

Rising caseloads, a disrupted recovery, and higher inflation

January 2022



The global economy enters 2022 in a weaker position than previously expected. As the new Omicron COVID-19 variant spreads, countries have reimposed mobility restrictions. Rising energy prices and supply disruptions have resulted in higher and more broad-based inflation than anticipated, notably in the United States and many emerging market and developing economies. The ongoing retrenchment of China's real estate sector and slower-than-expected recovery of private consumption also have limited growth prospects.

Global growth is expected to moderate from 5.9 in 2021 to 4.4 percent in 2022—half a percentage point lower for 2022 than in the October World Economic Outlook (WEO), largely reflecting forecast markdowns in the two largest economies. A revised assumption removing the Build Back Better fiscal policy package from the baseline, earlier withdrawal of monetary accommodation, and continued supply shortages produced a downward 1.2 percentage-points revision for the United States. In China, pandemic-induced disruptions related to the zero-tolerance COVID-19 policy and protracted financial stress among property developers have induced a 0.8 percentage-point downgrade. Global growth is expected to slow to 3.8 percent in 2023. Although this is 0.2 percentage point higher than in the previous forecast, the upgrade largely reflects a mechanical pickup after current drags on growth dissipate in the second half of 2022. The forecast is conditional on adverse health outcomes declining to low levels in most countries by end-2022, assuming vaccination rates improve world-wide, and therapies become more effective.

Elevated inflation is expected to persist for longer than envisioned in the October WEO, with ongoing supply chain disruptions and high energy prices continuing in 2022. Assuming inflation expectations stay well anchored, inflation should gradually decrease as supply-demand imbalances wane in 2022 and monetary policy in major economies responds.

Risks to the global baseline are tilted to the downside. The emergence of new COVID-19 variants could prolong the pandemic and induce renewed economic disruptions. Moreover, supply chain disruptions, energy price volatility, and localized wage pressures mean uncertainty around inflation and policy paths is high. As advanced economies lift policy rates, risks to financial stability and emerging market and developing economies' capital flows, currencies, and fiscal positions—especially with debt levels having increased significantly in the past two years—may emerge. Other global risks may crystallize as geopolitical tensions remain high, and the ongoing climate emergency means that the probability of major natural disasters remains elevated.

With the pandemic continuing to maintain its grip, the emphasis on an effective global health strategy is more salient than ever. Worldwide access to vaccines, tests, and treatments is essential to reduce the risk of further dangerous COVID-19 variants. This requires increased production of supplies, as well as better in-country delivery systems and fairer international distribution. Monetary policy in many countries will need to continue on a tightening path to curb inflation pressures, while fiscal policy—operating with more limited space than earlier in the pandemic—will need to prioritize health and social spending while focusing support on the worst affected. In this context, international cooperation will be essential to preserve access to liquidity and expedite orderly debt restructurings where needed. Investing in climate policies remains imperative to reduce the risk of catastrophic climate change.

The Forces Shaping the Outlook

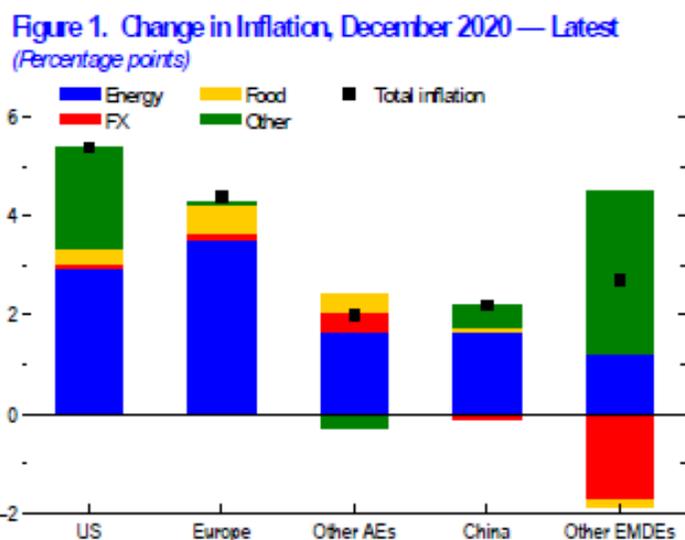
Adverse developments since the October WEO mean that the global economy is entering 2022 in a weaker position than anticipated. News of the Omicron variant led to increased mobility restrictions and financial market volatility at the end of 2021. Supply disruptions have continued to weigh on activity. Meanwhile, inflation has been higher and more broad-based than anticipated, particularly in the United States. Adding to these pressures, the retrenchment in China’s real estate sector appears to be more drawn out and the recovery in private consumption is weaker than previously expected.

The pandemic’s continued grip: Since the start of October, COVID-19 deaths have averaged about 7,000 a day worldwide, down from about 10,000 in late August. The diffusion of vaccines—although still uneven—has played a key role, with over 55 percent of people having received at least one dose. Yet the emergence of the Omicron variant in late November threatens to set back this tentative path to recovery. As of mid-January, Omicron appeared to be more transmissible than Delta, but its symptoms are perhaps less severe. The net effect on hospitalizations and deaths is still unknown. The baseline forecast is conditioned on adverse health outcomes—severe illness, hospitalizations, and deaths—coming down to low levels in most countries by the end of 2022. This assumes that most countries achieve vaccination rates consistent with the IMF’s pandemic proposal¹ by end-2022, therapies become widely accessible, and the combination proves effective in protecting against Omicron and any other variants that emerge. Some emerging market and developing economies are anticipated to fall short of the vaccination target in 2022 and achieve sufficiently broad coverage only in 2023.

Downside surprises in the second half of 2021: Supply disruptions continued into the fourth quarter, hindering global manufacturing—especially in Europe and the United States. A resurgence in COVID cases (particularly in Europe) also held back a broader recovery. In China, disruptions from COVID outbreaks, interruptions to industrial production from power outages, declining real estate investment, and a faster-than-expected withdrawal of public investment all contributed to a second-half slowdown. Although there were signs of a global turnaround in November—with a pickup in international trade and upside surprises for services activity and industrial production data—this only partially offset earlier declines.

Broadening price pressures: The emergence of a new variant is not the only risk that has crystallized in recent months. Inflation continued to rise throughout the second half of 2021, driven by several factors of varying importance across regions (Figure 1). Fossil fuel prices have almost doubled in the past year, driving up energy costs and causing higher inflation, most prominently in Europe. Rising food prices have contributed to higher inflation, for example in sub-Saharan Africa. Meanwhile, ongoing supply chain disruptions, clogged ports, land-side constraints, and high demand for goods have also led to broadening price pressures, especially in the United States. Higher imported goods prices have contributed to inflation for example in Latin America and the Caribbean region.

Monetary conditions have tightened globally (see box). In the United States, with price and wage pressures broadening, the Federal Reserve decided to accelerate its taper of asset purchases and signaled that it will raise rates further in 2022 than previously expected. The European Central Bank (ECB) has announced it will end net asset purchases under the Pandemic Emergency Purchase Programme in March 2022, while it will temporarily increase net purchases by a modest amount under its longer-standing Asset Purchase Programme. The ECB has also committed to maintaining its key interest rates at current levels until adequate progress is made toward stabilizing inflation at its medium-term target.



Global Growth Set to Moderate and Inflation to Persist Longer

Global growth is estimated at 5.9 percent in 2021 and is expected to moderate to 4.4 percent in 2022, half a percentage point lower than in the October 2021 World Economic Outlook (Table 1). The baseline incorporates anticipated effects of mobility restrictions, border closures, and health impacts from the spread of the Omicron variant. These vary by country depending on susceptibility of the population, the severity of mobility restrictions, the expected impact of infections on labor supply, and the importance of contact-intensive sectors. These impediments are expected to weigh on growth in the first quarter of 2022. The negative impact is expected to fade starting in the second quarter, assuming that the global surge in Omicron infections abates and the virus does not mutate into new variants that require further mobility restrictions. Forecasts are based on information up to 18 January 2022.

Table 1. Overview of the World Economic Outlook Projections
(Percent change, unless noted otherwise)

	Year over Year						Q4 over Q4 2/		
	Estimate		Projections		Difference from October 2021		Estimate		Projections
	2020	2021	2022	2023	2022	2023	2021	2022	2023
World Output	-3.1	5.9	4.4	3.8	-0.5	0.2	4.2	3.9	3.4
Advanced Economies	-4.5	5.0	3.9	2.6	-0.6	0.4	4.4	3.5	1.8
United States	-3.4	5.6	4.0	2.6	-1.2	0.4	5.3	3.5	2.0
Euro Area	-6.4	5.2	3.9	2.5	-0.4	0.5	4.8	3.2	1.8
Germany	-4.6	2.7	3.8	2.5	-0.8	0.9	1.9	4.2	1.6
France	-8.0	6.7	3.5	1.8	-0.4	0.0	5.0	1.9	1.7
Italy	-8.9	6.2	3.8	2.2	-0.4	0.6	6.2	2.5	1.7
Spain	-10.8	4.9	5.8	3.8	-0.6	1.2	4.9	5.0	2.5
Japan	-4.5	1.6	3.3	1.8	0.1	0.4	0.4	3.6	1.1
United Kingdom	-9.4	7.2	4.7	2.3	-0.3	0.4	6.3	3.8	0.5
Canada	-5.2	4.7	4.1	2.8	-0.8	0.2	3.5	3.9	1.9
Other Advanced Economies 3/	-1.9	4.7	3.6	2.9	-0.1	0.0	3.8	3.4	2.5
Emerging Market and Developing Economies	-2.0	6.5	4.8	4.7	-0.3	0.1	4.0	4.3	4.8
Emerging and Developing Asia	-0.9	7.2	5.9	5.8	-0.4	0.1	3.7	5.4	5.7
China	2.3	8.1	4.8	5.2	-0.8	-0.1	3.5	5.1	5.0
India 4/	-7.3	9.0	9.0	7.1	0.5	0.5	4.3	5.8	7.5
ASEAN-5 5/	-3.4	3.1	5.6	6.0	-0.2	0.0	3.5	5.6	5.9
Emerging and Developing Europe	-1.8	6.5	3.5	2.9	-0.1	0.0	5.8	2.2	3.0
Russia	-2.7	4.5	2.8	2.1	-0.1	0.1	4.2	2.1	1.8
Latin America and the Caribbean	-6.9	6.8	2.4	2.6	-0.6	0.1	3.7	1.8	2.6
Brazil	-3.9	4.7	0.3	1.6	-1.2	-0.4	0.6	1.5	1.4
Mexico	-8.2	5.3	2.8	2.7	-1.2	0.5	2.9	3.4	1.9
Middle East and Central Asia	-2.8	4.2	4.3	3.6	0.2	-0.2	...	...	...
Saudi Arabia	-4.1	2.9	4.8	2.8	0.0	0.0	5.2	5.3	2.8
Sub-Saharan Africa	-1.7	4.0	3.7	4.0	-0.1	-0.1	...	...	...
Nigeria	-1.8	3.0	2.7	2.7	0.0	0.1	2.4	2.1	2.3
South Africa	-6.4	4.6	1.9	1.4	-0.3	0.0	1.3	2.6	0.9
Memorandum									
World Growth Based on Market Exchange Rates	-3.5	5.6	4.2	3.4	-0.5	0.3	4.2	3.9	2.8
European Union	-5.9	5.2	4.0	2.8	-0.4	0.5	4.9	3.5	1.9
Middle East and North Africa	-3.2	4.1	4.4	3.4	0.3	-0.1	...	...	...
Emerging Market and Middle-Income Economies	-2.2	6.8	4.8	4.6	-0.3	0.0	4.0	4.3	4.8
Low-Income Developing Countries	0.1	3.1	5.3	5.5	0.0	0.0	...	...	...
World Trade Volume (goods and services) 6/	-8.2	9.3	6.0	4.9	-0.7	0.4	...	...	...
Advanced Economies	-9.0	8.3	6.2	4.6	-0.7	0.6	...	...	...
Emerging Market and Developing Economies	-6.7	11.1	5.7	5.4	-0.7	0.0	...	...	...
Commodity Prices (US dollars)									
Oil 7/	-32.7	67.3	11.9	-7.8	13.7	-2.8	79.2	-4.7	-6.8
Nonfuel (average based on world commodity import weights) 8/	6.7	26.7	3.1	-1.9	4.0	-0.4	17.2	1.5	-1.6
Consumer Prices									
Advanced Economies 8/	0.7	3.1	3.9	2.1	1.6	0.2	4.8	2.8	2.0
Emerging Market and Developing Economies 9/	5.1	5.7	5.9	4.7	1.0	0.4	5.9	5.1	4.3

Among changes to advanced economy forecasts for 2022, a revised assumption removing the Build Back Better fiscal policy package from the baseline, earlier withdrawal of monetary accommodation, and continued supply chain disruptions have contributed to a downgrade of 1.2 percentage points for the **United States**. In **Canada**, weaker data outturns toward the end

of 2021 and anticipated softer external demand for 2022 (related to the US revision) have led to a 0.8 percentage-point downgrade. In the **euro area**, prolonged supply constraints and COVID disruptions produced a less severe revision of 0.4 percentage point—led by a markdown of 0.8 percentage point for **Germany** largely due to the economy’s exposure to supply chain shocks. Mobility restrictions imposed toward the end of 2021 are expected to drag on growth in the euro area in early 2022. In the **United Kingdom**, disruptions related to Omicron and supply constraints (particularly in labor and energy markets) mean that growth is revised down by 0.3 percentage point to 4.7 percent.

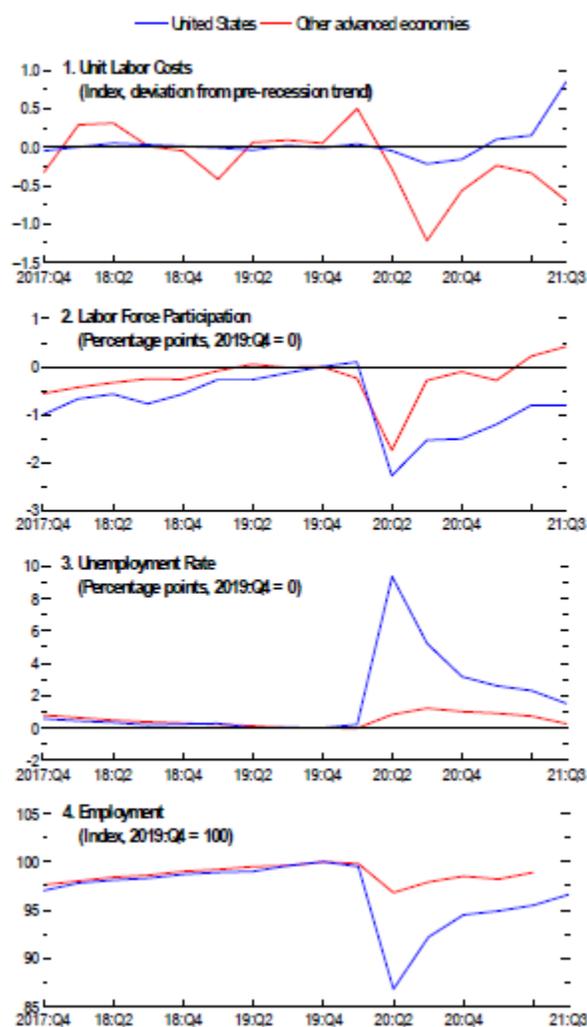
The 2022 forecast downgrade also reflects revisions among a few large emerging markets. In **China**, disruption in the housing sector has served as a prelude to a broader slowdown. With a strict zero-COVID strategy leading to recurrent mobility restrictions and deteriorating prospects for construction sector employment, private consumption is likely to be lower than anticipated. In combination with lower investment in real estate, this means that the growth forecast for 2022 is revised down relative to October by 0.8 percentage point, at 4.8 percent, with negative implications for trading partners’ prospects. The outlook has also weakened in **Brazil**, where the fight against inflation has prompted a strong monetary policy response, which will weigh on domestic demand. A similar dynamic is at work in **Mexico**, albeit to a lesser extent. In addition, the US downgrade brings with it the prospect of weaker-than-expected external demand for Mexico in 2022. In **Russia**, the forecast is marginally marked down because of a weak harvest and worse-than-expected third wave. **South Africa’s** growth forecast is downgraded in light of a softer-than-expected second half in 2021 and a weaker outlook for investment as business sentiment remains subdued.

The upward revision to global growth in 2023 is mostly mechanical. Eventually, the shocks dragging 2022 growth will dissipate and—as a result—global output in 2023 will grow a little faster. Among prominent revisions not due to the pandemic, **India’s** prospects for 2023 are marked up on expected improvements to credit growth—and, subsequently, investment and consumption—building on better-than-anticipated performance of the financial sector. **Japan’s** 2023 growth outlook is also revised up by 0.4 percentage point, reflecting anticipated improvements in external demand and continued fiscal support. The upward revision to 2023 global growth is, however, not enough to make up ground lost due to the downgrade to 2022. Cumulative global growth over 2022 and 2023 is projected to be 0.3 percentage point lower than previously forecast.

Inflation is expected to remain elevated in the near term, averaging 3.9 percent in advanced economies and 5.9 percent in emerging market and developing economies in 2022, before subsiding in 2023. Assuming medium-term inflation expectations remain well anchored, and the pandemic eases its grip, higher inflation should fade as supply chain disruptions ease, monetary policy tightens, and demand rebalances away from goods-intensive consumption towards services. The rapid increase in fuel prices is also expected to moderate during 2022–23, which will help contain headline inflation. Futures markets indicate oil prices will rise about 12 percent and natural gas prices about 58 percent in 2022 (both considerably lower than the increases seen

in 2021) before retreating in 2023 as supply-demand imbalances recede further. Similarly, food prices are expected to increase at a more moderate pace of about 4½ percent in 2022 and decline in 2023. In many countries, nominal wage growth remains contained despite employment and participation returning almost to pre-pandemic levels (Figure 2). But in the

Figure 2. Labor and Wages



United States the story is different: a sharp decline in unemployment has been accompanied by buoyant nominal wage growth. This suggests a degree of tightening in US labor markets not evident elsewhere. If US labor force participation remains below pre-pandemic levels and discouraged workers remain on the sidelines, tighter labor markets may feed through to higher prices. As a result, the Federal Reserve communicated in December 2021 that it will taper asset purchases at a faster pace and signaled that the federal funds rate will likely be raised to 0.75–1.00 percent by the end of 2022, some 50 basis points higher than in the previous guidance.

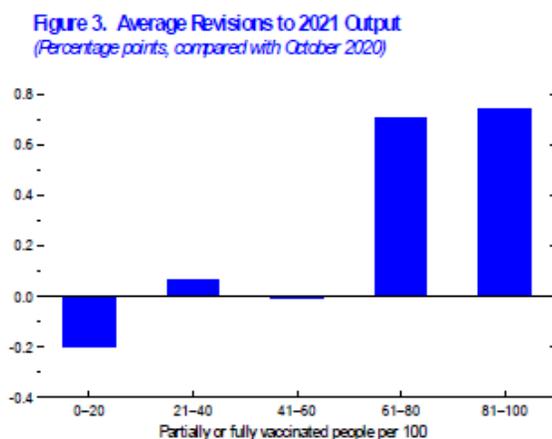
Less accommodative monetary policy in the United States is expected to prompt tighter global financial conditions, putting pressure on emerging market and developing economy currencies. Higher interest rates will also make borrowing more expensive worldwide, straining public finances. For countries with high foreign currency debt, the combination of tighter financial conditions, exchange rate depreciations, and higher imported inflation will lead to challenging monetary and fiscal policy trade-offs. Although fiscal consolidation is anticipated in many emerging market and developing economies in 2022, high post-pandemic debt burdens will be an ongoing challenge for years to come.

Global trade is expected to moderate in 2022 and 2023, in line with the overall pace of the expansion. Assuming that the pandemic eases over 2022, supply chain problems are expected to abate later in the year. The accompanying moderation in global goods demand will also help reduce imbalances. Cross-border services trade—particularly tourism—is expected to remain subdued.

Risks to the Outlook

The balance of risks remains tilted to the downside, with the outlook for the global economy depending critically on five key questions.

What is the likely path of the pandemic? Despite rapid and effective rollouts of vaccination programs in most advanced economies, vaccination programs in many emerging market and developing economies are too slow. This sluggish progress has been a contributing factor weighing on the recovery in under vaccinated countries (Figure 3). The most pressing health risk is the impact of the Omicron variant. Even if symptoms are less severe, increased transmissibility could still add to labor shortages and put extra pressure on hospitals, prompting tighter and longer-lasting mobility restrictions beyond the first quarter (as assumed in the baseline forecast). Global growth could fall below the baseline if these risks materialize.



Moreover, the global growth forecast assumes that adverse health outcomes—severe illness, hospitalizations, deaths—are brought to low levels in most countries by the end of 2022. But low current vaccination rates in many countries risk further new variants. The longer and more widely the COVID-19 virus circulates, the greater the likelihood of new mutations that evade vaccines, turn back the clock on the pandemic, and fuel social discontent if recurrent mobility restrictions are needed to slow transmission.

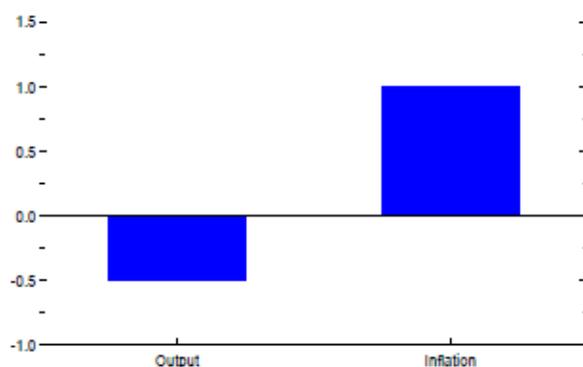
How will less accommodative monetary policy in the United States affect global financial conditions? With inflation on the rise and still large pent-up demand in the system in part due to the pandemic recovery program, US monetary policy will have to tighten. But how far and fast is not yet clear. **The WEO forecast is conditioned on an end to asset purchases in March 2022 and three rate increases in both 2022 and 2023**—consistent with what will be needed to bring inflation back down to the 2 percent medium-term goal. But there are upside risks. Inflation could turn out higher than expected (if, for instance, supply disruptions persist and wage pressures feed into inflation). A different policy stance will be required if circumstances change. Communicating such changes will be a delicate task and risks prompting strong market reactions that could, in turn, result in tighter financial market conditions. Markets’ reactions to (actual or perceived) changes in Federal Reserve policies

will govern how less-accommodative policy in the United States spills over to other countries, particularly emerging markets and frontier economies. Any miscommunication or misunderstanding of such changes may provoke a flight to safety, raising spreads for riskier borrowers. This may put undue pressure on emerging market currencies, firms, and fiscal positions

When will supply chain disruptions ease? The shift toward goods consumption, particularly in advanced economies, overloaded global supply chain networks during the pandemic. This problem was compounded by pandemic-related impediments to transportation and staffing, as well as by the inherently fragile nature of just-in-time logistics and lean inventories. The resulting disruption to global trade led to shortages and higher prices for imported consumer goods. Disruptions in the United States have been particularly severe, consistent with the larger switch into goods consumption. IMF staff analysis suggests that supply disruptions shaved 0.5–1.0 percentage point off global GDP growth in 2021 while adding 1.0 percentage point to core inflation (see Figure 4).

Although international shipping fleets have limited spare capacity, the bottlenecks are *often on land, with trucking and other services unable to move freight off the docks faster than new ships can bring it in*. These supply chain disruptions will eventually ease, not least because the composition of demand is likely to shift back to services (**households can buy only so many durable goods**). The baseline assumes supply-demand imbalances will wane over the course of 2022. But the longer they persist, the more likely they are to feed through to expectations of higher future prices and the larger the risk to the world economy. Dysfunctional global supply chains also leave economies less able to adapt to a possible resurgence of the pandemic, as clogged ports impede the flow of goods needed to adapt to changing public health conditions. The impact of the Omicron variant may further limit the efficiency of ports, add to shipping problems, and delay the rebalancing of consumer demand from goods to services—thus exacerbating supply-demand imbalances.

Figure 4. Impact of 2021 Shocks on World Output and Core Inflation (Percentage points)



Will tight labor markets drive up wages and cause persistently higher inflation? In the baseline forecast, inflation is expected to subside in the coming year and expectations to remain well anchored. Yet there is a risk that persistently elevated living costs and tighter labor markets will compel workers to ask for (and firms to accede to) higher wages. The resulting higher labor costs would in turn push up prices further, perpetuating an inflationary cycle that would require aggressive policy action to combat. These risks appear particularly salient in the United States, where labor market slack seems to have dissipated and labor costs have risen. Inflation in the United States also appears more broad-based—including shelter-related components—and supply disruptions are likely to last longer than in Europe or Asia (see more discussion below). In addition, workers who dropped out of in-person service professions (for example, leisure and hospitality), during the pandemic may be unwilling to return, leading to potential labor shortages in those industries. As such, wages in these professions will be an important bellwether for medium-term inflation as pre-pandemic activities resume, and demand rebalances back toward service consumption.

Latest World Economic Outlook Growth Projections

(real GDP, annual percent change)	ESTIMATE	PROJECTIONS	
	2021	2022	2023
World Output	5.9	4.4	3.8
Advanced Economies	5.0	3.9	2.6
United States	5.6	4.0	2.6
Euro Area	5.2	3.9	2.5
Germany	2.7	3.8	2.5
France	6.7	3.5	1.8
Italy	6.2	3.8	2.2
Spain	4.9	5.8	3.8
Japan	1.6	3.3	1.8
United Kingdom	7.2	4.7	2.3
Canada	4.7	4.1	2.8
Other Advanced Economies	4.7	3.6	2.9
Emerging Market and Developing Economies	6.5	4.8	4.7
Emerging and Developing Asia	7.2	5.9	5.8
China	8.1	4.8	5.2
India	9.0	9.0	7.1
ASEAN-5	3.1	5.6	6.0
Emerging and Developing Europe	6.5	3.5	2.9
Russia	4.5	2.8	2.1
Latin America and the Caribbean	6.8	2.4	2.6
Brazil	4.7	0.3	1.6
Mexico	5.3	2.8	2.7
Middle East and Central Asia	4.2	4.3	3.6
Saudi Arabia	2.9	4.8	2.8
Sub-Saharan Africa	4.0	3.7	4.0
Nigeria	3.0	2.7	2.7
South Africa	4.6	1.9	1.4
Memorandum			
Emerging Market and Middle-Income Economies	6.8	4.8	4.6
Low-Income Developing Countries	3.1	5.3	5.5

Source: IMF, *World Economic Outlook Update*, January 2022

Note: For India, data and forecasts are presented on a fiscal year basis, with FY 2021/2022 starting in April 2021. For the January 2022 WEO Update, India's growth projections are 8.7 percent in 2022 and 6.6 percent in 2023 based on calendar year. For India the impact of the Omicron variant is captured in the column for 2021 in the table.

Will China's real estate slowdown intensify? A broader slowdown in China will affect global prospects, principally via spillovers to commodity exporters and emerging markets. The baseline assumes a significant moderation in real estate investment growth in 2022, reflecting continued tight policies to rein in risks related to leveraged property developers. If the real estate slowdown intensifies further and balance sheet stresses spread beyond property developers, exposed banks and other financial intermediaries may be forced to shrink credit to the broader economy. Such an outcome would hold back investment and consumption, dragging overall growth lower with adverse implications for commodity exporters and other emerging markets.

Beyond these questions, the **ongoing climate emergency** continues to pose grave risks to the global economy. Major natural disasters are more likely, threatening all economies (as seen in the range of extreme weather events—floods, droughts, wildfires—across all continents in 2021). The recurrence of such events would deliver a twofold blow that would most harm vulnerable low-income (often low vaccination) countries, while also further straining global supply chains. Despite the stated ambition at the Glasgow climate conference (COP26), current commitments to reduce greenhouse gases fall far short of limiting the increase in global temperature to 2 degrees Celsius above preindustrial levels.

Other factors: Geopolitical tensions, including in eastern Europe and east Asia, imperil energy supply, international trade, and policy cooperation. Social unrest, which had declined earlier in the pandemic, is once again on the rise in some countries—related in part to elevated food and energy prices. Moreover, many of the tariff increases introduced during 2018–19 is still in place, and cross-border technology frictions remain salient. All of these elements threaten additional roadblocks in the path to recovery.

INTERNATIONAL MONETARY FUND

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