FOREWORD

COVID-19 became a major pandemic and overwhelmed health systems around the world. Amid tremendous uncertainty, governments enacted lockdowns. These developments triggered the sharpest contraction in economic activity recorded in quarterly national accounts, and financial markets initially crashed down in a fear spiral. The pandemic and its repercussions shaped public finances in the last three years and will continue to have a bearing even as the pandemic recedes.

After providing extraordinary support in 2020–21, fiscal policy is returning to normal. In many countries, the reduction in public deficits started already in 2021, and additional countries joined the trend in 2022 with monetary and fiscal policy tightening in almost three-quarters of countries. During the pandemic, many countries suspended fiscal rules, activated escape clauses, or modified fiscal targets to allow for the extraordinary policy response. Now, most plan to revisit their fiscal rules and frameworks before re-enacting them.

For the world, public debt-to-GDP ratios fell sharply in 2021 and 2022, bringing them about halfway back from the increase of about 15 percentage points of GDP in 2020. However, going forward, debt ratios are projected to start going up again in 2023 and continue to increase by about 1¼ percentage points per year over the medium term through 2028. Taken together, the level of public debt is now more elevated and projected to grow faster than foreseen before the pandemic, at the same time that real interest rates are also rising.

Developments in the United States and China shape these global public debt trends. In the United States, public debt to GDP is projected to increase by almost 3 percentage points of GDP per year from 2024, about twice the pace projected before the pandemic. By 2028 the United States' public debt ratio is projected to exceed 135 percent of GDP, surpassing the pandemic peak. For China, the public debt to GDP ratio is projected to increase continuously to reach 105 percent in 2028. The annual increase in the debt ratio, projected for China, is even more substantial than for the United States (4.5 against 2.8 percentage points). Excluding the United States and China, public debt ratios worldwide would be declining—albeit slowly—from 2023 to 2028.

Another legacy of the pandemic was the rapidly rising prices, especially of food and energy, which increased early in the pandemic, and later accelerated with the Russian invasion of Ukraine. The surge in inflation in 2021 and 2022 helped reduce debt ratios. The inflation surprise contributed about 9.4 percentage points of GDP (about 1¼ times the observed decline). The *Fiscal Monitor* looks at the effects of inflation on public finances and household budgets. It documents that inflation surprises erode the value of government debt for bondholders. More generally, inflation surprises benefit net debtors and penalize net creditors. Across households, the wealth effects of inflation are strongly influenced by age, with young households (net borrowers) benefiting and old households (net lenders) suffering from an erosion of wealth. In addition, the distributive effects of inflation depend on consumption patterns and the composition of incomes.

Fiscal policy can and should support monetary policy in bringing inflation back to target in a timely manner. Stronger fiscal balances contribute to cooling off aggregate demand and, hence, moderate the required increase in policy rates. In addition, rebalancing public finances helps limit public finance risks, and a more balanced policy mix contributes to financial stability, reducing the risk of observing fiscal-financial feedback loops.

The *Fiscal Monitor* looks at the possibility of fiscal policy contributing to disinflation while protecting the vulnerable. The results of our Chapter 2 indicate that when monetary policy acts alone or fiscal policies are not adequately targeted, the poorest households bear the brunt of the costs of disinflation. Higher interest rates are less costly for wealthier families as they have financial buffers and benefit from asset income. Fiscal tightening with targeted transfers moderates interest rate increases and allows for smaller declines in total private consumption (and no fall at all in the consumption of the poorest households).

Among the existential threats today's world faces, climate change stands out as one of the top threats. Under unchanged policies, emissions in this decade will likely increase and the path to limit temperature increases to 2° C above pre-industrial levels will be missed. In the end, collective global actions are urgently needed. One crucial argument comes from the fact that the countries that contribute least to global warming are the most vulnerable. Climate change is the topic of the forthcoming October 2023 *Fiscal Monitor*.

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