak of 4.9 percent in 2013 to just 3.1 percent in 2023 (Figure 8), lowering the pace of convergence in living standards between emerging market and developing economies and advanced economies, while also posing challenges for debt sustainability and investment in the climate transition.

10. Several forces are holding back growth. In the near-term, cyclical factors are at play, including monetary policy tightening to curb persistent inflation, fiscal consolidation, and base effects from the post-pandemic recovery in 2021 and 2022. In the medium-term, slower global growth partly reflects the slowdown of rapidly growing emerging market economies like *China*, scarring from the pandemic, weak productivity growth, a slower pace of structural reforms, and the rising threat of geoeconomic fragmentation, while demographic challenges from aging are expected to contribute to a slowdown in labor force participation in advanced economies.

11. Prudent domestic policies can help reinvigorate the medium term. Domestically, policymakers must restore macroeconomic stability by bringing inflation back to target and rebuild fiscal room for maneuver. Reforms that increase labor market flexibility—encouraging participation and reducing frictions—would support fiscal consolidation and soften inflationary pressures. In the medium-term, policymakers should focus on restoring debt sustainability and implementing targeted and carefully sequenced domestic reforms on the supply side. A push on clean energy investment will also be needed to deliver on climate commitments.

12. Increased multilateral cooperation is needed to help address global challenges and prevent further fragmentation. These include improving coordination on debt resolution, including through the G-20 Common Framework, supported by the Global Sovereign Debt Roundtable; eliminating trade restrictions (particularly on critical minerals, energy, fertilizers, and food); and enhancing cooperation on other global public goods such as climate, financial crisis prevention, and the regulation of emerging technologies such as artificial intelligence (AI).[9] Multilateral efforts to address data gaps, as envisaged in G-20 Data Gaps Initiative, will greatly facilitate policymaking in these areas.

B. Risks are to the Downside Amid Uncertainty over the Growth Outlook

13. Near-term risks to the outlook have become more balanced, but remain tilted to the downside.

- *Stickier-than-expected inflation could stem from multiple sources.* Tight labor markets and a rapid increase in wage demands to compensate for past cost-of-living increases could push up inflation and risk de-anchoring longer-term inflation expectations in some economies, partly due to the institutional setup of wage setting. The war in *Ukraine* and the conflict in *Israel* and *Gaza* could intensify, further raising food and fuel prices. Recent increases in commodity prices could persist resulting in a renewed cost-of-living crisis that would particularly hit the most vulnerable.

[9] IMF, 2023, "Surveillance Note: G-20 Finance Ministers and Central Bank Governors' Meetings, Gandhinagar, India."

- *Greater-than-expected pressures on underlying inflation could lead to disruptive repricing in the financial markets and an abrupt tightening in financial conditions.* Should inflation surprise to the upside, a sharp repricing could occur, triggering a sudden rise in expectations regarding interest rates and falling asset prices and result in tighter financial conditions.

- *Tighter global financial conditions could intensify debt distress*. The global credit cycle has started to turn as debt repayment capacity diminishes. Sovereign spreads are above pre-pandemic levels in most emerging market and developing economies with around a quarter of emerging market sovereign issuers trading at distressed levels. A further increase in borrowing costs would raise debt servicing costs as well as rollover risks, and hence default risks. A stronger-than-expected *US* dollar appreciation would exacerbate adverse effects on economies with a high share of *US* dollar-denominated debts.

- *Weaker-than-expected economic activity in China could weigh on the global economy*. Recent developments in the real estate sector highlight downside risks to *China's* growth forecast, with negative potential trade spillovers to the region and beyond. A deeper-than-expected contraction in the real estate sector could result in additional losses in the financial sector and affect local governments, while also leading to tighter financial conditions.

- *Deeper geoeconomic fragmentation would raise policy uncertainty, deterring both domestic and cross-border investment*. The ongoing risk that the world economy will separate into blocs amid the war in *Ukraine* and other geopolitical tensions could intensify, driving greater restrictions on trade (in particular, related to strategic goods, such as critical minerals); cross-border movements of capital, technology; workers, and international payments. Such developments could contribute to additional volatility in commodity prices and hamper multilateral coordination on global public goods.

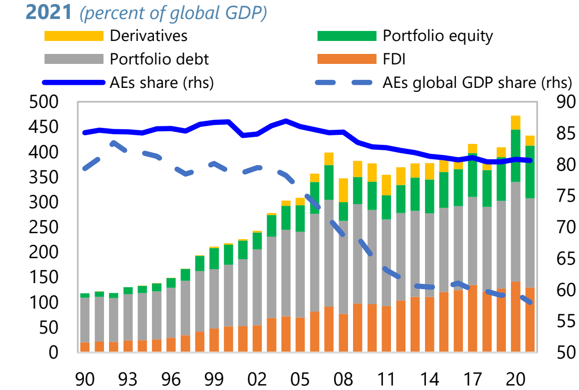
14. On the upside, *US* debt ceiling tensions and banking sector risks have receded in recent months and a faster-than-expected decline in headline inflation amid strong labor markets has raised the likelihood of favorable growth outcomes. Core inflation could fall faster than expected along with easing labor markets, which would reduce the need for monetary policy tightening and help deliver a softer landing. Recent developments in AI and progress in green technologies could rekindle productivity growth.

C. Fragmentation in a Financially Globalized World Will Be Costly with Multifaceted Impacts

15. Financial globalization—by facilitating greater cross-border capital flows—has contributed to economic development around the world. Global external financial assets and liabilities increased rapidly in the 1990s and 2000s, but momentum has slowed since the Global Financial Crisis (GFC) (Figure 9). In theory, capital flows can yield benefits for both source and recipient countries through various channels.[10] For instance, cross-border portfolio investment and debt flows can improve financial intermediation as savings are allocated efficiently from low- to high-return jurisdictions, while diversification permits better risk-sharing. Meanwhile, empirical evidence suggests that foreign direct investment (FDI) enables innovation and technology transfer, thereby boosting productivity. This channel is particularly relevant for emerging market and developing economies as they stand to benefit the most from capital formation and productivity spillovers. Moreover, capital flows may bring indirect benefits by imposing discipline on macroeconomic policies, promoting competition from foreign entrants, and enhancing public and corporate governance.[11]

Figure 9. Financial Globalization

Global external financial assets and liabilities, 1990-2021 *(percent of global GDP)*



Sources: External Wealth of Nations database; and IMF staff calculations.
Note: External financial assets and liabilities are decomposed by FDI, portfolio debt and equity investment, and derivatives, etc. AEs' share of global external financial assets and liabilities and that of global GDP is in blue solid and dashed line, respectively.

16. Macroprudential and capital flow management measures (MPM/CFMs) have been introduced to reduce inherent vulnerabilities in domestic financial systems. Despite the crucial benefits of financial globalization, it also exposes countries to certain risks, particularly in times of crisis. Capital flows can fuel the buildup of systemic vulnerabilities in the form of currency and maturity mismatches. Excessive capital flow volatility and vulnerability to sudden stops and reversals can be particularly severe in countries with weak monetary policy credibility. Greater integration into global financial markets also exposes an economy to spillovers from the global financial cycle, which can dampen monetary policy effectiveness, as policymakers lose control over domestic interest rates.[12] There is growing evidence that MPM/CFMs can be useful in certain circumstances—e.g., in the presence of financial frictions and balance sheet vulnerabilities—to help manage the risks from

[10] Committee on the Global Financial System (CGFS), 2021. "Changing Patterns of Capital Flows," CGFS Papers, Bank for International Settlements, Basel.

[11] Prasad and others, 2003, "Effects of Financial Globalization on Developing Countries: Some Empirical Evidence," IMF Occasional Paper 220.

[12] Adrian, Tobias, 2018, "Challenges for Monetary Policy from Global Financial Cycles," Remark at IMF-SNB High-level Seminar on the International Monetary System.

excessively large or volatile capital flows.[13] In particular, the GFC and its aftermath led to a series of MPM/CFMs introduced in G-20 countries such as *South Korea, India*, and *Indonesia*, which were largely assessed to be successful in improving financial sector resilience.[14] CFMs can further help enhance monetary autonomy when faced with global financial market shocks, allowing monetary policy to focus on domestic objectives.[15]

17. **Despite greater global financial integration, capital has struggled to flow "downhill", even more so as global financial conditions have tightened.** Reaping the benefits of capital inflows remains a central challenge for emerging market and developing economies in the absence of large downhill flows of capital.[16] Evidence suggests that capital has generally not flowed freely from advanced economies to emerging market and developing economies where returns on capital tend to be relatively higher. Indeed, emerging market and developing economies' share of global external financial assets and liabilities has increased only marginally from around 15 percent to 20 percent over the past three decades. This is in stark contrast to their share of world GDP that has more than doubled during the same period, highlighting an underrepresentation of emerging market and developing economies in the global financial system. Despite some reversal after the GFC, uphill capital flows from emerging market and developing economies to advanced economies reemerged in 2022. Going forward, a prolonged tightening of global financial conditions could trigger broad-based capital outflows from vulnerable emerging market and developing economies, which could also be detrimental to advanced economies if it leads to excessive leveraging and risk taking.[17] Lessons from previous episodes suggest that good macroeconomic fundamentals helped dampen disorderly market reactions to tight global financial conditions, while clear and effective communication by advanced-economy central banks is important to reduce the risk of excessive market volatility.[18]

18. **Geoeconomic fragmentation can add greater restrictions on capital flows, as they become concentrated among geopolitically aligned countries.** Recent evidence indicates fragmentation in capital flows, with geopolitical tensions impacting cross-border banking claims and portfolio allocation.[19] FDI is also becoming more responsive to geopolitical factors: both greenfield and brownfield FDI are increasingly concentrated among countries that share similar geopolitical views (Figure 10, left panel). The number of restrictive FDI policies introduced by G-20 economies has also surged recently (Figure 10, right panel), largely for national security-related investment screening mechanisms as well as sanctions imposed by/on Russia.

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[13] IMF, 2012, "The Liberalization and Management of Capital Flows: An Institutional View," Policy Paper.; IMF, 2022, "Review of The Institutional View on The Liberalization and Management of Capital Flows," Policy Paper No. 2022/008.

[14] IMF, 2017, "Increasing Resilience to Large and Volatile Capital Flows—The Role of Macroprudential Policies," Policy Paper.

[15] IMF, 2020, "Toward an Integrated Policy Framework," Policy Paper No. 2020/046.

[16] Boz and others, 2017, "Revisiting the Paradox of Capital: The Reversal of Uphill Flows," IMF Blog, March 7.

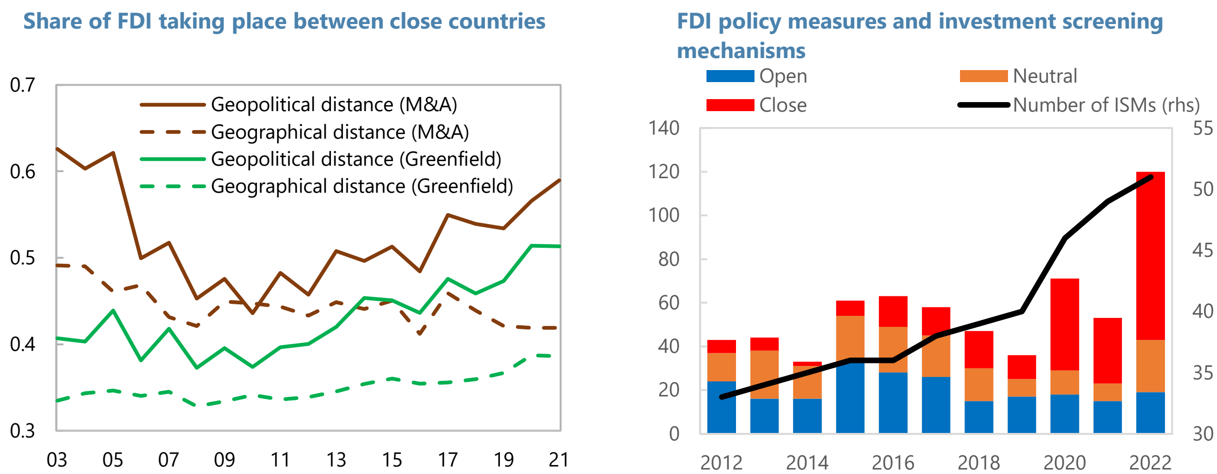
[17] IMF, 2023, External Sector Report, Chapter 1.

[18] Sahay and others, 2014, "Emerging Market Volatility: Lessons from the Taper Tantrum," IMF Staff Discussion Note 14/09.

[19] IMF, 2023, Global Financial Stability Report, Chapter 3, April.

19. The imposition of restrictions on trade and financial flows for national security reasons could have unintended consequences for global economic growth and financial stability. While the subsequent reconfiguration of supply chains might strengthen domestic security and help maintain a technological advantage, in most cases a policy-driven reversal of global financial integration will likely reduce diversification and make countries more vulnerable to macroeconomic shocks, alongside foregoing the crucial benefits of financial globalization.[20] For example, financial fragmentation could adversely affect cross-border investment, international payment systems, and asset prices, which would in turn fuel instability by raising banks' funding costs, reducing their profitability, and cutting their lending to the private sector.[21] Moreover, FDI fragmentation could substantially lower growth prospects, by impeding capital formation and technology diffusion.[22] This is of particularly concern for emerging market and developing economies, which rely heavily on FDI/capital inflows from countries which could have a strategic interest in rerouting FDI flows to trusted allies, further impeding capital from flowing downhill. Notwithstanding current geopolitical realities, multilateral efforts are the best approach to reduce such large and widespread economic costs of FDI fragmentation.

Figure 10. FDI Fragmentation



Sources: fDi Markets; Refinitiv Eikon; UNCTAD Investment Policy Monitor; PRISM dataset; and IMF staff calculations.
Note: The left chart plots the share of greenfield FDI (green) and brownfield FDI (brown) in a year taking place between country pairs that are similarly distant from the United States (i.e., countries in the same quintile of the distance distribution), separately for geopolitical (solid line) and geographical (dashed line) distance. The right chart illustrates a total number of FDI policy measures taken by G-20 and EU economies, broken down by the openness to FDI (open/neutral/close), as well as a total number of investment screening mechanisms (ISMs) by the same group of countries. Data on ISMs are from PRISM dataset (Bauerle Danzman and Meunier. 2023. "Mapping the Characteristics of Foreign Investment Screening Mechanisms: The New PRISM Dataset." *International Studies Quarterly*).

[20] Aiyar and others, 2023, "Geoeconomic Fragmentation and the Future of Multilateralism," IMF Staff Discussion Note 2023/001.

[21] IMF, 2023, Global Financial Stability Report, Chapter 3, April.

[22] IMF, 2023, World Economic Outlook, Chapter 4, April.

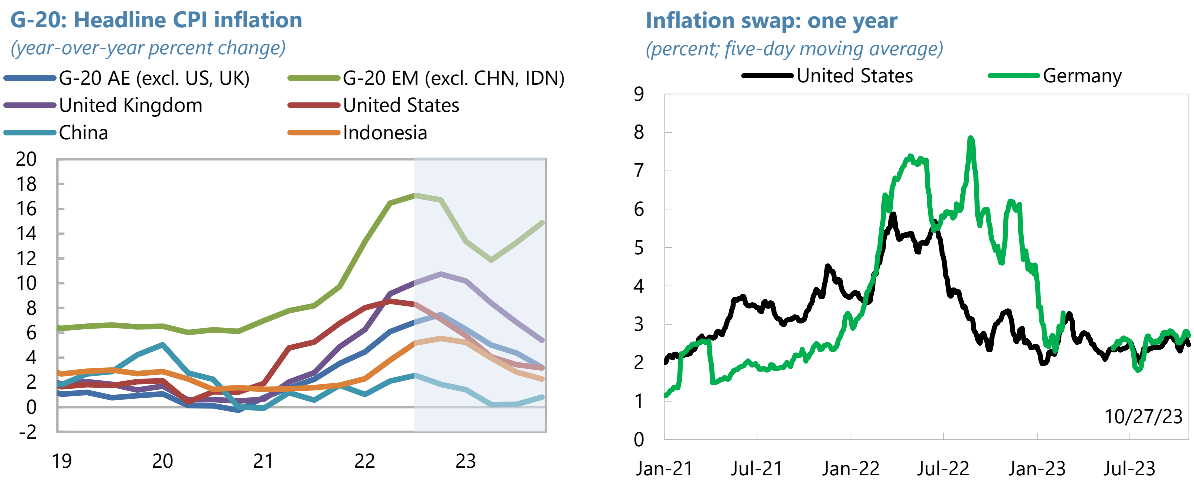
RESTORE PRICE STABILITY WHILE RAISING GROWTH PROSPECTS

A soft landing, with inflation returning to target from multidecade highs without recession and financial turmoil, is achievable. But policy challenges remain. Monetary policy needs to durably restore price stability, however, the stance of monetary policy should reflect a country specific pace of economic recovery and disinflationary pressures. Meanwhile financial sector policy must carefully monitor risks and tools to relieve potential financial stress should be used when needed. Sustained fiscal consolidation will help improve fiscal space, opening room for structural reforms to promote strong and inclusive growth.

A. Macroeconomic Policy Must Deliver Durable Disinflation while Maintaining Financial Stability and Strengthening Inclusive Growth

20. The main priority for G-20 policymakers is to steer inflation back to target without compromising financial stability. Global headline inflation is expected to fall from 8.7 percent in 2022 to 6.9 percent in 2023 and 5.8 percent in 2024 (Figure 11, left panel). But the inflation forecast for 2024 has been revised up by 0.9 percentage points since April WEO projections, as underlying (core) inflation is projected to decline more gradually, and inflation is not expected to return to target until at least 2025 in most cases. Central banks must durably anchor inflation expectations (Figure 11, right panel). Should expectations de-anchor, bringing down inflation could be even more costly—so it is critical to avoid premature easing until underlying inflation shows sustained signs of cooling.

Figure 11. Inflation Outlook

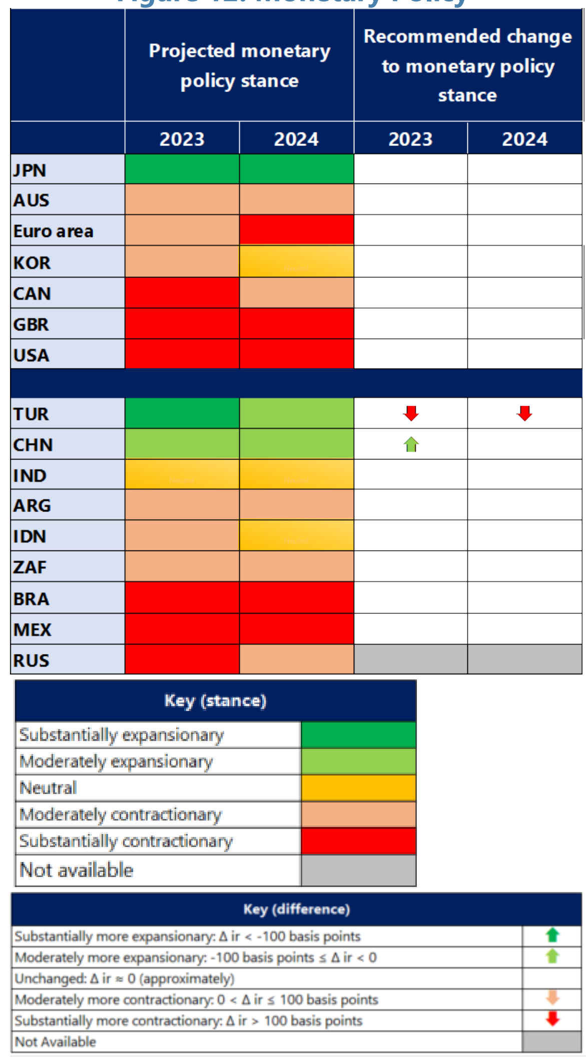


Sources: Bloomberg Finance L.P.; IMF, *World Economic Outlook;* IMF staff calculations.
Note: Projections through 2023Q4. AE: advanced economies; EM: emerging market economies.

Meanwhile, caution is warranted as the benign inflation outlook and growing expectations for a soft landing could be vulnerable to an abrupt tightening in financial conditions. Strong monetary policy frameworks and effective communications are vital. Central banks should continue to monitor the financial system and stand ready to maintain financial stability. Where progress on lowering inflation is more advanced, central banks should avoid easing policy rates prematurely.[23]

21. A well-coordinated policy mix should help to safeguard financial stability and allow monetary policy to stay its course. Credible medium-term fiscal consolidation is in many cases needed to restore fiscal buffers and ensure debt sustainability. Fiscal space is at a premium to implement much-needed structural reforms, as elevated debt levels are restricting investment, especially in emerging market and developing economies. To this end, untargeted fiscal support such as energy subsidies should be unwound as energy and food prices stabilize. However, the pace and composition of fiscal consolidation should be mindful of the need for targeted protection of the most vulnerable and the strength of private demand while supporting monetary policy and disinflation. Financial sector policies should focus on addressing financial stability risks to help central banks separate monetary policy objectives from financial stability goals.

Figure 12. Monetary Policy



Sources: IMF staff estimates and recommendations as of Sept. 25, 2023.
Note: ESP: permanent invitee. Euro area: the European Central Bank conducts monetary policy for the euro area as a whole, incl. for DEU, ESP, FRA, and ITA. RUS: policy recommendations are not available. SAU: has a fixed exchange rate.

Monetary Policy

22. Monetary policy is projected to remain appropriately tight through 2024 in most G-20 economies. The monetary policy stance in most G-20 economies tightened significantly in 2022 and policy interest rates remain elevated in 2023. Some economies that implemented additional sizable rate hikes in 2023 are expected to maintain the current tightening cycle (e.g., *Mexico, United Kingdom, United States;* Figure 12). In the *euro area*, given labor market tightness, strong nominal wage growth, and uncertainty about inflation persistence, a restrictive monetary policy stance may be needed for an extended period (with policy rates maintained close to current levels until late 2024). Other G-20 economies where inflation has come close to target are expected to gradually move to a more neutral monetary stance (e.g., *Indonesia, Korea*). In economies where price stability is not at risk, central banks are expected to maintain an accommodative monetary policy stance in 2024 (e.g., *China, Japan*).

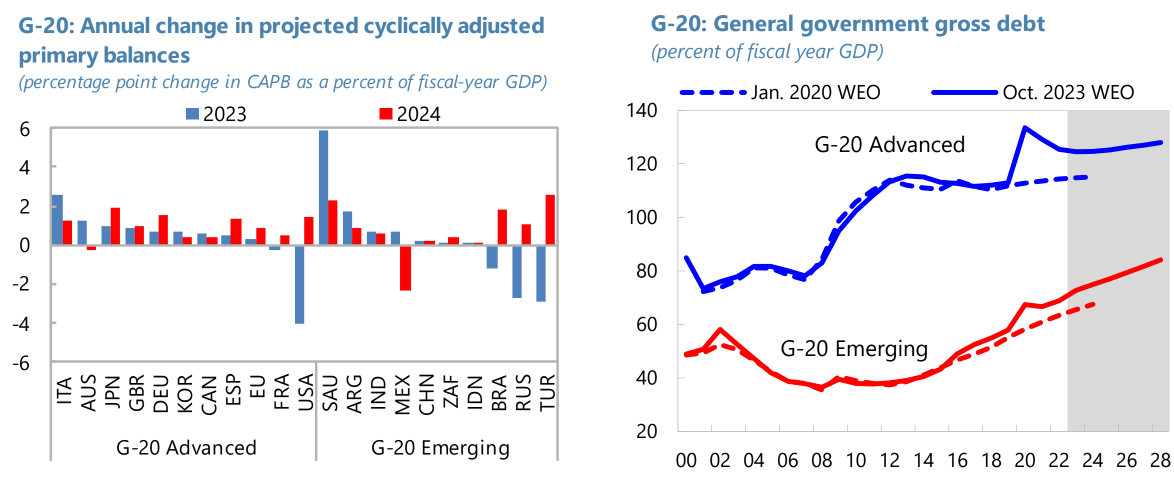
[23] IMF, 2023, Global Financial Stability Report, Chapter 1, October.

23. **Central banks need to avoid "premature easing" in some economies where inflation pressures are likely to persist—a restrictive stance is needed until there are clear signs price pressures have adequately receded.** Previous inflationary episodes indicate that easing policy too early can undo progress on inflation. In some cases, further increases in policy rates will be required to reach levels above the real neutral rate (e.g., *Türkiye*). By contrast, where inflation is well below target, a more accommodative monetary policy stance could help sustain growth (in *China*, where continued monetary support is appropriate). In economies where inflation is returning to target, a gradual and cautious move to a more neutral monetary stance is warranted. Nevertheless, central banks should proceed in a data-dependent manner and stand ready to adjust course depending on the flow of data on the evolving inflation outlook and the strength of monetary policy transmission.

Fiscal Policy

24. **While the fiscal stance is tightening in most economies, more is needed to rebuild buffers and restore debt sustainability.** As recovery support measures continue to be withdrawn, cyclically-adjusted primary balances are expected to improve this year and next in most G-20 economies (exceptions include *Mexico*, *Russia, Türkiye*, *United States*; Figure 13, left hand panel). Despite these improvements, G-20 public debt-to-GDP levels are projected to increase (Figure 13,

Figure 13. Fiscal Impulse And Public Debt

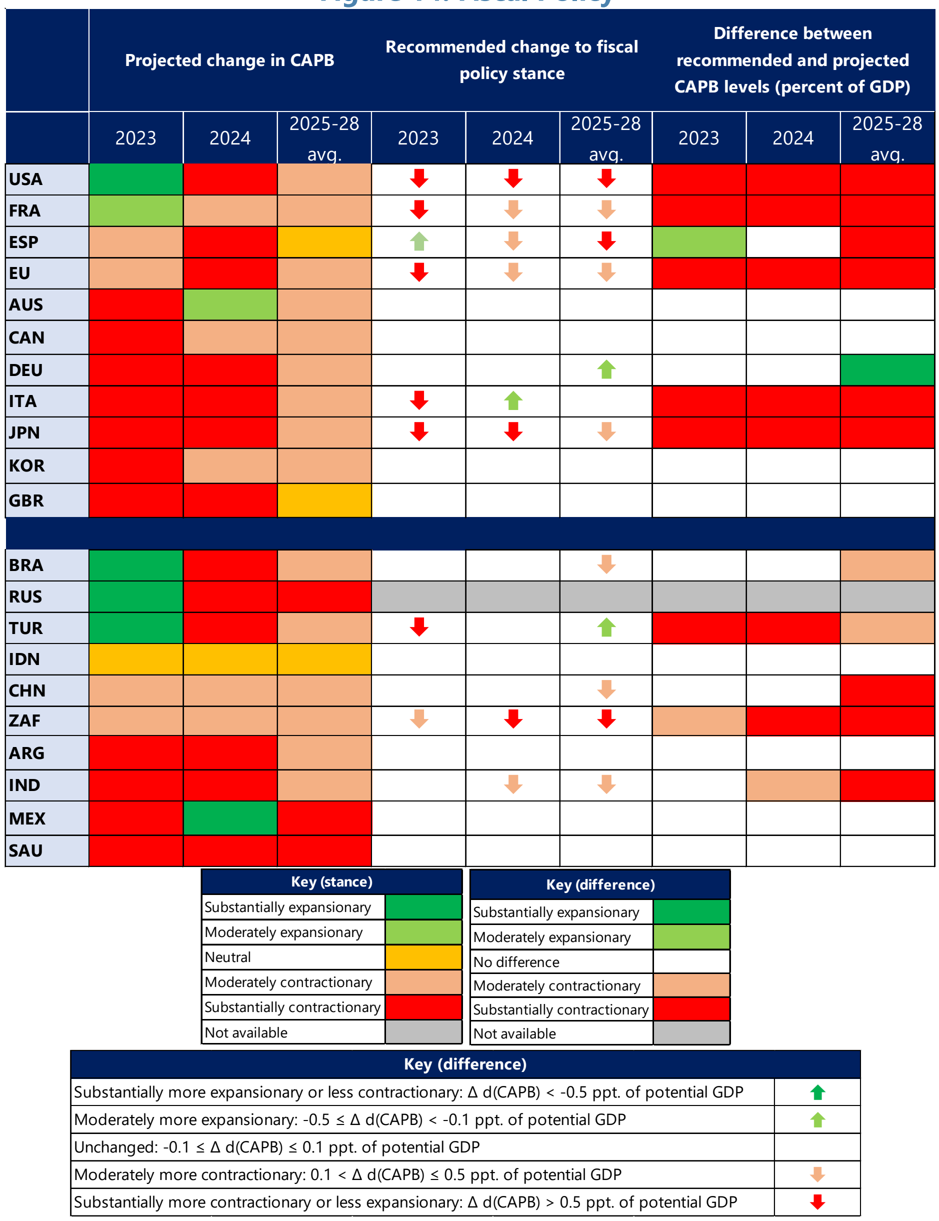


Sources: Haver Analytics; IMF, *World Economic Outlook;* and IMF staff calculations.

right hand panel). A larger-than-projected fiscal consolidation would be warranted this year in economies where public debt-to-GDP ratios need to be put on a firmly downward path (e.g., *Japan, South Africa, United States*; Figure 14). Over the medium term, more ambitious fiscal consolidation efforts are needed in some economies (e.g., *South Africa, Spain, United States*) to create fiscal space for necessary public investment, structural reforms, and targeted support for vulnerable people, while enhancing debt sustainability. Furthermore, consolidation efforts should be growth friendly—protecting growth-enhancing investments where space allows—and balance both spending cuts and revenue-raising measures to lower debt ratios.[24]

[24] IMF, 2023, World Economic Outlook, Chapter 3, April.

Figure 14. Fiscal Policy

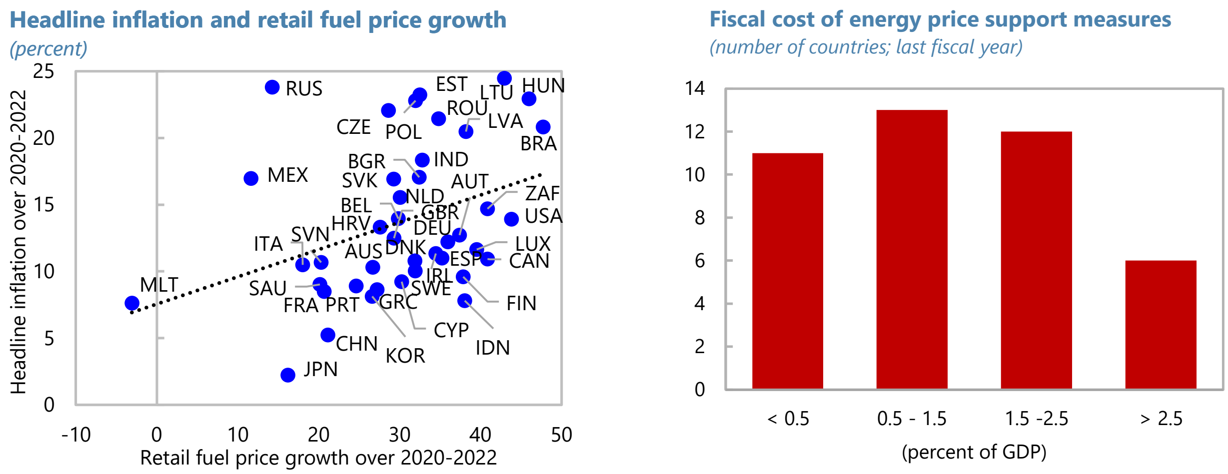


Sources: IMF staff estimates and recommendations as of Sept. 25, 2023.

Note: CAPB = cyclically adjusted primary balance. Includes crisis-related support and expiration over time on current policy settings. Recommended changes are relative to projected changes. Gray areas: data not shown/not available. CHN: augmented CAPB (incl. activity of local extra-budgetary units and government-guided investment funds). DEU: net of interest income. ESP (permanent invitee): primary structural balance (CAPB net of one-off spending). IND: gross debt definition of the primary balance. JPN: Projected path reflects staff's assessment of current policy settings; recommended path for 2024–27 reflects the fiscal consolidation needed to bring the debt-to-GDP ratio on a downward trajectory. RUS: non-oil cyclically adjusted structural primary balance (percent of potential GDP); Policy recommendations are not available. SAU: non-exported oil primary balance (percent of non-oil GDP; not cyclically adjusted). EU: The IMF does not prescribe recommendations for the EU-wide fiscal stance. Entries for the EU thus represent the GDP-weighted average of the projected change and the difference between the recommended and projected changes in the CAPB in each EU country (excluding Greece).

25. Fiscal adjustment should include the phasing out of untargeted measures while preserving targeted support for the most vulnerable. Although large-scale fiscal support helped reduce energy costs for businesses and households and mitigate inflation pressures to some extent (Figure 15, left panel), these broad untargeted measures should be retired as energy prices stabilize.[25] For many European countries, such measures have been estimated to exceed 2.5 percent of GDP (e.g., *Italy;* Figure 15, right panel). Should cost-of-living pressures reemerge, support for the most vulnerable people should take the form of temporary and well-targeted programs.

Figure 15. Energy Price Support Measures



Sources: Global Petrol Prices.com; IMF, *World Economic Outlook;* and IMF staff estimates and calculations.
Note: The left chart plots headline inflation rates over the period between 2020 and 2022 against retail fuel price growth rates over the same period for G-20 and EU economies excl. ARG and TUR. The dotted line is the OLS fitted line. The right chart shows a number of G-20 and EU economies with a corresponding category for fiscal cost of energy price support measures.

Financial Sector Policy

26. Financial stability must be closely monitored and safeguarded in support of disinflation efforts. The March 2023 banking sector turmoil highlighted regulatory and supervisory shortcomings. Considering risks to financial stability from the recent global monetary tightening cycle, stronger supervision and monitoring of financial stability risks will help achieve monetary policy objectives. In particular, supervisors should deploy stringent stress tests to estimate the potential effect of rising interest rates on borrowers' repayment capacity and, ultimately, on financial institutions. Regulators should also employ MPMs—preemptively as needed to address emerging risks, including ensuring banks' preparedness to access liquidity facilities and strengthening bank resolution regimes. Risk analyses should pay more attention to potentially vulnerable smaller financial companies, while closing supervisory and data gaps for nonbank financial institutions given their relatively excessive liquidity mismatches and heavy reliance on leverage. If severe market strains emerge, central banks should provide temporary liquidity support against eligible collateral promptly and forcefully, thereby limiting contagion while mitigating the risk of moral hazard.

27. Meanwhile, supervisors should be vigilant about stresses in the real estate sector. Exposures to liquidity and interest rate risks are concerning, particularly in countries with high levels

[25] Dao and others, forthcoming, "Unconventional Fiscal Policy in Times of High Inflation," IMF Working Paper.

of household debt and a large share of borrowing at floating rates (e.g., *Australia*, *Canada*). [26] With the ongoing shifts in demand for office and retail space since the pandemic, highly-leveraged positions in the commercial real estate sector should also be monitored closely in some economies (e.g., *euro area*, *United States*). In *China*, where there are significant downside risks from the ongoing property crisis, upgrading surveillance efforts should help improve the authorities' ability to address financial stability risks from the property sector.

External Sector Policy

28. Amid shifts in global financing conditions, external risks must be monitored and managed prudently to avoid financial instability. The prospects of continued monetary policy tightening in major advanced economies poses a challenge to the global financial system, especially to emerging market and developing economies where broad-based capital outflows are more likely to occur. Flexible exchange rates can mitigate risks by cushioning shocks and facilitating a faster economic recovery and firmly-anchored inflation expectations can provide greater freedom for monetary policy to respond.[27] But currency depreciation and sharp swings in risk premia could also exacerbate vulnerabilities in countries with elevated levels of dollar-denominated external debt.

29. CFMs and/or foreign exchange interventions (FXI) may help reduce external pressures. As guided by the IMF's Integrated Policy Framework (IPF), FXI may be appropriate on a temporary basis if currency movements and capital flows substantially raise financial stability risks or jeopardize the maintenance of price stability. Temporary CFMs on outflows may also be useful in imminent crisis or crisis circumstances but should not substitute for needed macroeconomic adjustments. As excess global current account balances can fuel trade tensions and protectionist measures or increase the risk of disruptive currency and capital flow movements, both excess surplus and deficit economies must exert policy efforts to promote external rebalancing. Fiscal consolidation is required to close gaps in countries with excess current account deficits, which will in turn help stabilize debt-to-GDP ratios (e.g., *Italy, South Africa, United States)*. In economies where excess current account surpluses persist, space exists for the use of resources in targeted areas to meet goals in climate, digital, and energy security (e.g., *Germany*), and procyclical fiscal policy should be avoided amid high hydrocarbon windfalls (e.g., *Saudi Arabia*).

B. Structural Reforms Can Support Policy Objectives in the Near- and Long-Term

30. By addressing longstanding vulnerabilities, structural reforms can boost economic activity in the short-term and improve resilience and medium-term growth prospects. Structural reforms that improve resource allocation and incentivize investment in physical and human capital can boost supply, help the fight against inflation, improve fiscal sustainability through higher domestic revenue mobilization and more efficient spending, and improve the medium-term growth outlook.

31. The consensus assessment by IMF and OECD staff reveals several key areas in need of reform (Figure 16).

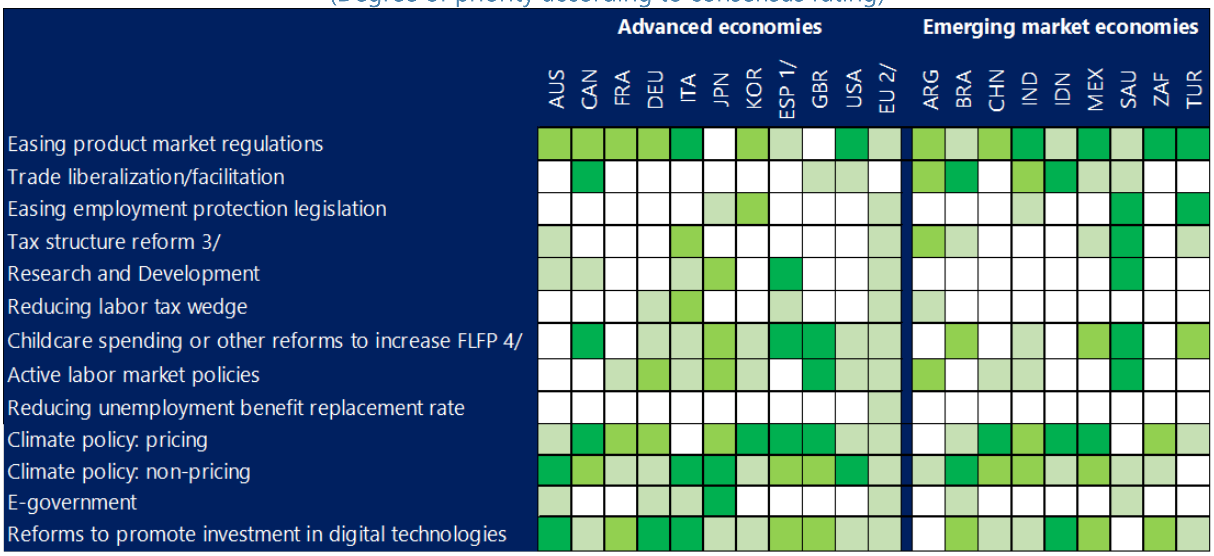
[26] IMF, 2023, World Economic Outlook, Chapter 1, April.

[27] IMF, 2023, External Sector Report, Chapter 2.

- **In most G-20 economies, product market reforms remain a key structural policy priority**. This includes reducing inefficiencies associated with state-owned enterprises (e.g., *China*, *South Africa*), lowering regulatory barriers to entry (e.g., *Canada*, *Germany*), and increasing access to finance to foster business dynamism.

Figure 16. Structural Reform Recommendations

(Degree of priority according to consensus rating)



Key: High; Medium; Low

Sources: Based on a consensus assessment by IMF and OECD staff as of Sept. 25, 2023.
Note: Priorities are country specific and not comparable across countries. RUS: policy recommendations are not available. SAU: only IMF rating used for consensus rating.
1/ ESP: permanent invitee.
2/ EU: Degree of priority based on a simple average of priorities for EU member countries. For non-G-20 EU member countries: only IMF ratings used. EU-wide recommendations are not taken into account. EU consists of both advanced and emerging market economies.
3/ Increase the share of consumption and property taxes in total tax revenues.
4/ FLFP: Female labor force participation.

- **Labor market reforms are also an important priority to increase growth and inclusion, notably for advanced economies**. These range from investments in training, apprenticeships, and matching—as well as reforms to immigration—to address skill shortages and mismatches (e.g., *France*, *Germany*, *Japan*, *Saudi Arabia, United Kingdom*), increasing flexibility in formal labor markets and calibrating the minimum wage to increase employment and reduce labor market informality (e.g., *Italy*), and providing childcare and parental leave or sustaining recently introduced programs to increase female labor force participation (e.g., *Australia*, *India*, *Korea*, *Saudi Arabia*, *Türkiye, United States*).

- **Reforms to encourage the green transition through carbon pricing or other means emerge as key priorities for most G-20 economies, both advanced and emerging.** A smart mix of instruments will be needed to accelerate low-carbon development while striking a balance between efficiency and acceptability. Carbon pricing is an integral part (e.g., *Canada*, *China*, *Indonesia*, *Korea*, *Mexico, United Kingdom*) and can help alleviate policy trade-offs by raising revenues to finance the green transition, but should be complemented by non-pricing mitigation strategies, particularly where direct carbon pricing is politically challenging. These include regulations, subsidies, support for climate finance, and the removal of regulatory barriers to renewable energy and transportation investment, among others (e.g., *Australia*, *Brazil*, *China*, *India*, *Italy*, *Japan*, *United States*). In general, climate policies—particularly carbon pricing—will need to be coupled with fiscal support targeted to those most affected and designed so that it does not interfere with price signals.

- **Trade liberalization remains a key priority, and industrial policies should be implemented carefully to avoid introducing distortions and increasing geoeconomic fragmentation.** Trade liberalization has been assessed as a key policy priority in several advanced and emerging G-20 economies (e.g., *United States, Canada, Brazil, India, Indonesia*). Reforms to reduce tariffs and other barriers to imports and exports would increase competition domestically as well as allow for further integration into global value chains and technology adoption. While industrial policy has a role to play in addressing market failures—in emerging market economies, to help enhance resilience to shocks and move up global value chains (e.g., *Saudi Arabia*, *Indonesia*), and in advanced economies, to accelerate the green transition by encouraging green innovation and the adoption of green technologies (e.g., *United States*, *Canada*, *European Union*)—it also has the potential to introduce new distortions, both to domestic resource allocation and to international trade.[28] Care must therefore be taken in the design and implementation of such policies to avoid discriminatory provisions such as local content requirements (e.g., the *United States*' Inflation Reduction Act and elements of *Saudi Arabia's* Vision 2030 Plan)—albeit World Trade Organization (WTO) compliance could differ according to coverage and membership status—and export restrictions (e.g., *Indonesia*). This is particularly important in the current conjuncture as discriminatory policies risk flaring geopolitical tensions, triggering retaliatory measures, and deepening geoeconomic fragmentation. As such, if industrial policies are to be deployed, governments should ensure they are time-bound and cost-effective to limit fiscal burdens. Moreover, to prevent a protectionist race where all countries lose, these policies must be consistent with countries' international obligations, including WTO rules.

32. Reforms to encourage innovation and technology adoption, to boost private and public investment, and to increase digitalization can contribute to strong and inclusive growth, as well as the green transition. Increased support for R&D is a structural reform priority in several advanced economies (e.g., *Italy*, *Spain*, *Japan*). This would help to address weak productivity growth as well as encourage the development and adoption of clean technologies. In emerging market economies, reforms to facilitate technology diffusion and increased investment in digitalization will be important in the medium-term to leverage emerging technologies, such as AI, as well as to support climate change adaptation and mitigation (e.g., *Brazil*, *Indonesia*, *Mexico, South Africa*). Such technology transfers will require robust governance—including strong legal and regulatory frameworks that promote transparency and accountability—property rights enforcement, and fair competition. Digitalization reforms, including e-government, are also key priorities in several G-20 advanced economies (e.g., *Australia*, *Germany*, *Japan*). Across the G-20, members will need to ensure that AI is appropriately regulated and harnessed responsibly, as outlined in the G-20 New Delhi Leaders' Declaration, so as to encourage innovation, while supporting inclusivity and mitigating risks to labor markets, privacy, security, and equity.[29,30]

[28] Cherif and others, 2022, "Industrial Policy for Growth and Diversification: A Conceptual Framework," Departmental Paper No 2022/017.

[29] G-20 New Delhi Leaders' Declaration, September 2023.

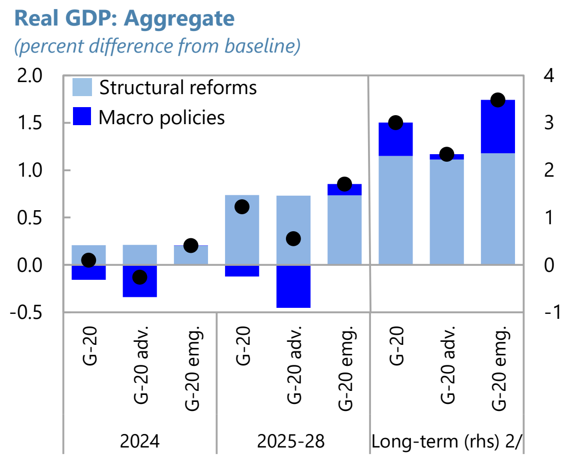
[30] Pizzinelli and others, 2023, "Labor Market Exposure to AI: Cross-Country Differences and Distributional Implications.", IMF Working Paper.

C. Implementing Macroeconomic Policy and Structural Reform Recommendations would Deliver Substantial Benefits

33. Aligning monetary and fiscal policies with IMF staff recommendations would help reduce inflation or stabilize debt in some countries and boost growth in others. Figures 17-19 show the results of a global model simulation in which the recommended macroeconomic policies and structural reforms are implemented in each G-20 economy. While most countries with above-target inflation have forcefully tightened monetary policy in the past year and are expected to keep rates elevated in the near-term, in some cases even stronger monetary policy tightening is warranted to accelerate disinflation (e.g., *Türkiye*). Moreover, stronger fiscal consolidation can help the fight against inflation, while also rebuilding fiscal buffers and enhancing debt sustainability (e.g., *China*, *France*, *India*, *Italy*, *Japan*, *South Africa*, *Türkiye*, *United States*). Stronger fiscal consolidation, particularly in the *United States*, would also imply spillovers to other countries, contributing positively to medium-term output growth in most G-20 economies. While tighter policies can come at the cost of lower domestic growth, in all cases this is partially offset by an improvement in net exports. In contrast, adopting a moderately more expansionary monetary policy in *China*—where core inflation is relatively low—would help support growth in the near-term, mitigating the negative growth impact of recommended fiscal tightening to stabilize debt. Finally, in *Indonesia*, financing increased public infrastructure investment through revenue mobilization and energy subsidy reform would lead to substantial aggregate productivity improvements without hindering fiscal sustainability.

34. Adopting structural reform recommendations would raise growth prospects and inclusivity. Macroeconomic policy levers are somewhat constrained by ongoing efforts to fight inflation and reduce debt vulnerabilities in many economies. Against these constraints, as well as the productivity slowdown in advanced economies, implementing growth-enhancing structural reform recommendations would help raise growth prospects, particularly in the long-term (Figure 17).[31] Domestically, such reforms would lead to an increase in output of at least 0.5 percent by 2028 in all countries, with particularly large benefits in *India*, *Italy*, *Mexico*, and *Türkiye*. Furthermore, positive cross-border spillovers from productivity-enhancing reforms would be significant, particularly to close trading partners who benefit from knowledge spillovers (e.g., positive spillovers from *United States* product market reforms to productivity in *Canada* and *Mexico*, and productivity spillovers among *France*, *Germany*, *Italy*, and *Spain*). To reap the full benefits, it is important to prioritize and sequence reforms:

Figure 17. Impact Of Adjusting Policies To Recommendations: Real GDP 1/



Sources: IMF, G-20 Model simulations; IMF, *World Economic Outlook*; and IMF staff calculations.
1/ Results for different policies and income groups are derived from model simulations with all country's relevant policies applied simultaneously.
2/ Impact as of 2032. Impact reflected on right-hand scale.

[31] Due to modeling limitations, trade liberalization, climate, and digitalization policies are not included in the simulations shown in Figures 17-19. Trade liberalization reforms would likely amplify the benefits of structural reforms.

the benefits of structural reforms in emerging market economies have historically been largest when begun with a package of first-generation reforms to governance, business regulation, and the external sector, which then lay the foundations for second generation reforms to credit, labor markets and support the green transition. Furthermore, reforms to remove barriers to female labor force participation would not only increase inclusivity but also support economic efficiency and growth by improving the allocation of human capital.[32]

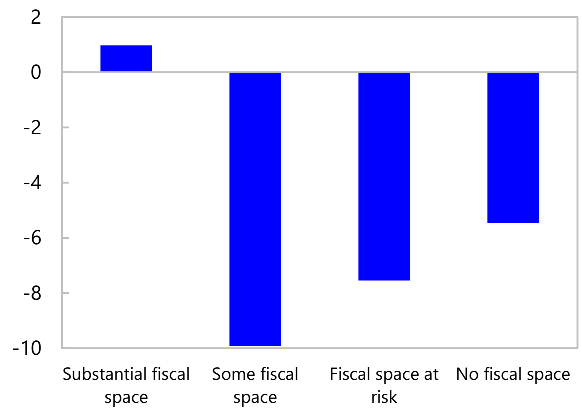
35. Implementing recommended policies would improve the outlook for public debt and reduce external imbalances.

- *Tighter fiscal policy and growth-enhancing structural reforms would help to reduce public debt burdens in the medium-term*. Such reforms would reduce government debt ratios in countries with limited fiscal space (Figure 18), including those with fiscal space at risk (e.g., *Spain, India*, *Italy*) or no fiscal space (*e.g., South Africa*). Recommended fiscal tightening in the *United States* would drive the bulk of the decline in debt ratios in countries with some fiscal space. In countries with substantial fiscal space, implementing recommended policies would instead increase debt ratios, due to domestic fiscal policy (e.g., *Germany*) or in response to spillovers (e.g., *Saudi Arabia*).
- Implementing recommended macroeconomic policies and structural reforms would help rotate global demand, addressing current account imbalances and contribute to more balanced global growth (Figure 19, left panel).
    - Such policies would increase current account balances in broadly balanced G-20 advanced economies (e.g., *Spain*) and, to a lesser extent, emerging market economies (e.g., *China*), primarily through domestic fiscal contraction (Figure 19, right panel).
    - In contrast, current account balances would decline in G-20 advanced economies with excess surpluses (*Germany*) and some emerging market economies with excess surpluses (*Mexico*, *Saudi Arabia*), primarily due to spillovers from policy adjustments in other economies, notably from fiscal tightening in the *United States*. While *India's* surplus would increase due to recommended fiscal consolidation and spillovers from structural reforms, in aggregate the current account balance of emerging market economies with excess surpluses would decrease.

Figure 18. Impact Of Adjusting Policies: Debt

Government net debt, 2028

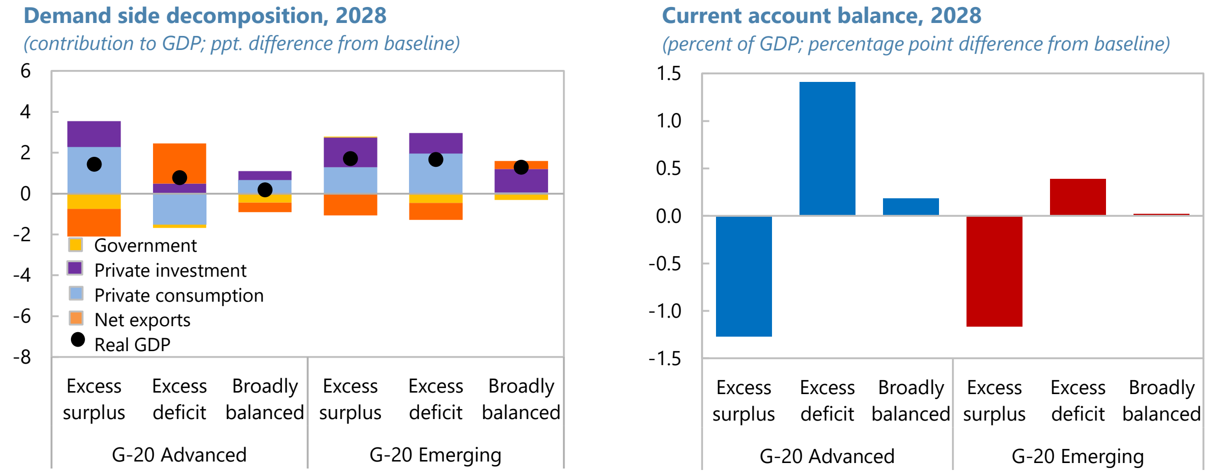
(percent of GDP; percentage point difference from baseline)



Sources: IMF, G-20 Model simulations; IMF, *World Economic Outlook;* and IMF staff calculations.
Note: Countries with "substantial" fiscal space include AUS, DEU, KOR, RUS, SAU; "some" include CAN, CHN, FRA, GBR, IDN, JPN, MEX, TUR, USA; "at risk" include BRA, ESP, IND, ITA; "none" include ARG, ZAF. ESP is a permanent invitee. Categorization is based on latest published assessments. EU rules are not taken into account for EU member countries. For most countries, a decrease in government net debt corresponds to a reduction in gross debt in percent of GDP; for some, it corresponds to an increase in government assets in percent of GDP. RUS: policy recommendations are not available.

[32] Budina and others, 2023, "Structural Reforms to Accelerate Growth, Ease Policy Trade-Offs, and Support the Green Transition in Emerging Market and Developing Economies", IMF Staff Discussion Note.

Figure 19. Impact Of Adjusting Policies To Recommendations: Debt And Demand



Sources: IMF, G-20 Model simulations; IMF, *World Economic Outlook;* and IMF staff calculations.
Note: Country groups are based on overall external balance assessments compared with the levels consistent with medium-term fundamentals and desirable policies in 2022 (IMF, 2023, External Sector Report): DEU, IND, MEX, SAU: excess surpluses (i.e., "stronger" or "moderately stronger" external balances); ARG, CAN, FRA, ITA, RUS, TUR, USA, ZAF: excess deficits (i.e., "weaker" or "moderately weaker" external balances); and AUS, BRA, CHN, ESP, GBR, IDN, JPN, KOR: broadly balanced (i.e., external balances are "broadly in line"). RUS: policy recommendations are not available.

- For G-20 economies with excess current account deficits, implementing recommended policies is expected to increase the current account balance in emerging market economies overall, particularly *South Africa* through tighter domestic fiscal policy. Similarly, implementing recommended policies would have a significant positive impact on G-20 advanced economies with excess deficits in aggregate—particularly in the *United States* and *France*, due to large recommended fiscal contractions. *Canada* is an exception, where spillovers from fiscal tightening in the *United States* and domestic structural reforms would lead to a decline in the current account balance.

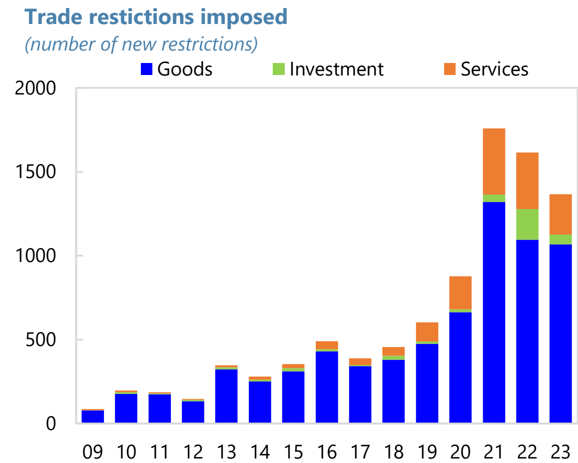
COOPERATE TO SOLVE GLOBAL CHALLENGES

Action is needed to end the war in Ukraine and mitigate its impact on the vulnerable. Coordinated and well-designed multilateral policies are crucial to tackle common problems, as well as help immunize the global economy to future shocks. Further geoeconomic fragmentation must be avoided to preserve hard-won efficiency and equity gains from global trade and financial integration. Increased policy coordination and financial support for low-income countries will be necessary to meet development goals and prevent catastrophic climate change.

A. A Considered Approach to International Cooperation focusing on Global Public Goods is Essential to Reverse Geoeconomic Fragmentation

36. Ending the war in Ukraine is an urgent priority to reduce human suffering directly and prevent further cost-of-living crises. *Russia*'s invasion of *Ukraine* and associated sanctions has led to human suffering in *Ukraine* and *Russia* as well as food and energy shortages globally. While the cost-of-living crisis has somewhat abated, progress on mitigating the impact of the war on commodity prices is fragile—evidenced by *Russia*'s withdrawal from the Black Sea Grain Initiative in July 2023—and there is a risk of reigniting the cost-of-living crisis the longer the conflict persists.

Figure 20. Trade Restrictions



Source: Global Trade Alert, and IMF staff calculations.
Note: Bars reflect the new interventions per year. For 2023, data as of Aug. 21, 2023.

37. Strengthening international trade and investment linkages is critical to support global economic prosperity and resilience. Early indications of trade fragmentation threaten to unwind growth and development.[33] Maintaining and improving open trade and investment is a shared responsibility that will—together with domestic policies to share their gains more widely—increase prosperity for all. Policymakers should be aware that imposing trade and investment restrictions, including those for national security reasons, could have unintended consequences for global economic growth and financial stability, rolling back decades of global integration that has helped lift hundreds of millions out of poverty.[34] Fragmentation of commodity markets will take a further toll, particularly on low-income countries with greater reliance on commodity imports. Policy uncertainty associated with fragmentation will exacerbate adverse outcomes further by delaying investment decisions. As such, stronger multilateral efforts, especially through the WTO, are required to promote trade openness and predictability while mitigating risks from policy-driven geoeconomic fragmentation. Where multilateral efforts stall, open and nondiscriminatory plurilateral initiatives

[33] WTO, 2023, "Annual Report 2023"

[34] World Bank, 2022, "Poverty and Shared Prosperity 2022: Correcting Course"

could be a practical way forward. Where countries opt for unilateral actions, credible "guardrails" may be needed to mitigate global spillovers and protect the vulnerable.

38. Support vulnerable economies. Emerging market and developing economies face large financing needs to meet their development goals and invest in climate action—to the order of $3 trillion in additional annual spending by 2030 for emerging market economies excluding *China*—but many have limited policy space following multiple shocks.[35] There are several ways in which G-20 countries can support the world's most vulnerable. First, G-20 members can support efforts to scale up investment through domestic resource mobilization, complemented with private capital and official development financing. Second, ensure proper access to and adequate resources for the global financial safety net. This includes expanding the availability of pooled resources in the IMF, completing the 16th General Review of Quotas, and closing funding shortfalls of the IMF's Poverty Reduction and Growth Trust (PRGT) and the Resilience and Sustainability Trust (RST) including via rechanneling of special drawing rights. Effort is also required to replenish the Catastrophe Containment and Relief Trust (CCRT). Third, the G-20 can do much to prevent unsustainable debt burdens from holding back the prospects of developing economies. While recent progress in implementing the G-20 Common Framework is encouraging, additional efforts, including through the Global Sovereign Debt Roundtable, are needed to help ensure that debt resolution is more effective, predictable, and timely. Finally, it is the responsibility of all countries to collaborate to eliminate remaining export barriers on foods and fertilizers, build resilience in food markets, and enhance global food security.[36]

B. Accelerate the Green Transition

39. International efforts to mitigate the existential threat from climate change must be strengthened—delays will substantially outweigh the costs of an orderly and just climate transition.[37] International efforts to reduce emissions must be stepped up to achieve decarbonization goals, as current and announced policies are not expected to deliver the emissions reduction goals in the 2015 Paris Agreement. Such efforts should include public investment support in renewable energy, R&D and other subsidies to promote a green transition, data transparency and sharing, and global coordination on carbon pricing—which is essential to contain the fiscal costs of the transition and get investment incentives right.[38] Additionally, fiscal transfers that dampen incentives to reduce fossil-fuel based energy, including measures to combat the cost-of-living crisis, should be phased out or redesigned so as not to interfere with price signals. While efforts to combat climate change imply economic and fiscal costs—particularly for fossil fuel exporters or carbon-intensive economies—these will only increase if action is delayed.

[35] G-20 Independent Experts Group, 2023, "Strengthening Multilateral Development Banks".

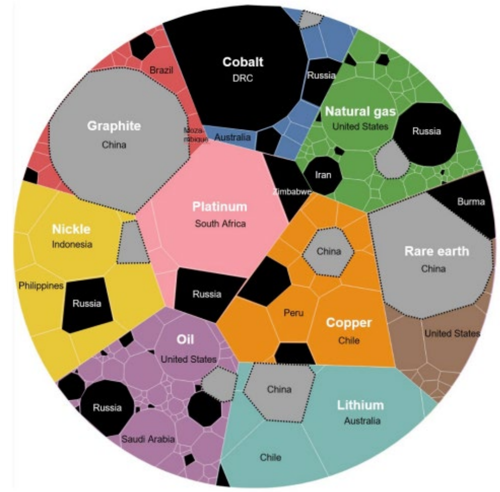
[36] G-20 Frame Working Group, 2023, "G-20 Report on Macroeconomic Impacts of Food and Energy Insecurity and their Implications for the Global Economy."

[37] G-20 Frame Working Group, 2023, "G-20 Report on Macroeconomic Risks Stemming from Climate Change and Transition Pathways."

[38] Parry and others, 2021, "Proposal for an International Carbon Price Floor among Large Emitters", IMF Staff Climate Note

40. The fight against climate change will require careful international coordination, and consideration of international spillovers. Efforts to decarbonize economies while ensuring energy security and respecting the principle of joint but differentiated responsibilities will require close international coordination or risk further fueling geoeconomic fragmentation. Recently passed legislation in several countries, such as the *United States* Inflation Reduction Act (IRA) and the *European Union* Green Deal and Emissions Trading System, takes important steps towards encouraging development and adoption of green technologies. From a global perspective, such policies imply both upside and downside risks. The former stem from the non-rivalrous nature of innovation, whereby climate policies in advanced economies could lead to technology diffusion to emerging market economies via green FDI outflows. However, downside risks are also relevant, as some policies to accelerate the green transition have introduced discriminatory measures—e.g., subsidies with local sourcing requirements as in the IRA—which IMF research has found to be associated with reduced technology diffusion, and which could exacerbate geoeconomic fragmentation.[39] A lack of international coordination on such policies also risks giving rise to a "subsidy race". Moreover, the geographical concentration of key commodities (e.g., minerals for clean technology and semi-conductors) increases the risk that access to them is disrupted by countries' efforts to re-shore commodity supply chains for national security or geopolitical reasons, as in the *United States*, the *European Union*, and *China* (Figure 21).[40] The international community must work together to encourage diffusion of green innovation across borders and discourage the tendency towards ratcheting up protectionism.

Figure 21. Global Production Structure: Selected Commodities, 2020



Source: Aiyar, Shekhar, Ilyina, Anna, and others (2023); Geoeconomic Fragmentation and the Future of Multilateralism. Staff Discussion Note SDN/2023/001.
Note: Countries shaded in black are under sanctions; China is denoted in gray.

[39] Hasna and others, Forthcoming, "Green Innovation and Diffusion: Policies to Accelerate Them and Expected Impact on Macroeconomic and Firm-level Performance", IMF Staff Discussion Note.

[40] IMF, 2023, World Economic Outlook, Chapter 3, October.

Table 1. Real GDP Growth

(percent)

	Year over Year							
			Projections (Oct. 2023)			Deviations (from Jul. 2023)		
	2021	2022	2023	2024	2028	2023	2024	2028
World	**6.3**	**3.5**	**3.0**	**2.9**	**3.1**	**0.0**	**-0.1**	**0.1**
Advanced Economies	5.6	2.6	1.5	1.4	1.7	0.0	0.0	0.0
Euro area	5.6	3.3	0.7	1.2	1.3	-0.2	-0.3	0.0
Emerging Market and Developing Economies	6.9	4.1	4.0	4.0	3.9	0.0	-0.1	0.0
G-20 1/	6.6	3.2	3.1	2.8	2.9	0.1	0.0	0.1
Advanced G-20 2/	5.3	2.3	1.5	1.3	1.7	0.2	0.1	0.0
Emerging G-20 3/	7.7	3.9	4.5	4.0	3.7	0.1	-0.1	0.0
Argentina	10.7	5.0	-2.5	2.8	2.5	0.0	0.0	0.3
Australia	5.2	3.7	1.8	1.2	2.3	0.2	-0.3	0.0
Brazil	5.0	2.9	3.1	1.5	2.0	1.0	0.3	0.0
Canada	5.0	3.4	1.3	1.6	1.7	-0.4	0.2	0.0
China	8.4	3.0	5.0	4.2	3.4	-0.2	-0.3	0.0
France	6.4	2.5	1.0	1.3	1.4	0.2	0.0	0.0
Germany	3.2	1.8	-0.5	0.9	0.9	-0.2	-0.4	0.0
India 4/	9.1	7.2	6.3	6.3	6.3	0.2	0.0	0.3
Indonesia	3.7	5.3	5.0	5.0	5.0	0.0	0.0	0.0
Italy	7.0	3.7	0.7	0.7	0.9	-0.4	-0.2	0.0
Japan	2.2	1.0	2.0	1.0	0.4	0.6	0.0	0.0
Korea	4.3	2.6	1.4	2.2	2.1	0.0	-0.2	-0.1
Mexico	5.8	3.9	3.2	2.1	2.1	0.6	0.6	0.3
Russia	5.6	-2.1	2.2	1.1	0.9	0.7	-0.2	0.2
Saudi Arabia	3.9	8.7	0.8	4.0	3.1	-1.1	1.2	0.0
South Africa	4.7	1.9	0.9	1.8	1.4	0.6	0.1	0.0
Spain 5/	6.4	5.8	2.5	1.7	1.6	0.0	-0.3	0.0
Türkiye	11.4	5.5	4.0	3.0	3.2	1.0	0.2	0.0
United Kingdom	7.6	4.1	0.5	0.6	1.5	0.1	-0.4	0.0
United States	5.9	2.1	2.1	1.5	2.1	0.3	0.5	0.0
European Union	5.9	3.6	0.7	1.5	1.7	-0.3	-0.2	0.0

Sources: IMF, *World Economic Outlook*, October 2023 and July 2023 updates.
1/ G-20 aggregates exclude the European Union.
2/ Includes *Australia, Canada, France, Germany, Italy, Japan, Korea, United Kingdom, and United States*.
3/ Includes *Argentina, Brazil, China, India, Indonesia, Mexico, Russia, Saudi Arabia, South Africa, and Türkiye*.
4/ For *India*, data and forecasts are presented on a fiscal year basis, with FY 2022/23 starting in April 2022.
5/ *Spain* is a permanent invitee.