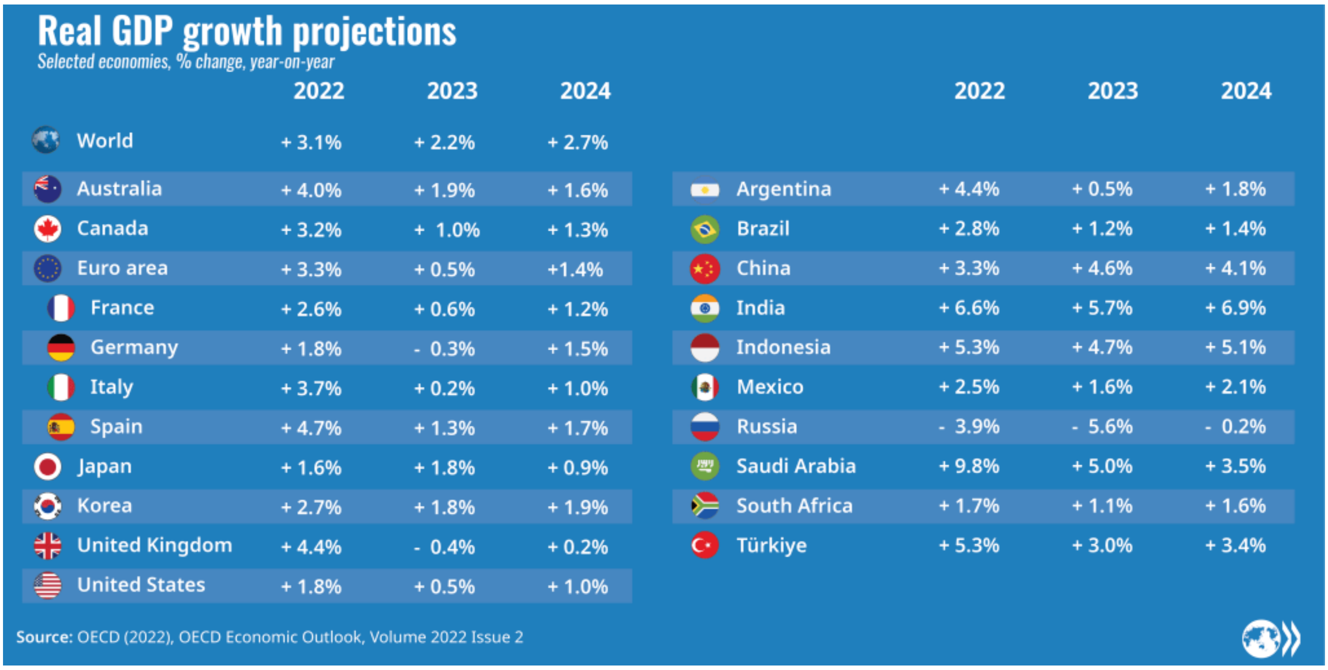
Confronting the Crisis

By Álvaro Santos Pereira, OECD Chief Economist ad interim

The global economy is reeling from the largest energy crisis since the 1970s. The energy shock has pushed up inflation to levels not seen for many decades and is lowering economic growth all around the world. In the new *OECD Economic Outlook*, we are now forecasting that world growth will decline to 2.2% in 2023 and bounce back to a relatively modest 2.7% in 2024. Asia will be the main engine of growth in 2023 and 2024, whereas Europe, North America and South America will see very low growth.



Real GDP growth projections

Selected economies, % change, year-on-year

	2022	2023	2024		2022	2023	2024
World	+ 3.1%	+ 2.2%	+ 2.7%				
Australia	+ 4.0%	+ 1.9%	+ 1.6%	Argentina	+ 4.4%	+ 0.5%	+ 1.8%
Canada	+ 3.2%	+ 1.0%	+ 1.3%	Brazil	+ 2.8%	+ 1.2%	+ 1.4%
Euro area	+ 3.3%	+ 0.5%	+1.4%	China	+ 3.3%	+ 4.6%	+ 4.1%
France	+ 2.6%	+ 0.6%	+ 1.2%	India	+ 6.6%	+ 5.7%	+ 6.9%
Germany	+ 1.8%	- 0.3%	+ 1.5%	Indonesia	+ 5.3%	+ 4.7%	+ 5.1%
Italy	+ 3.7%	+ 0.2%	+ 1.0%	Mexico	+ 2.5%	+ 1.6%	+ 2.1%
Spain	+ 4.7%	+ 1.3%	+ 1.7%	Russia	- 3.9%	- 5.6%	- 0.2%
Japan	+ 1.6%	+ 1.8%	+ 0.9%	Saudi Arabia	+ 9.8%	+ 5.0%	+ 3.5%
Korea	+ 2.7%	+ 1.8%	+ 1.9%	South Africa	+ 1.7%	+ 1.1%	+ 1.6%
United Kingdom	+ 4.4%	- 0.4%	+ 0.2%	Türkiye	+ 5.3%	+ 3.0%	+ 3.4%
United States	+ 1.8%	+ 0.5%	+ 1.0%				

Source: OECD (2022), OECD Economic Outlook, Volume 2022 Issue 2

Higher inflation and lower growth are the hefty price that the global economy is paying for Russia's war of aggression against Ukraine. Although prices were already creeping up due to the rapid rebound from the pandemic and related supply chain constraints, inflation soared and became much more pervasive around the world following Russia's invasion.

As a consequence of the unexpected surge in prices, real wages are falling in many countries, slashing purchasing power. This is hurting people everywhere. If inflation is not contained, these problems will only become worse. Thus, fighting inflation has to be our top policy priority right now.

Central banks around the world are increasing interest rates to curb inflation and anchor inflation expectations in their respective economies. This strategy is starting to pay off. For example, in Brazil, the central bank moved swiftly, and inflation has started to come down in recent months. In the United States, the latest data also seem to suggest some progress in the fight against inflation. Nevertheless, monetary policy should continue to tighten in the countries where inflation remains high and broad-based.

In the fight against rising prices, it is also essential that fiscal policy works hand-in-hand with monetary policy. Fiscal choices that add to inflationary pressures will result in even higher policy rates to control inflation. This means that policy support to shield families and firms from the energy shock should be targeted and temporary, protecting vulnerable households and firms without adding to inflationary pressures and increasing public debt burdens. Governments have already done a lot to ease the economic pain from high energy and food prices, including price caps, price and income subsidies and reduced taxes. However, since energy prices are likely to remain high and volatile for some time, untargeted measures to keep prices down will become increasingly unaffordable, and could discourage the needed energy savings.

Energy markets remain among the significant downside risks around this outlook. Europe has gone a long way to replenish its natural gas reserves and curb demand, but this winter in the Northern Hemisphere will certainly be challenging. The situation might be even more complicated in the winter of 2023-2024, as replenishing gas reserves might prove more difficult next year. Higher gas prices, or outright gas supply disruptions, would entail significantly weaker growth and higher inflation in Europe and the world in 2023 and 2024.

Rising interest rates will also pose many challenges and risks. Debt repayment will be more expensive for firms, governments and households who have variable rate debt obligations or when taking on new debt. We are particularly concerned about low-income countries, over half of which are already in (or at high risk of) debt distress and now face tightening financial conditions. Currency depreciation vis-à-vis the US dollar in many of these countries, and in emerging markets, adds to these risks.

Russia's war against Ukraine is also aggravating global food insecurity by putting pressure on prices, supplies, and food affordability. Some of the most vulnerable people around the globe face the highest risk of food insecurity, and many governments lack the means to address this problem. Keeping markets open and agricultural goods flowing, as well as providing well-targeted aid, should be the utmost priority to avoid further food disruptions and hunger in many of these countries.

Policies for a stronger recovery

Policymakers must take bold policy actions to confront these challenging times. In addition to monetary and fiscal policies, it is time for governments to go back to structural policies to tackle some of the most pressing current issues.

First, investing in energy security and diversifying energy supplies is imperative. To prevent energy disruptions, many countries are reverting temporarily to more polluting and carbon-emitting energy sources. However, high energy prices and concerns about energy security are also encouraging governments and firms to diversify energy sources and boost investment in renewables. Strengthening energy grids and investing in energy efficiency and green technologies will need to be high on political agendas to ensure that we reach our net zero emissions goals. The OECD aims to support this effort through its Inclusive Forum on Carbon Mitigation

Approaches (IFCMA), a forum of dialogue between countries at different stages of development that will allow us to better understand and analyse diverse policy approaches to carbon mitigation and their effects.

Second, governments need to keep markets open and international trade flowing. This will strengthen competitive pressures and will help alleviate supply constraints. In contrast, pursuing protectionist policies would be a serious setback for many countries, in particular the world's poorest, and would significantly damage the global economy.

Third, fostering employment is essential to boost potential growth and achieve a stronger and more inclusive recovery. For example, governments should work to decrease the gaps in employment rates between men and women in countries where these gaps remain high. Investing in skills is also essential, to counteract the human capital losses that occurred during the pandemic, especially for the most vulnerable, and address the persistent and emerging skill shortages that many countries are facing.

Summing up

We are currently facing a very difficult economic outlook. Our central scenario is not a global recession, but a significant growth slowdown for the world economy in 2023, as well as still high, albeit declining, inflation in many countries. Risks remain significant. In these difficult and uncertain times, policy has once again a crucial role to play: further tightening of monetary policy is essential to fight inflation, and fiscal policy support should become more targeted and temporary. Accelerating investment in the adoption and development of clean energy sources and technologies will be crucial to diversifying energy supplies and ensuring energy security. A renewed focus on structural policies will allow policymakers to foster employment and productivity, as well as to make growth work for all. In other words, it is in our hands to overcome this crisis. And if we choose to undertake the right set of policies, we will certainly increase our chances of success.

Editorial from the OECD Economic Outlook, November 2022