EXECUTIVE SUMMARY

Current Developments

Rising inflation and climbing interest rates have supplanted more than a decade of muted inflation and low interest rates in many countries. Recession concerns are surfacing and geopolitical tensions have increased further as Russia's invasion of Ukraine persists (October 2022 *World Economic Outlook*). Fiscal policy trade-offs are increasingly difficult, especially for high-debt countries where responses to the COVID-19 pandemic exhausted their fiscal space. Households are struggling with elevated food and energy prices, raising the risk of social unrest.

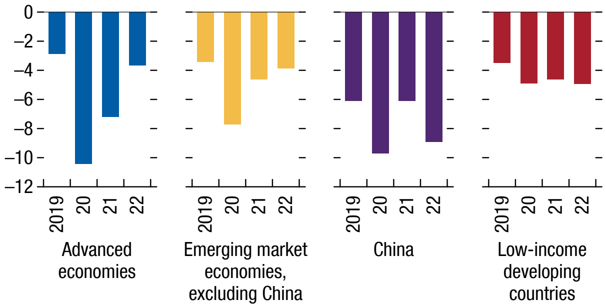
A Shifting Landscape Puts Pressure on Budgets

In 2021 and 2022, fiscal deficits have fallen sharply in advanced and emerging market economies but remain larger than prepandemic levels across income groups (Figure ES.1). The contraction in the average deficit for advanced economies and emerging market economies (excluding China) is notable, reflecting the unwinding of pandemic-related measures amid rising inflation. In addition, many oil exporters are now running fiscal surpluses because of higher oil revenues. Conversely, China's deficit is projected to widen in 2022 as growth slows and inflation remains low. For low-income developing countries, which had a relatively mild fiscal response to the pandemic, the average deficit has barely changed. Compared with 2019, the larger deficits in advanced economies and low-income developing countries reflect higher spending than three years ago (partly because of responses to the food and energy crises), whereas in emerging market economies it is mainly because revenues have yet to rebound.

Global government debt is projected to be 91 percent of GDP in 2022, which is about 7.5 percentage points above the prepandemic levels, despite the recent reduction in the ratio for many countries (Figure ES.2). Debt decreased because of deficit reduction, economic recovery, and inflation shocks (Figure ES.3).

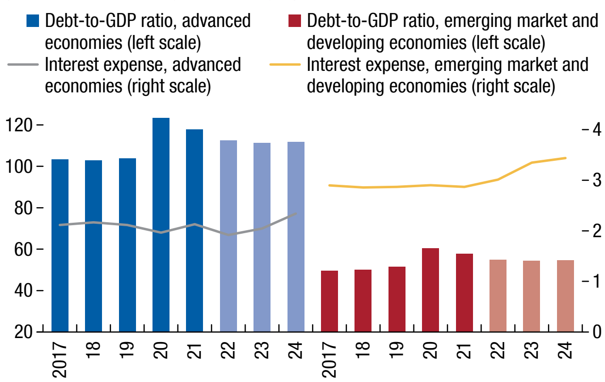
The sharp rise in food and energy prices also puts pressure on government budgets. Food and energy prices remain well above prepandemic levels—the UN Food and Agriculture Organization's Food Price Index for August 2022 was 45 percent higher than in 2019. Countries have implemented new

Figure ES.1. National Budget Balances, by Income Group, 2019–22
(Percent of GDP)



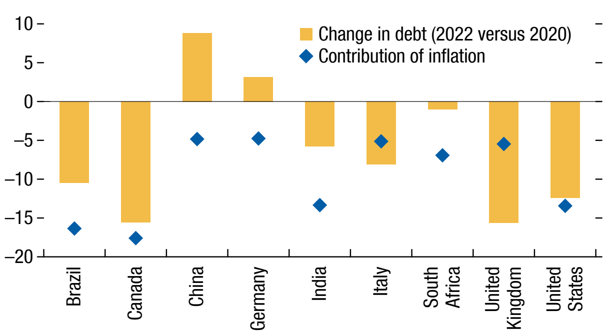
Source: IMF, World Economic Outlook database.

Figure ES.2. National Gross Debt and Interest Expense, by Income Group, 2014–24
(Percent of GDP, weighted averages)



Sources: IMF, World Economic Outlook; and IMF staff calculations.
Note: China is excluded. Bars for 2022–24 are projected data.

Figure ES.3. Effect of Inflation Shock on the Debt Ratio, Selected Countries, 2022 versus 2020
(Percent of GDP)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.

measures, including price subsidies, tax cuts, and cash transfers, to help households. In most countries, the announced measures cost more than 0.5 percent of GDP (excluding existing subsidies) reflecting in part insufficient targeting. Low-income developing countries have incurred the highest relative cost for new food-related measures (Figure ES.4).

Budget constraints are tightening as global financial conditions become more challenging (October 2022 *Global Financial Stability Report*). Many emerging market economies and low-income developing countries have been managing surging spreads in 2022; the median spread for low-income developing countries has increased over 50 percent in the past year (Figure ES.5). Interest expense relative to GDP is projected to rise over the coming years even as debt stabilizes. If inflation becomes more volatile, borrowing costs could rise further as investors require a higher premium for long-term debt. Also, revenue could fall if higher interest rates reduce central bank profits and the related dividend payments to governments. Moreover, almost 60 percent of the lowest-income economies are already in or at high risk of debt distress, highlighting the need for a robust Common Framework for debt relief.

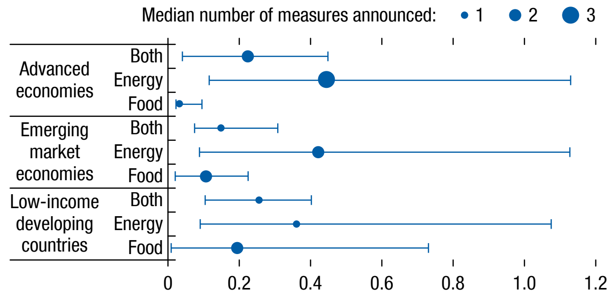
The global economy is slowing amid continued tight financing conditions. A sharp downturn would further accentuate trade-offs among competing priorities of demand management, debt stabilization, protection of vulnerable populations, and investment for the future.

Fiscal Policy Needs to Adjust

Defining a consistent medium-term policy framework for the postpandemic world is crucial. Relying on repeated inflation surprises to reduce public debt is not a viable strategy and will lead to spending pressures (for example, wages and cost of services). Reducing deficits, as many advanced and emerging markets are projected to do (Figure ES.6), is necessary to help tackle inflation and address debt vulnerabilities. Fiscal consolidation sends a powerful signal that policymakers are aligned in their fight against inflation, which, in turn, would reduce the size of required policy rate increases to keep inflation expectations anchored and keep debt servicing costs lower than otherwise. Many countries are also revamping their fiscal rules to anchor policies. While politically difficult, gradual and steady fiscal tightening is less disruptive than an abrupt fiscal pullback brought on by loss of market confidence.

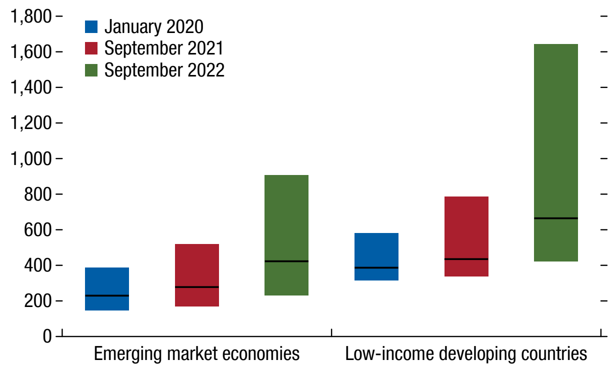
Prioritizing policies and programs is increasingly vital as governments operate within tighter budgets. Top priorities are to ensure everyone has access to affordable food and to protect low-income households from rising inflation.

Figure ES.4. Food and Energy Support Policies, by Income Group
(Percent of GDP, median, 20th and 80th percentiles)



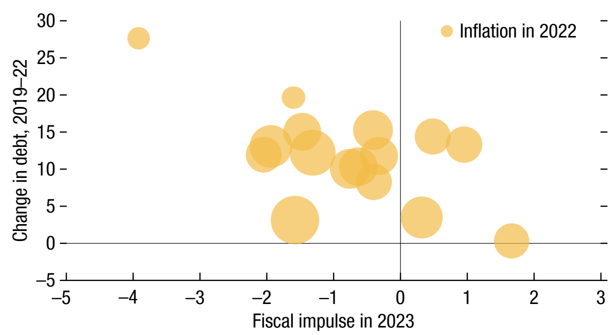
Source: IMF staff estimates.
Note: Whiskers reflect the 20th and 80th percentiles. Dots reflect the median and the number of announced measures of each type.

Figure ES.5. Sovereign Spreads, by Income Group, 2020–22
(Basis points)



Source: JPMorgan Emerging Market Bond Index.
Note: Lines are median and shaded areas are interquartile ranges for a sample of 49 emerging market economies and 9 low-income developing countries.

Figure ES.6. Fiscal Impulse, Inflation, and Debt for G20 Countries
(Percent of GDP)



Source: IMF, World Economic Outlook database.
Note: Includes Spain; excludes Argentina, Russia, Saudi Arabia, and Türkiye. Fiscal impulse is measured by the change in the cyclically adjusted primary balance. The size of the bubble reflects the inflation rate.

Faced with long-lasting supply shocks and broad-based inflation, attempts to limit price increases through price controls, subsidies, or tax cuts will be costly to the budget and ultimately ineffective. Governments should allow prices to adjust and provide temporary targeted cash transfers to the most vulnerable. Price signals are critical to promote energy conservation and encourage private investment in renewables. Public investment in critical areas should be safeguarded. As part of the prioritization effort, countries may need to raise additional revenues and contain the growth of other expenditures, including public wages, both of which could help contain overall wage and price pressures. In the dwindling number of countries with fiscal space, and where inflation is under control, automatic stabilizers should operate fully.

Helping People Bounce Back

Government policies foster resilience by helping households and firms recover from or adjust to adversity. In advanced economies, fiscal actions were swift and forceful to protect people's livelihoods from the outset of the COVID-19 pandemic and laid the foundation for a quick bounceback. Such measures also involved fiscal costs and risks, with implications for policies going forward. Fiscal responses were more diverse among emerging markets and developing economies, with many economies financially constrained throughout the pandemic.

Building a resilient society requires government actions to protect households and firms against large losses of *real* income and employment—the focus of this *Fiscal Monitor*. It also requires actions in other intertwined areas, including (but not limited to) health care and pandemic preparedness, adaptation to climate changes and natural disasters, and equitable access to opportunities. For example, a society with strong social safety nets and equitable access to health care and education helps ensure that individuals who lose their jobs do not suffer lasting setbacks in their well-being or lifetime earnings. The COVID-19 pandemic (and the global financial crisis a decade and a half ago) led to innovative and forceful discretionary fiscal responses, against the backdrop of constrained monetary policy with interest rates near zero or negative, in many advanced economies. The ensuing reassessment of the appropriate size and mix of policy tools in response to large crises can inform the response to current challenges, including the cost-of-living squeeze associated with spikes in food and energy prices, and can help governments prepare for future adversities:

- Social protection systems help people bounce back from unemployment, sickness, or poverty, making them resilient to a broad set of negative shocks. As demonstrated during the pandemic, social safety nets or broad-based cash transfers can be expanded quickly, often by leveraging new technologies. But preparation is necessary to make such systems more readily scalable and better targeted, to limit unnecessary spending, and to deliver support to those who truly need it. Reducing informality in the economy—a challenge in many low-income and developing economies—would allow people and firms to benefit from better protection when crises strike.
- Job-retention schemes provided strong income stabilization and were largely well targeted. They are a useful part of the fiscal toolbox alongside unemployment income support, particularly in situations in which layoffs would curb labor productivity.
- To cushion the blow from high food and energy prices, policies should in general avoid price subsidies or controls that are costly and ineffective, and instead target support to low-income households through social safety nets. Countries without strong safety nets can expand social programs (for example, school feeding and public transportation) or lump-sum discounts on utilities. For low-income developing countries, food security should be prioritized within the existing fiscal envelope.
- Exceptional financial support to firms averted an economy-wide implosion in recent crises but needs to be restricted to major crisis situations in which severe negative externalities, such as risks of widespread bankruptcies, are evident. Public interventions to support viable firms are risky because many countries have weak governance and limited capacity to assess or monitor firms' viability. To manage the fiscal risks from measures without immediate budget impact, such as direct lending and public guarantees, governments should focus on transparency, quantification of risks, good governance, and enlisting private sector expertise to assess firms' viability.

Building on the experience of the pandemic, policymakers can now develop tools that can be readily deployed and prepare strategies that set out desirable policy responses under various scenarios.

Where protection systems are well developed, and high-frequency economic indicators are reliable, prelegislated actions conditional on previously specified triggers may be considered (such as expanded unemployment insurance following consecutive employment drops). Encouraging the private sector to build its own resilience through insurance or having workers acquire new skills can reduce the need for government intervention, which can be devoted to protecting the most vulnerable households.

Policy trade-offs are at the forefront when designing fiscal strategies. To respond flexibly during adverse events, governments need to gradually build fiscal buffers in normal times (preferably in the context of a medium-term fiscal framework) and preserve debt sustainability and access to financing. Macroeconomic trade-offs also imply that when inflationary pressures are high, fiscal policy should protect the most vulnerable while pursuing a tightening stance to avoid overburdening monetary policy in the fight against inflation. Building buffers and tightening fiscal policy require prioritizing spending among competing needs and mobilizing revenues in a growth-friendly way. These trade-offs are stark for low-income countries that face adverse shocks while pursuing development goals—similarly important elements of resilience.

Domestic measures need to be complemented by global cooperation to foster resilience. Global synergies on pandemic preparedness and vaccine deployment were evident during the pandemic. Investing in climate adaptation can benefit from cooperation among countries. For emerging markets and developing economies that are at risk of a food crisis and have limited resources or capacity, greater global efforts can provide emergency financing, humanitarian assistance, and unhindered trade.