CHAPTER 1

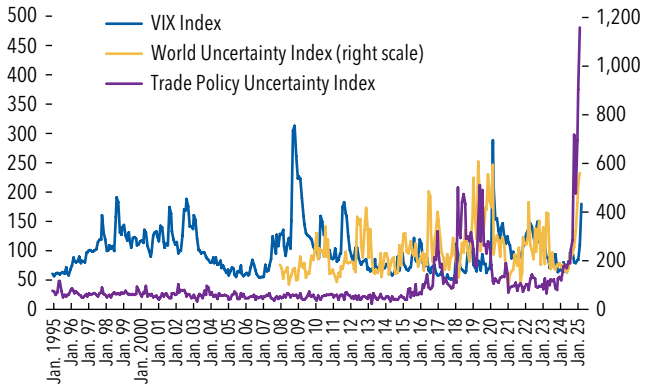
FISCAL POLICY UNDER UNCERTAINTY

Fiscal Outlook Worsens amid High Uncertainty

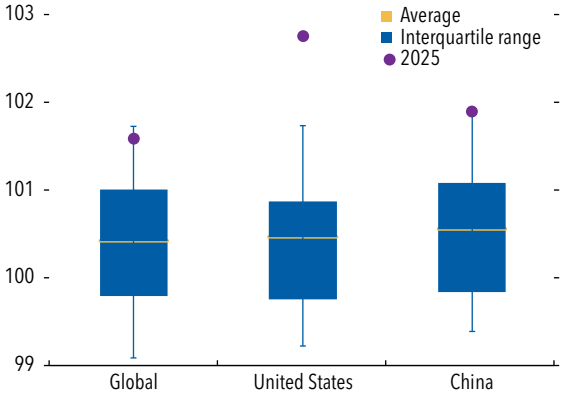
Elevated uncertainty and significant policy shifts are reshaping economic and fiscal outlooks. Major tariff announcements by the *United States*, countermeasures by other countries, and exceptionally high levels of policy uncertainty, are contributing to worsening prospects and heightened risks. Progress with disinflation appears to have stalled in many countries; growth prospects, already disappointing, have been significantly downgraded (see April 2025 *World Economic Outlook*), while escalating financial turbulence presents considerable downside risks (see April 2025 *Global Financial Stability Report*). On the fiscal front, many countries were already grappling with stretched budgets and rising public debt burdens. Increased economic and policy uncertainty (Figure 1.1, panels 1 and 2), rising yields in key economies, and widening spreads in emerging markets (Figure 1.1, panels 3 and 4), coupled with higher defense spending—particularly in Europe—and a challenging foreign aid landscape, are now

Figure 1.1. Rising Uncertainties with Tighter and More Volatile Financial Conditions

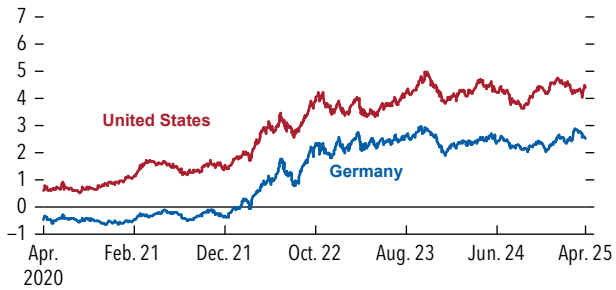
1. Geopolitical Risk, Trade Policy, and World Uncertainty Indexes
(Index)



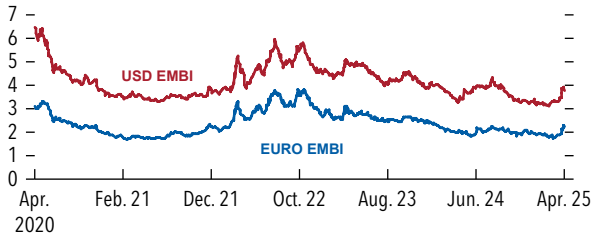
2. Fiscal Policy Uncertainty Index Distribution, 2005–25
(Index)



3. 10-Year Bond Yields
(Percent)



4. Emerging Market Bond Index Global Sovereign Spread
(Basis points)



Sources: Bloomberg Finance L.P.; Fiscal Policy Uncertainty Index: Hong, Nguyen, and Ke 2024; Geopolitical Risk Index: Caldara and Iacoviello 2022; Trade Policy Uncertainty Index: Caldara and others 2020; and World Uncertainty Index: Ahir, Bloom, and Furceri 2022.
Note: The data for panels 1 and 2 have April 10, 2025, as cutoff date. The data for panels 3 and 4 have April 14, 2025, as cutoff date. A higher number means higher uncertainty and vice versa. Panel 1 presents the index relative to 2008 (where index = 100 in 2008), meaning a value of 200 represents uncertainty that is twice as high as in 2008. Panel 2 standardizes the index with a mean of 100 and a standard deviation of one, meaning that an increase of one unit corresponds to a one-standard-deviation increase. Vertical bars in panel 2 correspond to the 10th and 90th percentiles. EMBI = Emerging Market Bond Index; USD = US dollars; VIX = Chicago Board Option Exchange Volatility Index.

further complicating the fiscal outlook. In this volatile landscape, countries will need to first and foremost put their own fiscal house in order. A gradual fiscal adjustment within a credible medium-term framework is crucial for most countries to reduce debt, build fiscal buffers against uncertainties, accommodate priority spending, and improve long-term growth prospects.

The global fiscal situation deteriorated in 2024, but with notable divergence across countries. The global fiscal deficit increased by 0.1 percentage point, reaching an average of 5.0 percent of GDP (Table 1.1), whereas public debt rose by 1 percentage point to 92.3 percent of GDP (Table 1.2). This reflected ongoing legacies of high subsidies, social

Table 1.1. General Government Fiscal Balance, 2019–30: Overall Balance
(Percent of GDP, unless noted otherwise)

							Projections					
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
World	**–3.5**	**–9.5**	**–6.3**	**–3.7**	**–4.9**	**–5.0**	**–5.1**	**–4.7**	**–4.5**	**–4.5**	**–4.5**	**–4.6**
Advanced Economies	**–3.0**	**–10.3**	**–7.2**	**–2.9**	**–4.6**	**–4.7**	**–4.3**	**–3.9**	**–3.8**	**–3.9**	**–3.9**	**–4.0**
Advanced Economies excl. US	**–1.0**	**–7.6**	**–4.3**	**–2.3**	**–2.5**	**–2.6**	**–2.5**	**–2.5**	**–2.4**	**–2.5**	**–2.6**	**–2.6**
Canada	–0.0	–10.9	–3.1	0.6	0.1	–2.1	–1.9	–1.6	–1.4	–1.2	–1.0	–0.8
Euro Area	–0.5	–7.0	–5.1	–3.5	–3.6	–3.1	–3.2	–3.4	–3.5	–3.5	–3.6	–3.7
France	–2.4	–8.9	–6.6	–4.7	–5.4	–5.8	–5.5	–5.9	–6.1	–6.1	–6.0	–6.1
Germany	1.3	–4.4	–3.2	–2.1	–2.5	–2.8	–3.0	–3.5	–3.9	–4.1	–4.3	–4.4
Italy	–1.5	–9.4	–8.9	–8.1	–7.2	–3.4	–3.3	–2.8	–2.6	–2.4	–2.5	–2.5
Spain[1]	–3.0	–10.0	–6.7	–4.6	–3.5	–3.2	–2.7	–2.4	–2.3	–2.2	–2.1	–2.0
Japan	–3.0	–9.1	–6.1	–4.2	–2.3	–2.5	–2.9	–3.1	–3.3	–4.0	–4.6	–5.3
United Kingdom	–2.5	–13.2	–7.7	–4.6	–6.1	–5.7	–4.4	–3.7	–3.1	–2.8	–2.6	–2.3
United States	–5.8	–14.1	–11.4	–3.7	–7.2	–7.3	–6.5	–5.5	–5.4	–5.6	–5.5	–5.6
Other Advanced Economies	–0.1	–4.7	–1.1	0.7	–0.2	–0.5	–0.6	–0.3	–0.1	–0.1	–0.2	–0.2
Emerging Market and Developing Economies	**–4.4**	**–8.4**	**–5.0**	**–4.8**	**–5.2**	**–5.5**	**–6.1**	**–5.9**	**–5.5**	**–5.4**	**–5.3**	**–5.3**
Emerging Market and Middle-Income Economies	–4.4	–8.6	–5.0	–4.9	–5.3	–5.6	–6.3	–6.1	–5.6	–5.5	–5.4	–5.4
Emerging Markets excl. China	–3.1	–7.8	–4.2	–2.9	–4.2	–4.3	–4.5	–4.2	–3.8	–3.5	–3.4	–3.3
Excluding MENA Oil Producers	–4.6	–8.7	–5.3	–5.6	–5.8	–6.0	–6.5	–6.3	–5.9	–5.8	–5.7	–5.7
Asia	–5.6	–9.4	–6.3	–7.0	–6.4	–6.7	–7.6	–7.6	–7.2	–7.2	–7.1	–7.1
China[2]	–6.0	–9.6	–5.9	–7.3	–6.7	–7.3	–8.6	–8.5	–8.1	–8.1	–8.0	–8.1
India	–7.7	–12.9	–9.4	–9.0	–7.9	–7.4	–6.9	–7.2	–7.1	–7.0	–6.8	–6.7
Vietnam	–0.4	–2.9	–1.4	0.7	–2.4	–1.6	–3.4	–3.2	–3.0	–2.9	–2.9	–2.9
Europe	–0.6	–5.4	–1.7	–2.4	–4.2	–4.4	–4.0	–3.4	–3.0	–2.8	–2.7	–2.7
Russia	1.9	–4.0	0.8	–1.6	–2.5	–2.2	–1.0	–1.2	–1.1	–1.1	–1.2	–1.3
Latin America	–3.7	–8.2	–3.9	–3.6	–5.2	–4.8	–4.8	–4.0	–3.4	–3.1	–2.9	–2.9
Brazil	–4.9	–11.6	–2.6	–4.0	–7.7	–6.6	–8.5	–7.7	–6.3	–5.2	–4.9	–4.7
Mexico	–2.3	–4.3	–3.7	–4.3	–4.3	–5.7	–4.0	–3.3	–2.9	–2.9	–2.9	–2.9
MENA	–2.3	–8.2	–1.9	3.6	0.1	–1.6	–3.4	–3.2	–2.4	–1.8	–1.5	–1.2
Saudi Arabia	–4.2	–10.7	–2.2	2.5	–2.0	–2.8	–4.9	–4.9	–4.0	–3.7	–3.3	–3.1
South Africa	–5.1	–9.6	–5.5	–4.3	–5.4	–6.1	–6.6	–6.1	–5.9	–5.8	–5.7	–5.6
Low-Income Developing Countries	**–4.1**	**–5.4**	**–4.6**	**–4.5**	**–3.9**	**–3.4**	**–3.5**	**–3.3**	**–3.1**	**–3.1**	**–3.2**	**–3.2**
Kenya	–7.4	–8.1	–7.2	–6.1	–5.7	–5.5	–5.4	–5.0	–4.4	–3.9	–3.6	–3.6
Nigeria	–4.7	–5.6	–5.5	–5.4	–4.2	–3.4	–4.5	–4.5	–3.9	–4.3	–4.7	–4.7
Oil Producers	**–0.1**	**–7.3**	**–0.6**	**3.0**	**0.5**	**–0.9**	**–1.2**	**–1.3**	**–1.0**	**–0.8**	**–0.6**	**–0.5**
Memorandum												
World Output (percent)	**2.9**	**–2.7**	**6.6**	**3.6**	**3.5**	**3.3**	**2.8**	**3.0**	**3.2**	**3.2**	**3.2**	**3.1**

Source: IMF staff estimates and projections.

Note: The estimates and projections are based on statistical information available through April 14, 2025, but may not reflect the latest published data in all cases. For the date of the last data update for each economy, please refer to the notes provided in the online World Economic Outlook database.

All country averages are weighted by nominal GDP converted to US dollars (adjusted by purchasing power parity only for world output) at average market exchange rates in the years indicated and based on data availability. Projections are based on IMF staff assessments of current policies. For country-specific details, see "Data and Conventions" and Tables A, B, C, and D in the Methodological and Statistical Appendix. excl. = excluding; MENA = Middle East and North Africa.

[1] Including financial sector support.

[2] China's deficit and public debt numbers presented in this table cover a narrower perimeter of the general government than the IMF staff estimates in China Article IV reports (see IMF 2024 for a reconciliation of the two estimates).

Table 1.2. General Government Debt, 2019–30

(Percent of GDP)

							Projections					
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
Gross Debt												
World[1]	**83.8**	**98.9**	**94.0**	**89.9**	**91.3**	**92.3**	**95.1**	**96.7**	**97.5**	**98.2**	**98.9**	**99.6**
Advanced Economies	**103.6**	**122.0**	**115.5**	**109.3**	**108.2**	**108.5**	**110.1**	**110.9**	**111.5**	**112.0**	**112.6**	**113.3**
Advanced Economies excl. US	**100.4**	**114.8**	**109.1**	**101.7**	**99.5**	**98.4**	**99.7**	**100.2**	**100.2**	**100.4**	**100.4**	**100.7**
Canada[2]	90.2	118.1	112.6	104.2	107.7	110.8	112.5	110.9	109.4	107.9	106.2	104.1
Euro Area	83.6	96.5	93.9	89.5	87.4	87.7	88.7	89.7	90.4	91.1	91.9	92.9
France	98.1	114.8	112.7	111.3	109.7	113.1	116.3	119.1	121.6	123.9	126.1	128.4
Germany	58.7	68.0	68.1	65.0	62.9	63.9	65.4	67.0	68.5	70.4	72.5	74.8
Italy	133.8	154.3	145.7	138.3	134.6	135.3	137.3	138.5	138.6	138.2	137.7	137.7
Spain	97.6	119.2	115.6	109.4	105.0	101.8	100.6	99.0	97.6	96.0	94.5	93.0
Japan	236.4	258.4	253.7	248.3	240.0	236.7	234.9	233.7	232.1	231.2	231.1	231.7
United Kingdom	85.7	105.8	105.1	99.6	100.4	101.2	103.9	105.4	106.1	106.5	106.5	106.1
United States[2]	108.2	132.0	124.7	118.8	119.0	120.8	122.5	123.7	124.9	125.9	127.0	128.2
Emerging Market and Developing Economies	**54.5**	**64.1**	**63.2**	**63.4**	**67.4**	**69.5**	**73.6**	**76.7**	**78.4**	**79.7**	**80.9**	**82.0**
Emerging Market and Middle-Income Economies	55.2	65.0	64.0	64.2	68.2	70.3	74.8	78.1	80.0	81.5	82.9	84.2
Emerging Markets excl. China	52.0	61.4	58.4	55.0	57.5	56.7	58.4	59.6	60.0	60.2	60.2	60.1
Excluding MENA Oil Producers	56.8	66.5	65.7	66.7	70.8	72.9	77.3	80.7	82.5	84.0	85.4	86.8
Asia	58.8	68.9	69.6	73.1	77.8	82.3	87.9	92.0	94.3	96.4	98.3	100.2
China[3]	59.4	69.0	70.1	75.5	82.0	88.3	96.3	102.3	105.9	109.2	112.6	116.0
India	75.0	88.4	83.5	82.2	81.2	81.3	80.4	79.6	78.8	77.9	76.9	75.8
Vietnam	41.0	41.3	39.2	34.9	34.4	32.9	33.6	34.9	35.6	36.1	36.6	37.1
Europe	28.4	36.9	34.4	31.8	33.6	34.9	37.9	40.0	40.9	41.6	42.2	42.8
Russia	13.7	19.2	16.5	18.5	19.5	20.3	21.4	22.5	23.7	24.7	25.9	27.2
Latin America	67.5	76.6	70.8	68.3	74.0	70.4	71.6	72.5	72.9	73.0	72.6	72.2
Brazil[4]	87.1	96.0	88.9	83.9	84.0	87.3	92.0	96.0	98.1	99.1	99.4	99.4
Mexico	51.9	58.5	56.7	53.8	52.8	58.4	60.7	61.1	61.1	61.1	61.2	61.3
MENA Region	43.1	54.2	51.3	43.4	44.0	44.6	47.4	49.8	50.8	51.6	52.2	52.5
Saudi Arabia	21.6	31.0	28.6	23.8	26.2	29.9	34.8	38.5	40.9	42.9	44.5	45.9
South Africa	56.1	68.9	68.7	70.8	73.4	76.4	79.6	81.7	83.7	85.5	87.1	88.7
Low-Income Developing Countries	**43.1**	**50.1**	**49.4**	**50.2**	**53.7**	**52.7**	**52.0**	**50.3**	**48.9**	**47.7**	**46.4**	**45.2**
Kenya	59.1	68.0	68.2	67.8	73.0	65.6	68.3	70.2	69.8	68.1	66.2	64.4
Nigeria	30.2	35.6	36.8	40.4	48.7	52.9	52.5	51.6	49.1	47.6	46.4	45.4
Oil Producers	**45.3**	**59.6**	**55.0**	**48.0**	**51.4**	**53.2**	**55.8**	**57.1**	**57.5**	**57.8**	**57.9**	**58.0**
Net Debt[5]												
World[1]	**67.0**	**78.2**	**75.7**	**72.0**	**72.0**	**73.1**	**75.0**	**76.1**	**76.8**	**77.4**	**78.0**	**78.7**
Advanced Economies	**73.3**	**84.8**	**82.0**	**78.6**	**78.6**	**79.6**	**81.2**	**82.2**	**82.9**	**83.7**	**84.6**	**85.6**
Canada[2]	8.7	16.3	14.2	13.6	14.4	11.9	12.5	13.2	13.6	13.9	14.2	14.1
Euro Area	68.6	78.4	76.6	74.8	73.8	74.7	76.0	77.4	78.4	79.4	80.6	81.8
France	89.0	101.6	100.5	101.1	101.6	105.0	108.2	111.0	113.5	115.8	118.0	120.3
Germany	39.8	45.3	46.3	46.3	46.2	47.7	49.6	51.6	53.7	56.0	58.6	61.3

Table 1.2. General Government Debt, 2019–30 *(continued)*
(Percent of GDP)

							Projections					
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
Italy	121.4	140.9	133.6	127.1	124.1	125.1	127.3	128.8	129.2	129.0	128.8	129.0
Spain	83.1	100.7	96.4	98.6	93.5	91.2	89.5	88.3	87.1	86.0	84.9	83.7
Japan	151.6	162.0	156.0	149.5	136.0	134.6	134.2	134.3	134.2	134.8	136.2	138.1
United Kingdom	75.8	93.1	91.6	89.8	91.8	93.7	95.1	96.4	97.1	97.5	97.4	97.0
United States[2]	81.1	95.6	95.5	91.6	94.0	96.5	98.0	99.2	100.4	101.4	102.7	104.0

Source: IMF staff estimates and projections.

Note: The estimates and projections are based on statistical information available through April 14, 2025, but may not reflect the latest published data in all cases. For the date of the last data update for each economy, please refer to the notes provided in the online World Economic Outlook database.

All country averages are weighted by nominal GDP converted to US dollars (adjusted by purchasing power parity only for world output) at average market exchange rates in the years indicated and based on data availability. Projections are based on IMF staff assessments of current policies. For country-specific details, see "Data and Conventions" and Tables A, B, C, and D in the Methodological and Statistical Appendix. excl. = excluding; MENA = Middle East and North Africa.

[1] Gross and net debt averages do not include the debt incurred by the European Union and used to finance the grants portion of the NextGenerationEU package. This debt totaled €58 billion (0.4 percent of European Union GDP) as of December 31, 2021, and €158 billion (1 percent of European Union GDP) as of February 16, 2023. Debt incurred by the European Union and used to on-lend to member states is included within member state debt data and regional aggregates.

[2] For cross-economy comparability, gross and net debt levels reported by national statistical agencies for economies that have adopted the 2008 System of National Accounts (Canada, United States) are adjusted to exclude unfunded pension liabilities of government employees' defined-benefit pension plans.

[3] China's deficit and public debt numbers presented in this table cover a narrower perimeter of the general government than the IMF staff estimates in China Article IV reports (see IMF 2024 for a reconciliation of the two estimates).

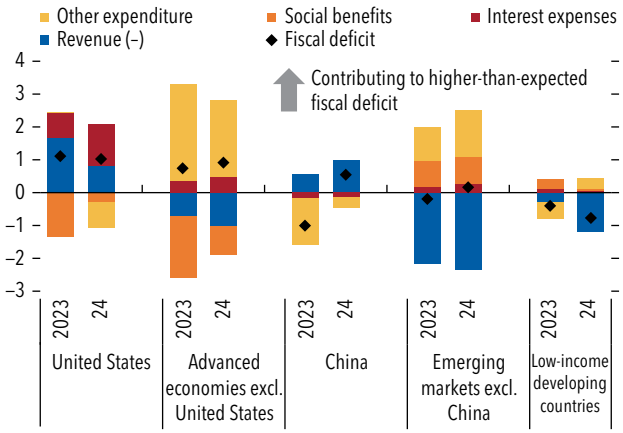
[4] Gross debt refers to the nonfinancial public sector, excluding Eletrobras and Petrobras, and includes sovereign debt held on the balance sheet of the central bank.

[5] Net debt refers to gross debt minus financial assets in the form of debt instruments.

benefits, other current spending from the COVID-19 pandemic (Figure 1.2), and rising net interest expenses (Figure 1.3). Compounding these challenges, 53 percent of low-income developing countries and 23 percent of emerging markets were at high risk of debt distress or in debt distress.

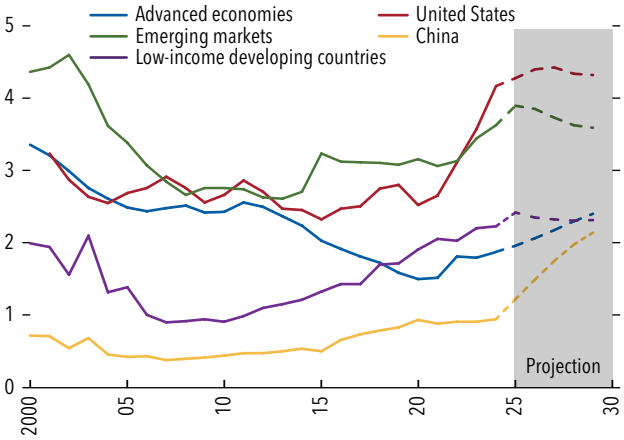
Economic forecasts are surrounded by high uncertainty mostly due to the swift escalation of trade tensions and policy ambiguity. Based on the April 2025 *World Economic Outlook* "reference point" forecast, using information available as of April 4, 2025, global public debt is projected to rise by an additional 2.8 percentage points of GDP in 2025, approaching 100 percent of GDP in 2030 and surpassing the pandemic peak (Table 1.2). Major economies, such as *Brazil*, *China*, *France*, *South Africa*, the *United Kingdom*, and

Figure 1.2. Fiscal Policy Legacies from the COVID-19 Pandemic
(Percentage points of GDP)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: For China, spending on social benefits is not separately reported in the *World Economic Outlooks*. The bars indicate differences between pandemic projections and current projections for each revenue and spending item. Current projections refer to April 2025 *World Economic Outlook* reference point; pandemic projections refer to April 2020 *World Economic Outlook* projections. excl. = excluding.

Figure 1.3. General Government Interest Expenses
(Percent of GDP)



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

the *United States*, are key contributors to the increase in global public debt.[1] In addition, gross financing needs are expected to remain elevated across many countries. Risks of even higher debt levels have increased due to tighter and more volatile financial conditions and heightened economic uncertainty.

Recent Fiscal Developments and Outlook

Budget deficits and debt levels in many countries remained elevated in 2024, diminishing room for budgetary maneuver, albeit with considerable heterogeneity across countries (Tables 1.1 and 1.2; Figure 1.4).

Based on the April 2025 *World Economic Outlook* "reference point" forecast using information available as of April 4, 2025, the fiscal outlook is influenced by three main factors: tariffs, uncertainty, and financial conditions. Tariffs imposed by importing countries create a negative supply shock, resulting in higher prices and reduced output and productivity in the medium term. Conversely, exporting countries experience a negative demand shock from these tariffs, leading to a short-term decline in demand and downward price pressures. Retaliatory tariffs from exporting countries have the opposite effect. Recent tariff announcements have increased uncertainty and contributed to tighter, more volatile financial conditions, leading to higher borrowing costs. The interplay between demand and supply effects will also influence exchange rate movements against trading partners. Moreover, tariffs directly impact import revenues. While higher tariffs may yield increased short-term revenue, this effect is likely to wane as higher prices lead to declining imports and output.

The Two Largest Economies: Diverging from Other Income Groups

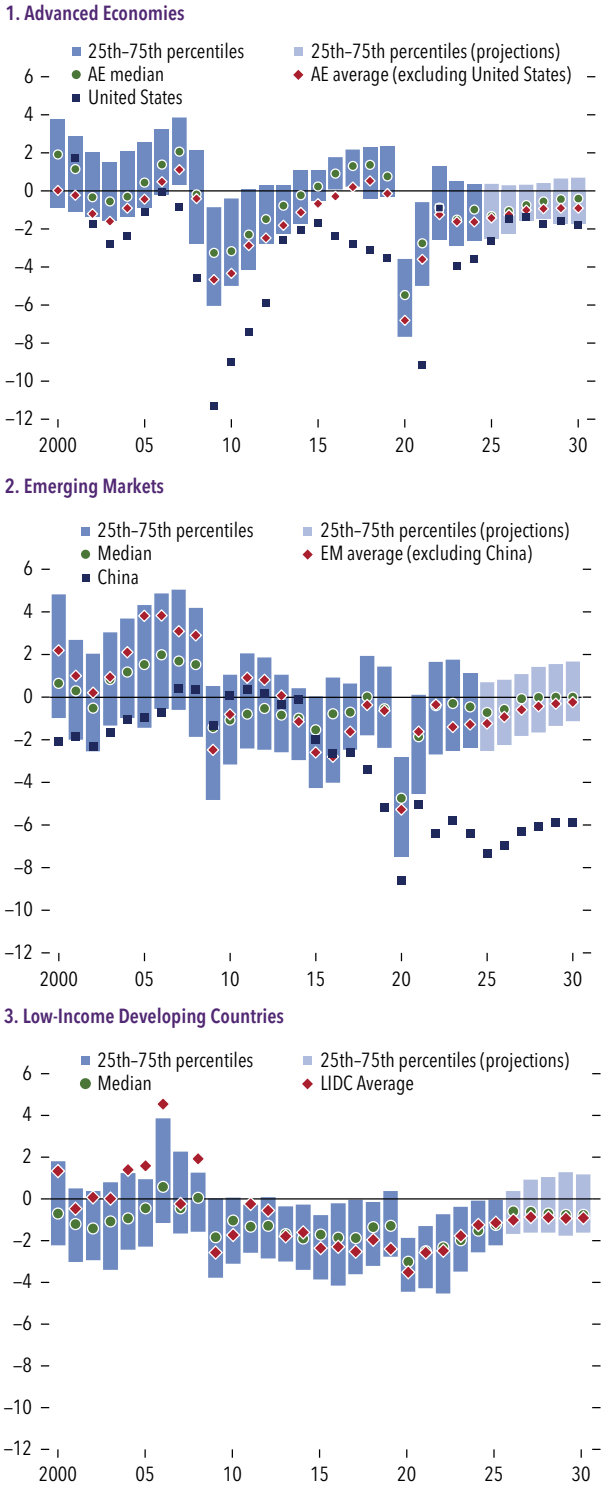
Fiscal deficits and debt in the two largest global economies, the *United States* and *China*, continue to critically shape global fiscal developments.

United States

In 2024, the general government fiscal deficit in the *United States* remained broadly unchanged and

[1]In this chapter, data on *China's* public finances cover a narrower scope of the general government compared to the staff estimates presented in the IMF China Article IV. For a reconciliation of the two estimates, refer to IMF (2024).

Figure 1.4. Primary Balances in Advanced Economies, Emerging Markets, and Low-Income Developing Countries
(Percent of GDP)



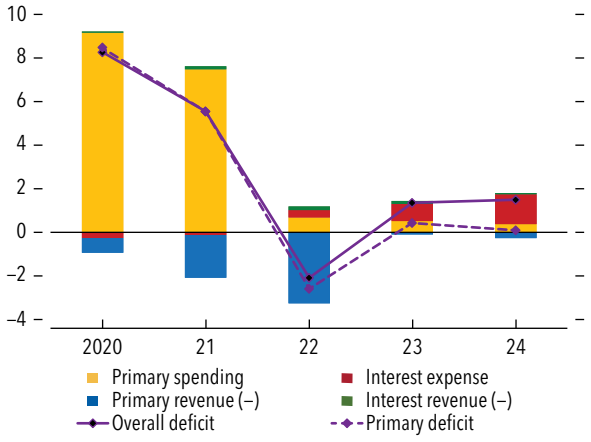
Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: The light-toned blocks from 2025 to 2030 in each panel indicate projections. Afghanistan and Sudan are excluded from the sample of low-income developing countries analyzed in panel 3. AE = advanced economy; EM = emerging market; LIDC = low-income developing country.

elevated at 7.3 percent of GDP. While the primary fiscal deficit declined from 3.9 to 3.6 percent of GDP, the increase in net interest expenses offsets this improvement, through both higher interest rates and initial debt levels. Revenue increased by 0.4 percentage point of GDP, partly owing to postponed tax deadlines from the previous year for some disaster-affected taxpayers. Primary spending as a share of GDP remained broadly unchanged, in part resulting from a pause in education spending on student loan cancellations, which is currently in litigation, and the phaseout of pandemic-related income-security programs. With both revenue and primary spending as a share of GDP nearly back to prepandemic levels, the 2024 fiscal deficit exceeded them primarily because of interest expense, which increased by 1.4 percentage points of GDP compared to 2019 (Figure 1.5).

Nominal yields on 10-year US Treasury bonds surged to about 4.75 percent at the start of 2025—the highest level since November 2023 as the Federal Reserve signaled a slower pace of rate cuts as a result of strong economic data, stickier inflation, and rising fiscal policy uncertainty (Figure 1.6; April 2025 *Global Financial Stability Report*). Since then, the upward trend has reversed, and nominal yields fell to 4.2 percent at the end of March, driven largely by the term premium amid fiscal and debt issuance strategy considerations, only to climb back to 4.5 percent by April 11, 2025, following the April 2 tariff announcements. From April 1 to April 11, 2025, the 10-year US nominal interest rate increased 31 basis points.

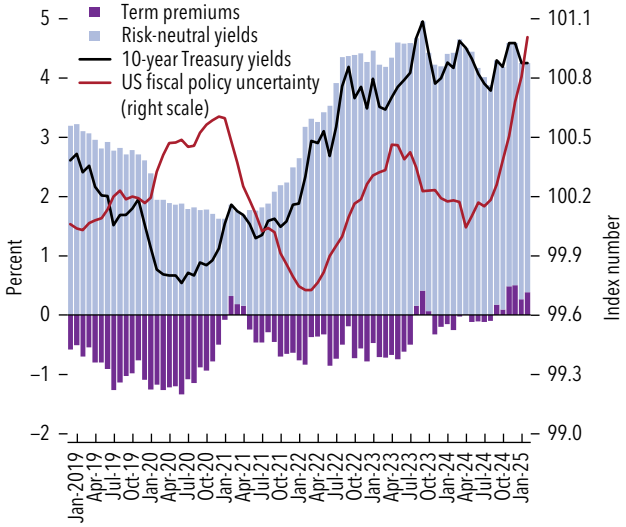
Figure 1.5. Drivers of Changes in the US Fiscal Deficit Relative to Prepandemic Levels

(Percentage points of GDP, relative to 2019)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: The figure shows changes in the general government overall deficit-to-GDP ratio and its components for the United States relative to 2019. Changes in the primary-revenue-to-GDP ratio contribute negatively to changes in the overall deficit.

Figure 1.6. US 10-Year Treasury Nominal Yields, Risk Premiums, and Fiscal Uncertainty



Sources: Federal Reserve Bank of New York; Hong, Nguyen, and Ke 2024; and IMF staff calculations.
Note: The data in the figure have the cutoff date of April 10, 2025. The decomposition into monthly risk-neutral yields and term premiums is based on Adrian, Crump, and Moench (2013). Fiscal policy uncertainty is reported as a 12-month moving average.

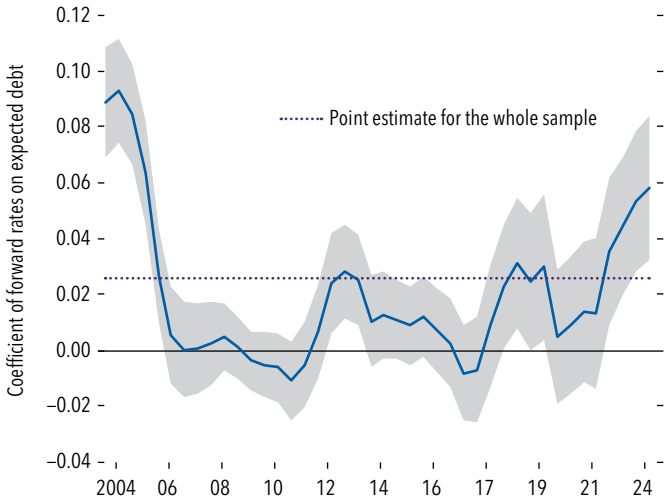
The overall fiscal deficit is projected to decrease from 7.3 percent of GDP in 2024 to 6.5 percent in 2025 (Table 1.1), contingent on higher tariff revenues. However, the magnitude of the tariff revenue increase is highly uncertain. Higher tariffs generally lead to a reduction in imports, with the extent of this decline depending on the price elasticity of demand at the bilateral product-country level. Estimates of price elasticity are affected by factors such as changes in real demand due to higher import prices, tariff evasion, and trade diversion—where imports from high-tariff countries are redirected through low-tariff countries. The tariff schedule itself is also uncertain and plays a crucial role. The pause on the April 2 tariffs and the ratcheting up of tariff rates between *China* and the *United States* announced around April 9 (top-down model-based scenario in the April 2025 *World Economic Outlook*) could lead to very different tariff schedules and result in lower import revenues. For instance, a tariff rate of 100 percent could substantially reduce imports of goods with a price elasticity of −1, resulting in negligible revenue, while imports of inelastic goods may experience minimal decline, potentially generating higher revenue. Additionally, tariffs can dampen economic activity (see Box 1.2 of the April 2025 *World Economic Outlook*),

which may negatively affect other tax bases, such as income taxes, potentially offsetting some of the revenue gains from tariffs.

Without significant policy changes, the deficit is projected to drop to 5.6 percent of GDP in the medium term, fueled by a 0.7 percentage point rise in revenues. Net interest expenses are projected to remain historically high at about 3.8 percent of GDP, while the debt-to-GDP ratio could rise by about 1 percentage point annually, reaching 127.6 percent by 2030 (Table 1.2). These projections are highly uncertain and do not account for measures under discussion in Congress, under the budget reconciliation bill. The debate will focus on raising the debt ceiling, extending or making permanent the provisions of the Tax Cuts and Jobs Act set to expire at the end of 2025, and examining various spending cuts and increases.

In addition, rising future debt could add further pressure on long-term interest rates and government financing costs. New analysis confirms that higher expected future debt and deficits could lead to higher long-term interest rates (Furceri, Gonçalves, and Li, forthcoming). Specifically, an increase of 10 percentage points of GDP in US public debt between 2024 and 2029 could lead to a 60-basis-point rise in the 5-year forward to 10-year rate. Similar results hold for the 10-year Treasury nominal yield (Figure 1.7). The analysis also suggests that projected fiscal balances are significantly and positively associated with the 10-year term premiums (see Online Annex 1.1).

Figure 1.7. Effect of Expected Public Debt on US Forward Interest Rates
(Time-varying coefficient of forward rates on expected debt)



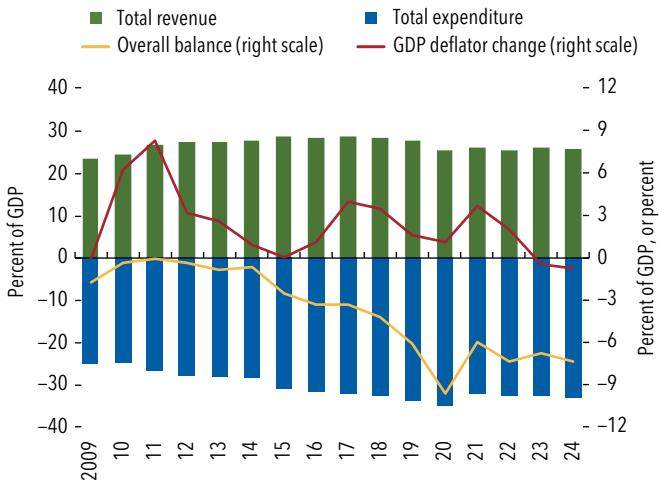
Source: Furceri, Gonçalves, and Li forthcoming.
Note: Shaded area represents the 90 percent confidence interval. See Online Annex 1.1 for details.

China

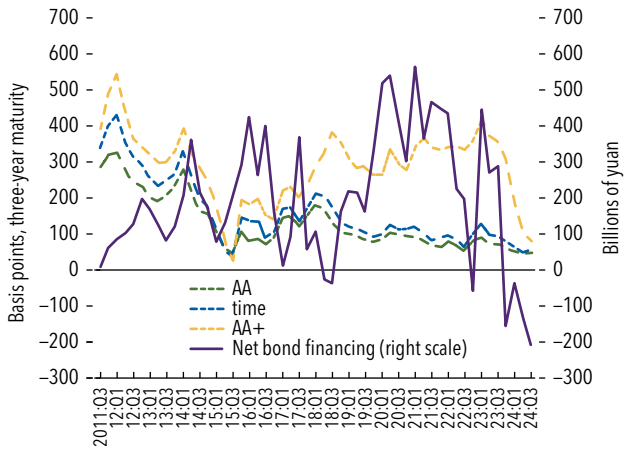
China's fiscal deficit increased by 0.6 percentage point of GDP in 2024, reaching the high level of 7.3 percent. General government revenues fell by 0.4 percent of GDP (Figure 1.8, panel 1), primarily because of a 3.4 percent decline in tax revenues. Moreover, land sales dropped by 22.4 percent year over year owing to the depressed property market. This decline was partially offset by a 25.4 percent increase in nontax revenues, likely driven by contributions from state-owned

Figure 1.8. General Government Fiscal Variables, GDP Deflator Change, and Local Government Financial Vehicle Net Bond Financing in China

1. General Government Fiscal Variables and the GDP Deflator Change



2. Local Government Financial Vehicle Net Bond Financing and Credit Spread of Bonds by Credit Rating



Sources: IMF, World Economic Outlook database; Wind; and IMF staff calculations.
Note: AA+, AA, and AA– denote the credit rating.

enterprises and enhanced local government efforts to collect fines and fees. Budget execution was slow until last September 2024, with local government financial vehicles facing financing limitations. Notably, net bond issuance from these vehicles turned negative since the last quarter of 2023, despite low spreads (Figure 1.8, panel 2), likely because the central government imposed stricter borrowing constraints.

Since September 2024, government agencies have announced various policies to support the economy, including a multiyear plan to address local governments' hidden debt. *China* plans to swap 10 trillion yuan of off-budget debt with official debt from 2024 to 2028, which will raise the official debt-to-GDP ratio while alleviating some financing pressures on local governments. Consequently, budget execution saw an uptick in the last quarter of 2024.

China's fiscal stance is expansionary in 2025 with the deficit projected to further increase to 8.6 percent of GDP. This increase is driven by lower nontax revenues, and policies announced in the 2025 budget aimed at modestly boosting consumption and strengthening social safety nets. The (on-budget) fiscal expansion outlined in the 2025 budget is a positive step, as it will help support the economy and lower the current account surplus. Although recent reforms to increase the retirement age may alleviate some spending pressures, elevated deficits are expected to push public debt to 116 percent of GDP by 2030 (Table 1.2). However, the outlook faces unusually high uncertainty. Escalating geoeconomic tensions and prolonged trade policy uncertainty present considerable headwinds to growth, which not only reduce the tax base but also necessitate increased fiscal support, further elevating the pressure on both deficits and debt.

Advanced Economies (Excluding the United States): Debt Is Stabilizing but with Large Divergences

The average primary deficit in advanced economies (excluding the *United States*) remained unchanged at 1.6 percent of GDP in 2024 (Figure 1.4, panel 1), whereas the overall deficit increased slightly by 0.1 percent of GDP from 2023 (Table 1.1). Lower short-term interest rates and longer debt maturities relative to the *United States* helped mitigate the rise in interest expenses (Figure 1.3). However, some advanced economies experienced an increase in their deficits, because of the persistence of high or even slightly rising fossil fuel subsidies (*Finland*).[2]

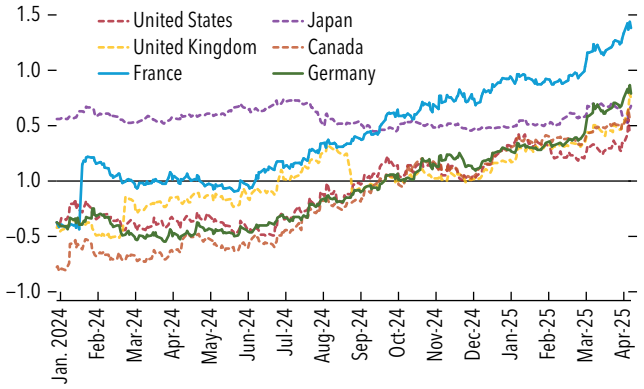
Since early 2023, long-term bond yields have been somewhat volatile across most advanced economies. However, term spreads—defined as the difference between 10- and 2-year bond yields—have been on a rising trend since mid-2024 (Figure 1.9, panel 1). This increase is driven primarily by heightened risk stemming from concerns about trade uncertainty, future inflation and growth, fiscal and monetary policy, and debt management. A notable example is the recent spike in the German Bund term spread, which followed the announcement of a political agreement to ease government debt limits, highlighting the volatility in term spreads observed in recent weeks. The April 2 tariffs initially led to a decline in long-term yields of benchmark government bonds, as investors sought safe-haven assets amid fears of a deteriorating global economic outlook. However, this decline was short-lived, with 10-year yields rising sharply within days. In contrast, 2-year bond yields have consistently decreased, reflecting expectations of further policy rate cuts by major central banks (April 2025 *Global Financial Stability Report*). New domestic and external debt issuances have exhibited a relatively flat trend, regardless of the volumes and maturities involved, although with sizable fluctuations around the trend (Figure 1.9, panel 2).

Planned fiscal consolidation is expected to stabilize debt at about prepandemic levels in the medium term, although there are significant differences across countries (Figure 1.4, panel 1) and high uncertainty about the projections, given the increased trade policy uncertainty. The weighted average of public debt is projected to surpass 100 percent of GDP by 2030 (Table 1.2). Notably, whereas public debt in *Belgium*, *France*, and the *Slovak Republic* is projected to rise by more than 10 percentage points of GDP in the next five years, it is expected to decline by more than 15 percentage points of GDP in *Cyprus*, *Greece*, and *Portugal*. Expenditure pressures may further increase debt risks and strain fiscal sustainability (October 2024 *Regional Economic Outlook: Europe*). Those pressures include population aging, notably if pension and health care reforms are not enacted (Chapter 2; Chapter 2 of the April 2025 *World Economic Outlook*), and spending to soften the potential impact of tariffs.

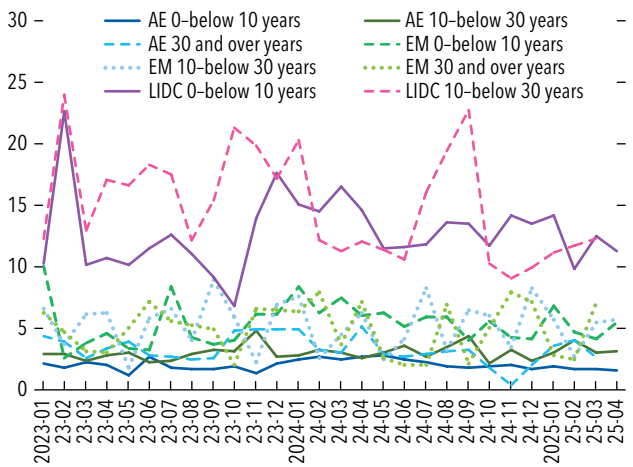
[2]In 2024, fossil fuel subsidies in *Finland* amounted to 0.5 percent of GDP (see Black and others 2023 and their estimates and forecasts at https://climatedata.imf.org/pages/mitigation#mi3).

Figure 1.9. Evolution of Term Spreads for Select Advanced Economies and the Weighted Average of Yield to Maturity of Recent Emissions in Different Income Groups
(Percent)

1. Recent Evolution of Term Spreads for Select Advanced Economies



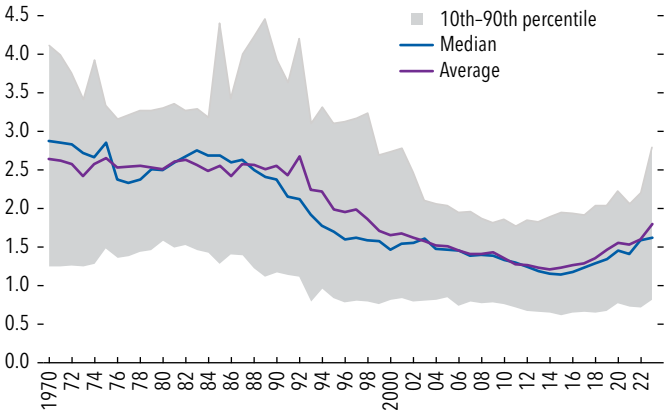
2. Weighted Average of Yield to Maturity of Recent Government Bond Issuances



Sources: Bloomberg Finance L.P.; and IMF staff calculations.
Note: The data in the figure have the cutoff date of April 10, 2025. Lines in panel 1 show the difference between the 10- and 2-year yields for each selected advanced economy. Lines in panel 2 show the weighted average for all primary domestic and external debt issuance yield to maturities for distinct country groups across different maturity categories. AE = advanced economy; EM = emerging economy; LIDC = low-income developing country.

In *Europe*, a stronger strategic alliance within the *European Union* has heightened pressure on defense expenditures. Most European Union countries have been increasing their defense budgets in recent years, averaging a rise of 0.2 percentage point of GDP between 2020 and 2023 (Figure 1.10). In some instances, the increases have exceeded 1 percent of GDP (notably in *Poland*). The macrofiscal impact of higher military spending will depend on how it is financed, the monetary policy response to the resulting demand shock, and the implications of economies of scale and regional spillovers. However, fiscal vulnerabilities may emerge if European countries fail to outline a credible plan for gradually financing higher spending, including the intended mix of tax hikes and spending cuts, while managing their defense budgets transparently. This will also have implications for the credibility of the new European Union Governance Framework (Box 1 of the April 2024 *Regional Economic Outlook: Europe*; Box 1.3 of the April 2024 *Fiscal Monitor*).

Figure 1.10. Military Spending in the European Union
(Percent of GDP)

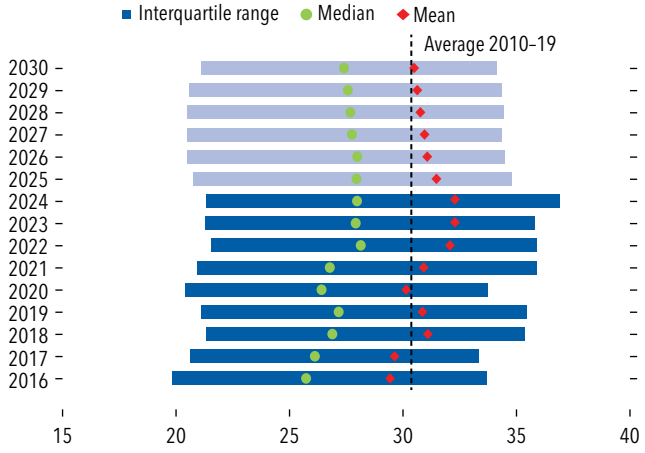


Sources: Stockholm International Peace Research Institute Military Expenditure Database; and IMF staff calculations.

Emerging Markets (Excluding China): Modest Expenditure-Based Consolidation Ahead

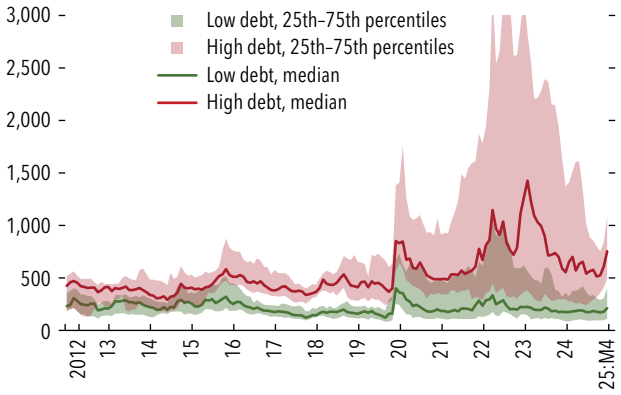
In emerging markets (excluding *China*), the average primary deficit remained stable in 2024 at 1.3 percent of GDP, whereas the overall deficit increased slightly to 4.3 percent of GDP. This is attributed to higher revenues (Figure 1.11)—for example, in some oil-exporting countries—which partially offset rising expenditures. However, fiscal developments varied markedly across countries. *Argentina* achieved its first primary surplus since 2008 by cutting expenditures by more than 5 percentage points of GDP. In contrast, many economies with elections in 2024, as well as large emerging markets such as *Indonesia*, *Mexico*, and *Saudi Arabia*, reported higher fiscal deficits compared to 2023.

Figure 1.11. Distribution of Fiscal Revenues in Emerging Markets (Excluding China) per Year
(Percent of GDP)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: Light-toned blocks indicate projections.

Figure 1.12. Foreign-Currency Sovereign Spreads in Emerging Market and Developing Countries
(Basis points, monthly)



Sources: Haver Analytics; and IMF staff calculations.
Note: The data in the figure have the cutoff date of April 10, 2025. " Low debt" refers to countries whose public debt levels are in the bottom third of the sample; "High debt" refers to countries whose public debt levels are in the top third. Solid lines correspond to the median distribution of foreign-currency spreads, whereas shaded areas correspond to the interquartile range.

Sovereign spreads, on average, continued to decline in many emerging market and developing economies in 2024 (Figure 1.12). This trend persisted despite the strength of the US dollar (2024 *External Stability Report*) and its effect on foreign-denominated debt,[3] as well as rising economic and fiscal policy uncertainty, which could potentially affect spreads (Box 1.1 of the April 2024 *Fiscal Monitor*). One possible explanation is the compression in fluctuations of the global risk premium for US dollar-denominated credit-risk instruments observed in 2024. In addition, domestic policies that have reduced debt levels and improved policy frameworks have also played a significant role in some emerging market and developing economies. However, spreads have widened since April following higher financial market volatility.

Fluctuations in yields on new domestic and external issuance (Figure 1.9, panel 2) have impacted overall issuance levels. External debt issuance has fallen by 20 percent year over year in the first quarter of 2025, while total issuance has increased by 6 percent in the same period, highlighting the divergence in borrowing costs across countries. Whereas *Mexico* and *Saudi Arabia* have benefited from similar or lower foreign-currency yields compared to previous years—helping them to increase issuance volumes—others, such as *Egypt*, have seen their external bond yields rise significantly.

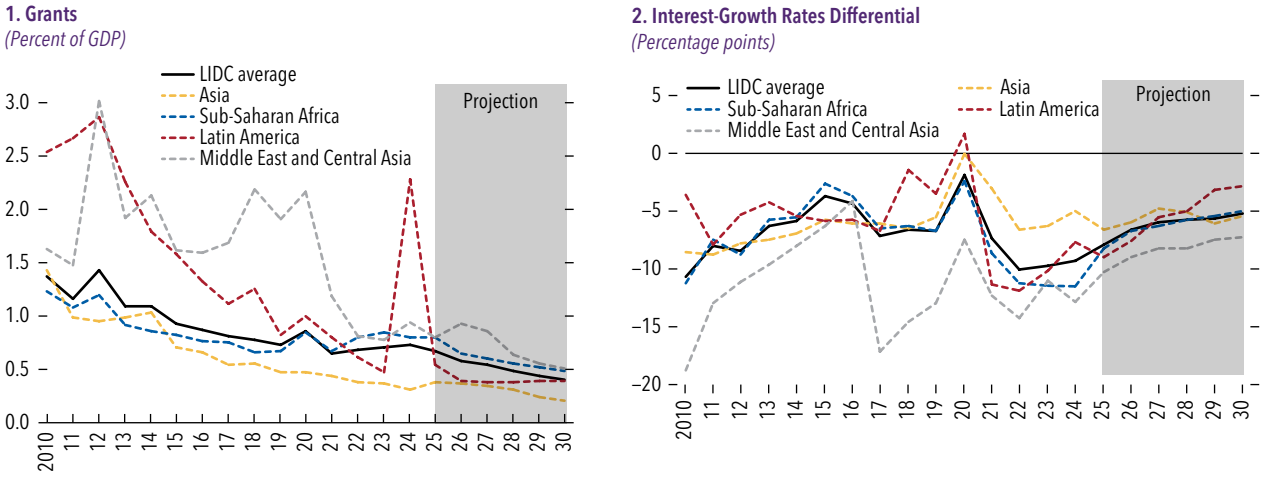
Emerging markets (excluding *China*) are projected to gradually reduce their primary deficits, mainly through spending cuts. By 2025, the primary deficit is expected to slightly decline by 0.1 percentage point to 1.2 percent of GDP, driven by stricter public spending controls and reforms in countries such as *India*, *Mexico*, and *Türkiye*. Although projected tax revenues are expected to decline in the medium term, particularly in oil-exporting countries given softer oil prices, the primary deficit should decrease to 0.2 percent of GDP on average by 2030. Yet, significant improvements in public debt are hindered by high debt-servicing costs, slow fiscal adjustments, and risks from new sources of unidentified debt (October 2024 *Fiscal Monitor*). Under current policies, public debt is projected to rise to 60 percent of GDP by 2030. Notably, debt is expected to increase by more than 18 percentage points of GDP in *Romania* and 25 percentage points of GDP in *Gabon*.

Low-Income Developing Countries: Less Aid and Lower Interest-Growth Rate Differential

In 2024, low-income developing countries experienced an improvement in their primary deficit

[3]In recent decades, most emerging market and developing economies have transitioned from a negative aggregate net international investment position in foreign currency to a positive one, thereby reducing risks associated with domestic currency depreciation and enhancing the insurance role of national balance sheets in response to economic shocks. Nonetheless, the prevalence of short positions in foreign currency for debt among these economies still renders them vulnerable to depreciation pressures (Box 1.2 of the 2023 *External Stability Report*).

Figure 1.13. Grants and Interest-Growth Rates Differential in Low-Income Developing Countries



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: The spike in 2024 for the Latin American regional average in panel 1 reflects a sharp increase in foreign aid for Haiti, given the debt forgiveness granted by Venezuela of $1.7 billion in exchange for a lump-sum payment of $500 million. Panel 2 shows the difference between long-term real interest rate and real GDP growth. Panel 2 excludes Sudan from the sample. LIDC = low-income developing country.

from 1.8 to 1.2 percent of GDP. Revenue-to-GDP ratios increased because of higher economic growth, but this was partially offset by rising primary expenditures on average. Notable examples of such offsetting are *Nigeria* and *Somalia*. Effective interest rates have resulted in the highest net interest outlays in two decades, averaging 23 percent of tax revenues. The average public-debt-to-GDP ratio decreased from 53.7 percent in 2023 to 52.7 percent in 2024, although it remains close to 10 percentage points higher than before the pandemic. Many countries face challenges accessing external financing and have seen a recent decline in foreign aid, which is projected to continue decreasing in the medium term (Figure 1.13, panel 1). For example, annual grants as a percentage of GDP in the *Republic of Tanzania* have fallen to less than one-sixth of the average over the previous two decades. Additionally, in the *Sahel region*, traditional development partners have been reluctant to reengage after military coups (October 2024 *Regional Economic Outlook: Sub-Saharan Africa*).

Average primary deficits and public debt levels are expected to improve by 2025 and remain relatively stable in the medium term (Figure 1.4, panel 3), whereas public debt is expected to decline to 45.2 percent of GDP in the medium term. About two-thirds of low-income developing countries are expected to consolidate their debt in 2025, with reductions in their public-debt-to-GDP ratio notably exceeding 15 percentage points in *Zambia* and *Zimbabwe*. This adjustment will be driven more by increased revenues than by spending cuts, as expected for *Ethiopia*. Despite these improvements, fiscal challenges persist, exacerbated by a declining interest-growth differential (Figure 1.13, panel 2) that adds to debt risks. Accordingly, high net interest expenses are estimated to remain above 2 percent of GDP (20 percent of tax revenues) for all years until 2030.

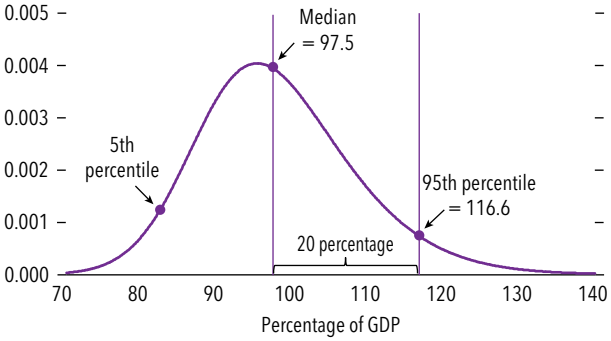
Risks to the Fiscal Outlook

Risks to the fiscal outlook have intensified since the October 2024 *Fiscal Monitor*. The IMF's debt-at-risk framework uses information up to December 2024 to estimate the likelihood of all potential future trajectories of public debt, quantifying the impact of a wide range of factors on future debt levels and uncertainties surrounding them.[4] Global debt-at-risk three years ahead is estimated at about 117 percent

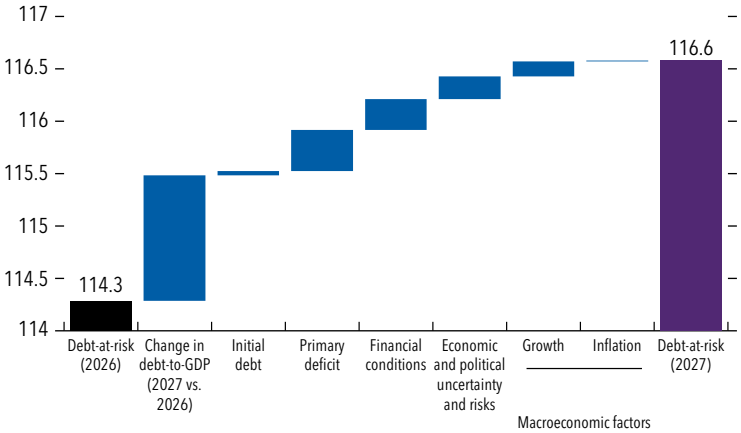
[4]The IMF's debt-at-risk framework uses information up to December 2024 to estimate the likelihood of all potential future trajectories of public debt, quantifying the impact of a wide range of factors on future debt levels and uncertainties surrounding them. The debt-at-risk analysis complements current tools reported in bilateral surveillance to assess debt vulnerabilities, such as the IMF Sovereign Risk and Debt Sustainability Framework. The debt-at-risk framework does not examine debt sustainability but complements other tools by forecasting empirically the probability distribution of the global debt path in a way that allows for asymmetries and comparisons across countries and over time. For more details, see the October 2024 *Fiscal Monitor*, Online Annex 1.1, and Furceri and others (forthcoming).

Figure 1.14. Global Public Debt-at-Risk 2027 and Changes from 2026

1. Global Public Debt-at-Risk 2027
(Probability density of the three-year-ahead debt-to-GDP ratio forecast using data from 2024)



2. Drivers of the Change in Global Debt-at-Risk between 2026 and 2027
(Percentage points)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: Panel 1 displays the probability density function, which is estimated using panel quantile regressions of the debt-to-GDP ratio on various political, economic, and financial variables. The global sample is comprised of 47 countries, accounting for more than 90 percent of global debt. Dots indicate the predicted 5th, 50th (median), and 95th percentiles of the debt-to-GDP ratio (October 2024 *Fiscal Monitor*, Online Annex 1.2). Panel 2 plots the contributions from the conditioning variables used for the debt-at-risk model to the estimated level of debt-at-risk. The black bar denotes the debt reference point from the April 2025 *World Economic Outlook*. Blue bars refer to contribution from the conditioning variables. The purple bar indicates the value of the global debt-at-risk.

of GDP for 2027 (Figure 1.14, panel 1), about 2 percentage points of GDP higher than projected in the October 2024 *Fiscal Monitor*. This increase is primarily driven by higher projected debt levels for 2027 and persistently elevated primary deficits in 2024 (Figure 1.14, panel 2).[5]

Major policy shifts since early 2025 have introduced new risks. Soaring tariffs announced by the *United States* on April 2, 2025, and countermeasures by other countries, escalating uncertainty, and tighter global financial conditions could significantly amplify debt risks. While the US administration's April 9, 2025, announcement to pause some country-specific tariffs partially mitigates some risks associated with higher tariffs and retaliation, geoeconomic uncertainty, and risks of financial turbulence remain elevated. In addition, according to the April 2025 *World Economic Outlook* post-April 9 model-based forecast, a ratcheting up of trade wars between *China* and the *United States* is projected to result in lower growth outcomes for both countries. This decline would propagate through global supply chains, resulting in significant negative spillovers on output and fiscal positions in other countries (April 2024 *Fiscal Monitor*). Specifically, the effects of weaker growth in *China* and the *United States* are expected to intensify in 2026 and beyond, while gains in other regions will diminish. This dynamic will ultimately contribute to weaker global growth and an increase in global deficits and debt through trade, financial, and commodity price channels. A narrowing of global imbalances and an increase in global output relative to the reference point could lead to more favorable fiscal outcomes (Box 1.1 of April 2025 *World Economic Outlook*).

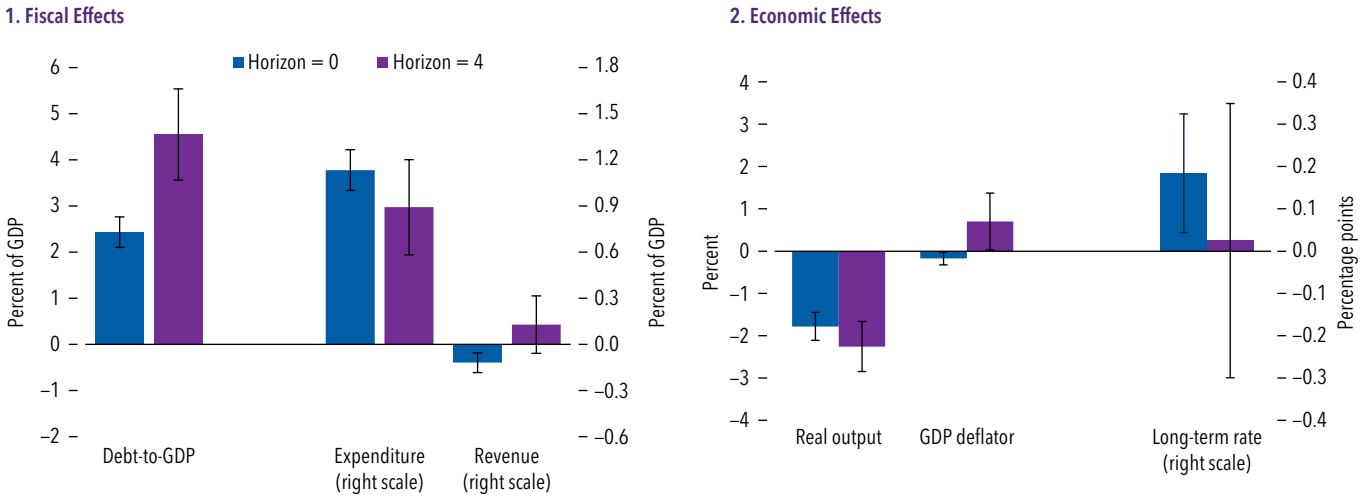
Escalating Geoeconomic Uncertainty

Geoeconomic uncertainty has escalated in recent months (Figure 1.1, panel 1), fueled by the sharp increase in import tariffs, and heightened trade and policy uncertainty.[6] These uncertainties can exacerbate fiscal risks by slowing economic growth, primarily through their detrimental impact on investment. Uncertainties can also disrupt trade (Aiyar and others 2023; Campos and others 2023) by reducing consumption and investment levels and creating a potential need to rearrange supply chains (Aslam and others 2018; Constantinescu, Mattoo, and Ruta 2020).

[5]The median of the global debt distribution for 2027 is fitted to match the corresponding debt reference point projection in the April 2025 *World Economic Outlook* (see also Online Annex 1.2). The upside risks to the global debt outlook—that is, the difference between the 95th percentile and the median—are estimated at 20 percentage points of GDP. That is a much higher level than downside risks—that is, the difference between the median and the 5th percentile—which is estimated at 15 percentage points.

[6]Geoeconomic uncertainty stems from the uncertainties about economic and political variables affecting the level of global economic integration, such as movements in trade policies, investment, supply chains, finance, labor, and technology flows.

Figure 1.15. Macrofiscal Effects of Geoeconomic Uncertainty



Sources: Fernandez-Villaverde, Mineyama, and Song 2024; IMF, World Economic Outlook database; and IMF staff calculations.
Note: The bars indicate the response to a one-standard-deviation increase in the Geopolitical Fragmentation Index (Fernandez-Villaverde, Mineyama, and Song 2024). The lines represent the 90 percent confidence band. Horizons denote the years after the shock. See Online Annex 1.3 for more details on the analyses and estimations.

In addition, increased military spending, notably in European economies, will impact fiscal positions both directly and indirectly by influencing overall economic output.

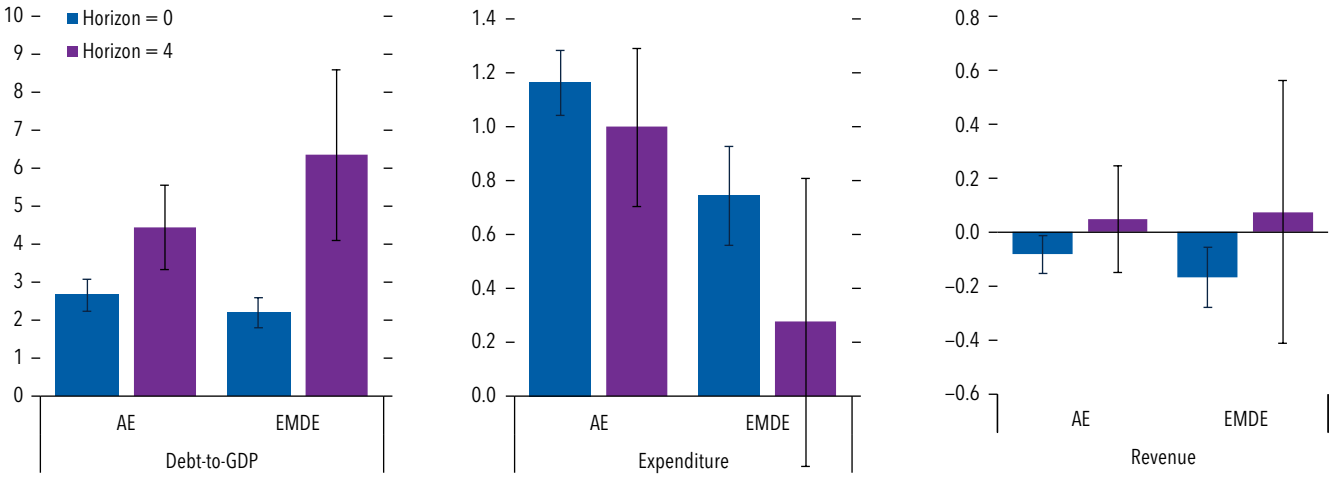
New analyses indicate that a significant rise in geoeconomic uncertainty—reflecting sharp shifts in trade policies, investment, supply chains, finance, labor, and technology flows—is associated with a public debt increase of about 4.5 percent of GDP in the medium term (Figure 1.15).[7] This increase is driven by a widening of the overall fiscal deficit, marked by higher expenditures and lower revenues, a persistent reduction in real output, and a temporary rise in long-term interest rates. Specifically, geoeconomic uncertainty results in a persistent increase in public spending of 0.9 percentage point of GDP in the medium term, coupled with an initial decline in revenues of 0.1 percentage point of GDP. There is also a persistent reduction of 2.3 percent in GDP in the medium term and a temporary 0.2 percentage point increase in long-term interest rates.

Importantly, geoeconomic uncertainty has a more pronounced effect on the higher end of the future debt distribution as it increases both the level of debt and the uncertainty surrounding it, with the 95th percentile (debt-at-risk) estimated to be about 3 percentage points larger than the 50th percentile. The findings also indicate that debt risks for countries already experiencing high debt levels are likely to amplify during times of heightened geoeconomic uncertainty, such as now.

The impact of geoeconomic uncertainty on public debt is similar across different economies, although slightly more pronounced in emerging market and developing economies than in advanced economies. Specifically, geoeconomic uncertainty is associated with a significant and sustained increase in public debt, amounting to 4 percentage points of GDP in advanced economies and 6 percentage points of GDP in emerging market and developing economies (Figure 1.16). The fiscal mechanisms underlying this increase vary markedly between these groups. In advanced economies, the debt rise is primarily driven by a substantial and lasting increase in public spending, estimated at about 1 percentage point of GDP in the medium term. This increase can be attributed largely to expenditure on other forms of fiscal support and on heightened military spending. In contrast, increases in public debt in emerging market and developing economies stem from a significant decline in revenues, which is particularly pronounced in the near term (Online Annex Figure 1.3.2, Figure 1.16).

[7]The significant increase in geoeconomic uncertainty refers to a one-standard-deviation rise in the Geopolitical Fragmentation Index (Fernandez-Villaverde, Mineyama, and Song 2024), similar in magnitude to the drop observed in 2001 with China's accession to the World Trade Organization. For further details on the data and methodology, see Furceri, Poplawski-Ribeiro, and Prifti and Online Annex 1.3.

Figure 1.16. Fiscal Effects of Geoeconomic Uncertainty in Advanced versus Emerging Market and Developing Economies
(Percentage points of GDP)



Sources: Fernandez-Villaverde, Mineyama, and Song 2024; IMF, World Economic Outlook database; and IMF staff calculations.
Note: The bars indicate the response to a one-standard-deviation increase in the Geopolitical Fragmentation Index (Fernandez-Villaverde, Mineyama, and Song 2024) index. The lines represent the 90 percent confidence band. Horizons denote the years after the shock. See Online Annex 1.3 for more details on the analyses and estimates. AE = advanced economy; EMDE = emerging market and developing economy.

Tighter and More Volatile Financial Conditions in the United States

A further tightening of financial conditions and heightened market volatility in the *United States* could have significant repercussions for economies worldwide by raising sovereign borrowing costs. Additionally, fluctuations in commodity prices—driven by weakened growth prospects and financial market volatility—could severely affect these countries. Uncertainty about US fiscal policy and long-term rates could amplify these risks.

Large and sudden increases in nominal Treasury yields typically lead to surges in government bond yields and exchange rate turbulence in emerging market and developing economies. For instance, a 100-basis-point increase in the 10-year US nominal interest rate could trigger an increase in long-term nominal interest rates peaking at 90 basis points in advanced economies and 100 basis points in emerging markets, with effects lasting over several months (April 2024 *Fiscal Monitor*).[8]

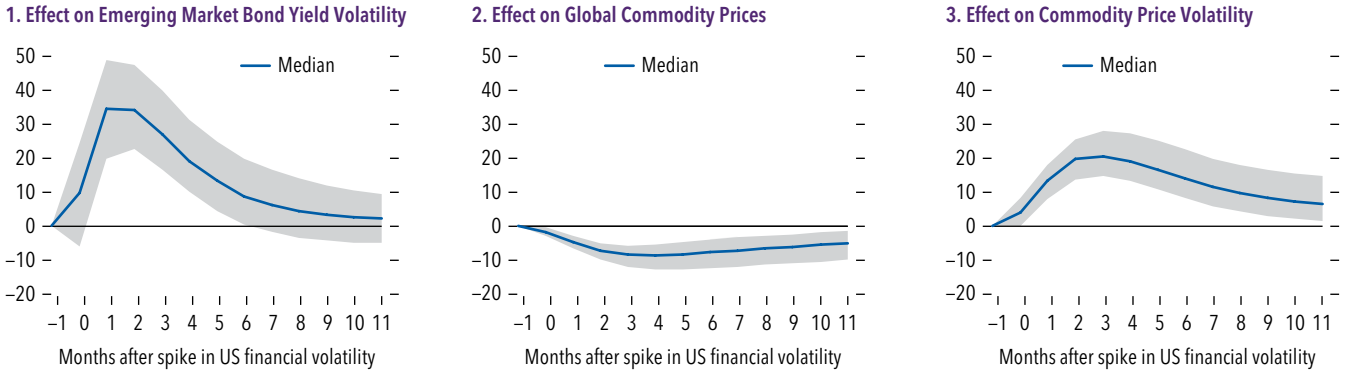
US financial volatility, including fluctuations in US sovereign yields, significantly effects the volatility of sovereign bond yields, particularly in emerging market and developing economies. Empirical evidence indicates that US financial volatility is a key driver of common factors influencing sovereign bond yields across countries (see October 2024 *Fiscal Monitor*).[9] These common factors account for more than 50 percent of fluctuations in foreign-currency-denominated sovereign bond yields and more than 30 percent in local currency-denominated bond yields for emerging market and developing economies, on average.[10] Furthermore, new analyses indicate that a substantial (two standard deviations) increase in US financial volatility is associated with a rise in emerging market bond yield volatility of approximately 30 percent after four months (Figure 1.17, panel 1).

[8]Additionally, uncertainty about US fiscal policy and resulting increase in US long-term rates also have a negative impact on financial conditions in other countries (see Box 1.1 of April 2024 *Fiscal Monitor*).

[9]A dynamic factor model with time-varying parameters and stochastic volatility is estimated for 45 emerging market and developing economies allowing for time-varying and country-specific estimates of the globally driven volatility of sovereign yields explained by global factors. US financial volatility is obtained from Ludvigson, Ma, and Ng (2021), which measures the volatility of the purely unforecastable component of future financial indicators, conditional on all available information.

[10]These findings are consistent with the literature suggesting that global factors drive bond yields (Diebold, Li, and Yue 2008; Gilchrist and others 2022) and also attest to the presence of a global financial cycle (Miranda-Agrippino and Rey 2020).

Figure 1.17. Spillovers of Financial Volatility in the United States
(Percent)



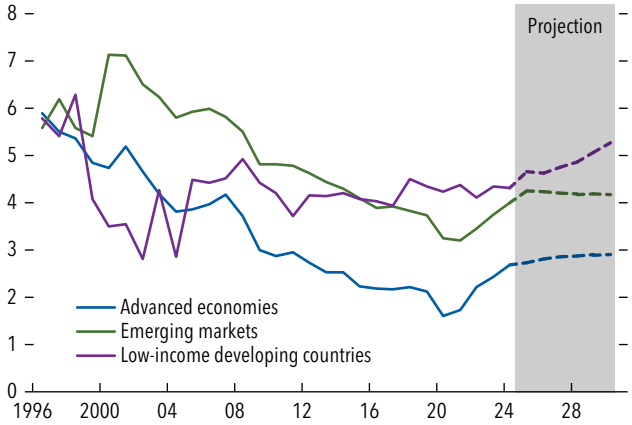
Sources: Federal Reserve Economic Data; JPMorgan; Ludvigson, Ma, and Ng 2021; and IMF staff calculations.
Note: The figure shows the impulse response functions from a Bayesian Vector Autoregressive model including US financial volatility, commodity price, the Chicago Board Options Exchange (CBOE) gold volatility, CBOE crude oil volatility, the volatility of sovereign bond yields in advanced economies (excluding the *United States*), and the volatility of sovereign bond yields in emerging market economies. The sample is from June 2008 to December 2024. The advanced economies and emerging market sovereign bond yield volatility is the standard deviation of daily Global Bond Index yields and Emerging Market Bond Index yield in the month, respectively. Commodity prices volatility in the figure is the CBOE crude oil volatility index. The US financial volatility is from Ludvigson, Ma, and Ng (2021). The financial volatility shock is scaled to be about two standard deviations. Shaded areas represent the 90th confidence interval.

Finally, US financial volatility significantly impacts commodity prices, resulting in lower prices and heightened price volatility. Specifically, a two-standard-deviation increase in the US financial volatility could lead to a decline in an approximate 8 percent decline in commodity prices and 20 percent increase in commodity price volatility (Figure 1.17, panels 2 and 3). Lower oil prices can have significant effects on fiscal positions of oil-exporting countries (October 2015 *Fiscal Monitor*; Agboola, Chowdhury, and Yang 2024), impacting the size and design of their fiscal adjustments (Danforth, Medas, and Salins 2016).

Higher-than-Expected Interest Rates

While effective yields on government debt are expected to stabilize at elevated levels (Figure 1.18), the increased financial market volatility and larger-than-anticipated fiscal deficits heighten the risks of rising interest rates and expenses. Fiscal deficits may exceed expectations due to escalating spending pressures, including increased defense spending, initiatives to mitigate the potential impact of tariffs, and a challenging landscape for foreign aid, all of which could contribute to rising interest rates. For example, recent empirical analysis (Nose and Menkulasi 2025) suggests that a 1 percentage point of GDP increase in primary deficits in emerging markets and developing economies could lead to a persistent rise in 10-year bond yields, peaking at approximately 36 basis points after 2.5 years (see Online Annex 1.4 and Online Annex Figure 1.4.1).[11]

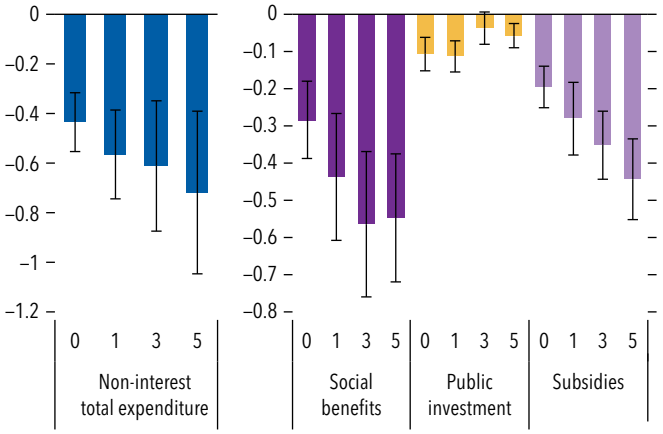
Figure 1.18. Effective Yields on Government Debt
(Percent)



Sources: IMF, Sovereign Debt Monitor; IMF, World Economic Outlook database; and IMF staff calculations.
Note: The figure shows the ratio of interest expenditures to debt. The shaded area highlights reference point projections.

[11]In addition, bond yields in emerging market and developing economies are becoming increasingly sensitive to domestic banks' exposure to public debt and the growth of local currency bond markets (October 2023 *Global Financial Stability Report*). Estimates suggest that a stronger sovereign-bank nexus—that is, a larger share of domestic sovereign bonds in domestic banks' total asset portfolio—amplifies the effect of expected fiscal policies on bond yields in these economies (Online Annex 1.4).

Figure 1.19. Crowding-Out Effects of Interest Expenses on Other Public Spending
(Percent of potential GDP)



Sources: IMF, Global Debt Database; IMF, Government Finance Statistics, IMF, *World Economic Outlook*; and IMF staff calculations.
Note: The figure shows the effect of a 1 percentage point of potential GDP increase in interest expenditures on selected budget categories 0, 1, 3, and 5 years ahead. The vertical lines show 68 percent confidence intervals (see Online Annex 1.5).

Emerging market economies, already grappling with the highest real financing costs in a decade, may now face the need to refinance their debt and fund fiscal spending at even higher rates. Higher-than-expected interest expenses present significant challenges to essential government spending.[12] Empirical evidence from 75 advanced and developing economies indicates that a 1 percentage point of potential GDP increase in interest expenses typically results in a permanent reduction of about 0.6 percentage point of potential GDP in non-interest expenditures in the medium term (Figure 1.19). In particular, social benefits decline by an average of 0.5 percent of potential GDP, and public investments fall by an average of 0.1 percentage point of potential GDP. For the average economy in the sample, this translates to a potential reduction in public investment of about 4 percent from its initial level of 2.5 percent of GDP following a 1 percentage point of potential GDP increase in interest expenses (see Online Table 1.5.1).

Fiscal Adjustment Needs and Effects

Higher debt levels and interest-growth differentials require larger primary balances to stabilize public-debt-to-GDP ratios. In 2024, the primary deficit that advanced and emerging market economies could sustain while stabilizing debt decreased by 0.6 percentage point of GDP on average (from 2.9 percentage points of GDP in 2023 to 2.3 percentage points of GDP in 2024). More economies exceeded debt-stabilizing primary deficit levels in 2024—57 percent of advanced economies in 2024 compared to 22 percent in 2023, and 51 percent of emerging market economies compared to 33 percent in 2023—indicating a greater need for adjustment (Figure 1.20, panel 1).[13] For low-income developing countries, this figure declined to 36 percent in 2024 from 39 percent in 2023.

More than a quarter of the countries, surpassing two-thirds of the global economy, are projected to have primary deficits above debt-stabilizing levels by 2030 (Figure 1.20, panel 2)—even before accounting for potential unidentified debt (October 2024 *Fiscal Monitor*) or new spending pressures such as higher military spending. To stabilize debt levels, the average adjustments required are 1.8 percentage points of GDP in advanced economies excluding the *United States*, 1 percentage point of GDP in emerging markets excluding *China*, and 0.4 percentage point of GDP in low-income developing countries (Figure 1.20, panel 2). Even in optimistic scenarios, many countries struggle to stabilize public debt. Figure 1.21 shows that even with lower and more ambitious primary deficits, 20 percent above their past performance, 12 percent of economies (or 15 countries in the sample) would still have primary deficits above debt-stabilizing primary deficits (see also Online Annex 1.6).

Fiscal adjustment is crucial to reduce not only debt levels but also debt risks. New analysis using the debt-at-risk methodology indicates that fiscal adjustments lower the future debt distribution, particularly impacting the right end of the debt forecast distribution (Figure 1.22, panel 1; Frangiamore, Furceri, and Pizzuto, forthcoming).[14] This is because fiscal adjustment reduces both the level of debt and uncertainty surrounding it (Figure 1.22, panel 2). A 1 percent of GDP fiscal adjustment is estimated to reduce the three-year-ahead debt-at-risk by about 0.3 percentage point of GDP in the short term, and 1.2 percentage points in the medium term

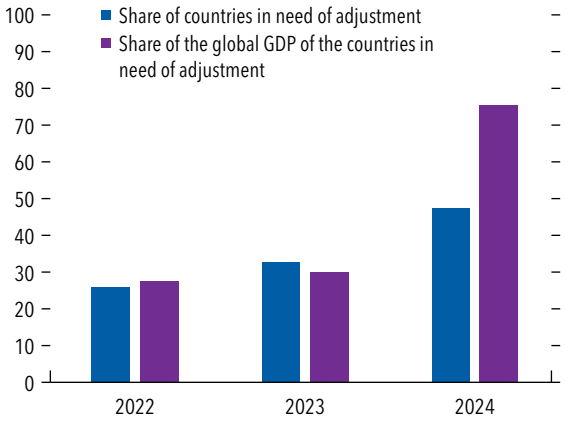
[12]The tightening of financing conditions could also trigger capital outflows, sharp exchange rate adjustments, and balance of payments crises for countries tries with weak buffers and high foreign currency debt (2024 *External Stability Report*).

[13]Debt-stabilizing primary deficits are calculated considering the reference-point forecast in the April 2025 *World Economic Outlook* database. See Online Annex 1.6 for a description of the methodology used to calculate them.

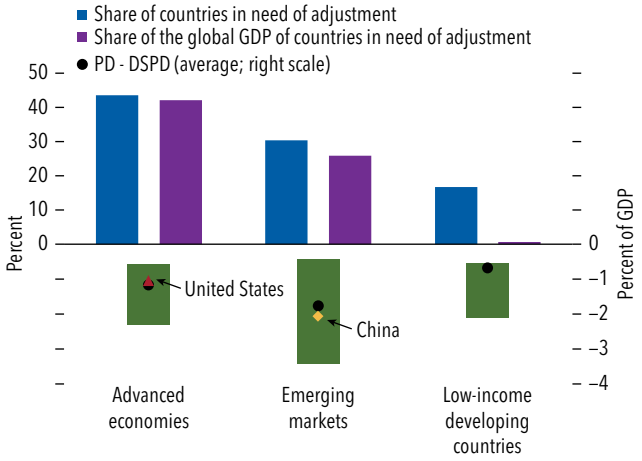
[14]Fiscal adjustment in the analysis corresponds to unexpected changes in fiscal balances that are exogenous to economic conditions.

Figure 1.20. Required Adjustment of the Primary Balance to Stabilize Public Debt
(Percent, unless stated otherwise)

1. Share of Economies with Primary Deficit above the Debt-Stabilizing Level



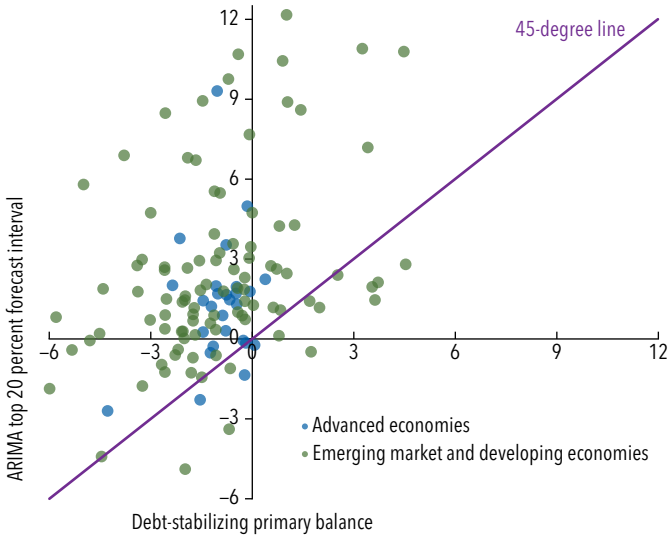
2. Share of Economies with Primary Deficit above the Debt-Stabilizing Level in 2030 and the Adjustment Required in the Primary Deficit



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: See Online Annex 1.6 for the formula describing the calculation of the debt-stabilizing primary balance and more details about the analyses in this figure. Blue bars in panel 1 show the share of economies with primary deficit (PD) higher than the debt-stabilizing primary deficit (DSPD), that is, PD > DSPD in each year for a sample of 37 advanced economies and 86 emerging market economies. Purple bars indicate the contribution of these economies to global GDP. Values in the blue bars in panel 2 indicate the share of economies with PD > DSPD in 2030. Purple bars indicate the contribution of these economies to global GDP. Adjustment needs (black dots for the weighted average for the income group) indicate the necessary change in primary deficits to stabilize debt for economies with PD > DSPD in 2030 with green bars representing the interquartile range for the adjustment needs.

(Figure 1.22, panel 3). These effects arise from improvements in the primary balance and real interest rates, which more than offset the decline in output. Furthermore, fiscal adjustments lead to a greater decline in debt-at-risk in countries with fiscal rules (Figure 1.22, panel 4), enhancing the credibility of fiscal measures and amplifying interest rate reductions.

Figure 1.21. Debt-Stabilizing Primary Balance versus an Optimistic Forecast of Primary Balance
(Percent of GDP)



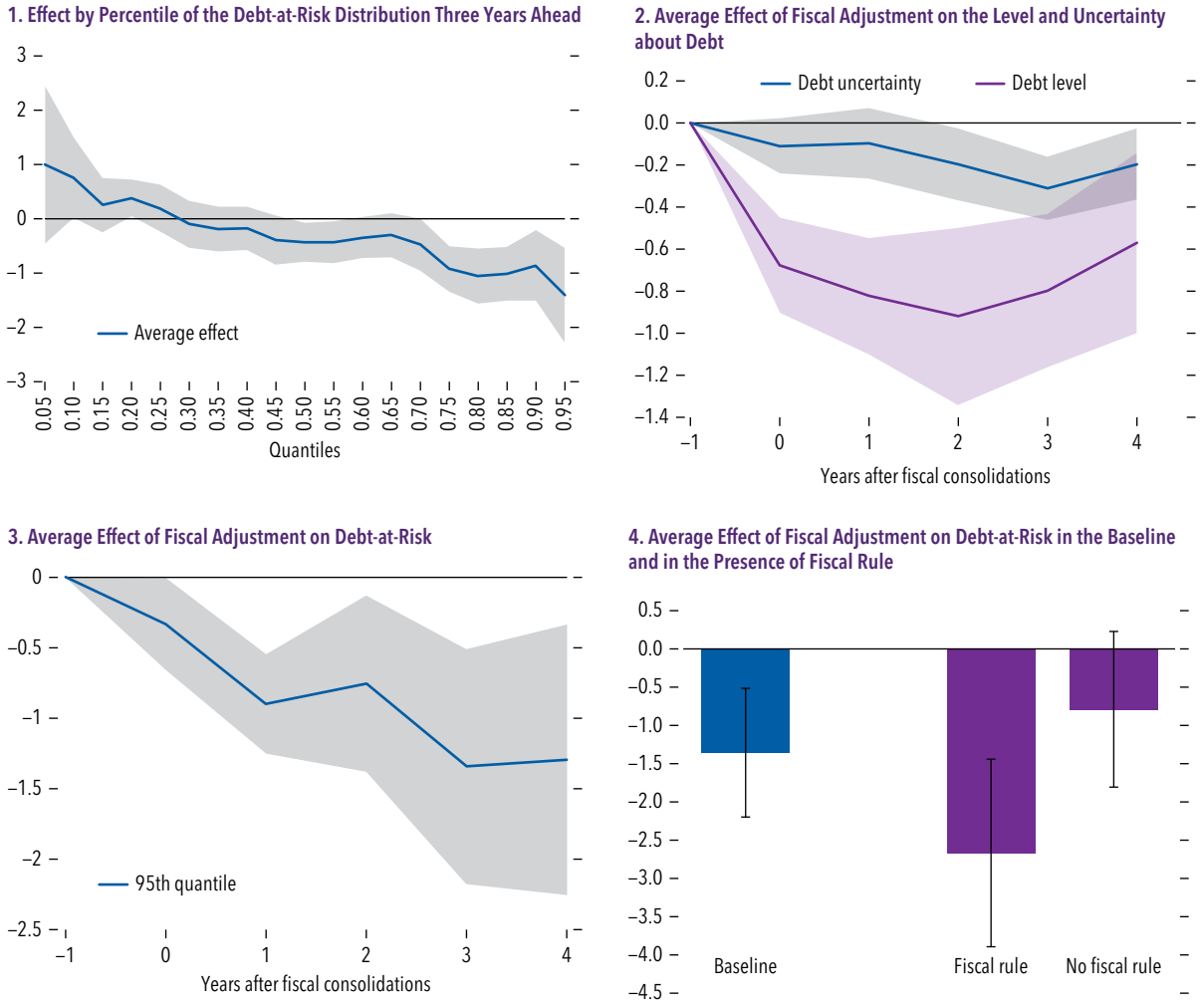
Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: The vertical axis indicates the forecast of the primary balance with a 20 percent probability, given its historical time series for each country, whereas the *x*-axis corresponds to the debt-stabilizing primary balance (for details, see Online Annex 1.6). ARIMA = autoregressive integrated moving average.

Policy Conclusions

The fiscal outlook has deteriorated since the October 2024 *Fiscal Monitor*. Major tariffs announcements, heightened uncertainty, financial market volatility, and diminishing foreign aid are adversely affecting public debts and deficits. Global public debt is now projected to reach nearly 100 percent of GDP by the end of the decade, surpassing the pandemic peak, with gross financing needs set to rise significantly. Sudden and disruptive tightening of financing conditions present a clear and present danger. Consequently, fiscal policy now faces a more pronounced trade-off among four key objectives: reducing debt, building and expanding buffers to address future shocks, meeting urgent spending needs, and enhancing growth prospects.

A gradual fiscal adjustment within a credible medium-term framework is needed in most countries to bring debt down while building additional buffers against heightened uncertainty. Adjustments must balance the pace and timing of debt reductions with economic growth and be tailored to the specific circumstances of each country, considering available fiscal space and overall economic conditions. Countries with limited fiscal space should prioritize public spending within their planned budgets and allow

Figure 1.22. Effects of Fiscal Adjustments on Debt and Debt-at-Risk
(Percent of GDP)



Sources: Frangiamore, Furceri, and Pizzuto forthcoming; World Economic Outlook database; and IMF staff calculations.
Note: Shaded areas in panels 1, 2, and 3 represent the 90 percent confidence interval. Panels 2 and 3 indicate the impulse response functions of debt-at-risk to fiscal consolidation over time. Bars in panel 4 represent the point estimate and lines the confidence intervals.

automatic stabilizers to operate fully. In contrast, nations with fiscal room facing significant spending pressures—including defense spending (for example, *Germany*)—could judiciously utilize available resources within well-defined medium-term fiscal frameworks. For the *United States*, a significant fiscal adjustment will be required over the medium term to put public debt on a decisively downward path. Different policy options could lead to this adjustment, but they will also rely on building social consensus to effectively address the ongoing fiscal imbalances. For *China*, fiscal expansion is welcome but could place greater focus on boosting consumption and supporting the property sector to better tackle the deflationary pressures facing the economy. Low-income developing countries should, in turn, stay the course in their fiscal adjustment plans.

More broadly, advanced economies with aging populations should reprioritize expenditures, advance pension and health care reforms (Chapter 2; Chapter 2 of the April 2025 *World Economic Outlook*), remove inefficient tax incentives, broaden the tax base, and pursue active labor policies for their working-wage labor force, including migrants (Chapter 3 of the April 2025 *World Economic Outlook*). Broadening the tax base can involve eliminating exemptions and improving the efficiency of tax expenditure (*Spain*, *United Kingdom*, and *United States*), progressively increasing income taxes (*United States*), or eliminating flat taxes on self-employment (*Italy*).

Permanent increases in defense spending should be accompanied by credible financing plans that outline how these increases will be gradually financed, along with the intended mix of tax hikes and spending cuts depending on the country's available fiscal space (*European Union*).

Emerging market and developing economies should reduce spending and increase revenues by reforming tax systems, broadening tax bases, and improving revenue administration. They should phase out energy subsidies (Chapter 2) and rationalize public wage bills while safeguarding public investment and upgrading social safety nets. Reforming state-owned enterprises is essential to enhance resource allocation, foster sector growth, and mitigate fiscal risks. Countries with low tax-to-GDP ratios must reassess existing tax rates and thresholds (*Mexico*), particularly for the value-added tax (VAT) and personal income taxes. Others might consider increasing VAT rates (*Thailand*), reintroducing goods and services taxes (*Malaysia*), and rationalizing tax expenditures (*Brazil*, *Egypt*, *Kyrgyz Republic*). Reforming and phasing out energy and fuel subsidies, as *Morocco* did between 2013 and 2015 (Chapter 2), is vital to limit cuts in other government spending (*Togo)* and foster market efficiency. Countries such as *Gabon* need to rein in public wage bills. Others should focus on investing in infrastructure and social programs to protect vulnerable populations (*India*, *Indonesia)*.

The recent roller coaster in financial markets, as highlighted in the April 2025 *Global Financial Stability Report*, underscores the need for preparedness against potential severe economic and financial disruptions. In cases of significant financial instability, fiscal policy can play a crucial role in supporting central banks and financial supervisors through tools such as direct lending, guarantees, and equity injections. These measures mitigate excessive deleveraging, prevent fire sales, and help restore confidence.

If necessary, governments could offer timely, targeted, and temporary support to communities and sectors severely affected by trade dislocations. Such extraordinary support must be accompanied by careful costing and enhanced transparency and monitoring. When trade disruptions are expected to be permanent, active labor market policies and skills retraining become essential. Fiscal policy plays a crucial role in facilitating and accelerating this adjustment. In all instances, policies must account for the country's available fiscal space. It is crucial for authorities to maintain fiscal discipline; failure to do so could turn fiscal policy from a source of confidence, protection, and support into one of instability and turmoil.

Medium-term frameworks and modern public financial management systems should effectively anchor adjustment paths and reduce fiscal policy uncertainty. For countries facing new spending needs—for example, in defense—it is essential to demonstrate a strong commitment to fiscal sustainability and prudence while ensuring transparency. Any permanent increase in fiscal outlays for investment and defense spending must be coupled with enhanced spending efficiency, strengthened procurement systems (*European Union*), and improved multiyear fiscal planning and macroeconomic forecasting to ensure realistic assessments of their impact on economic growth. The increase in outlays must be backed by credible financing plans detailing how they will be financed, including the planned mix of tax and spending measures.

More generally, trust in fiscal policy can be enhanced by integrating robust institutional frameworks (Chapter 2) with effective communication strategies (Bianchi, Dabla-Norris, and Khalid forthcoming) and involving stakeholders in the design of reforms (Chapter 3 of the October 2024 *World Economic Outlook*). Strengthening fiscal frameworks by improving compliance with fiscal rules, enhancing forecasting, better integrating medium-term plans into annual budgets, and making clear contingency plans for unforeseen developments can bolster credibility in advanced economies as well as emerging markets (*Brazil*, *India*, *Indonesia*, *South Africa*). Independent fiscal institutions, such as fiscal councils, should be adequately resourced to effectively assess and communicate fiscal plans, and so reinforce adjustment efforts. Medium-term fiscal plans should be further developed in consideration of financing conditions. To this end, medium-term debt management strategies should be developed simultaneously with fiscal frameworks to incorporate the potential impact of financing risks in the fiscal policy outlook.

Enhancing fiscal and debt governance, along with debt transparency, is essential to improve efficiency and mitigate debt risks. Countries must proactively identify and manage contingent liabilities, particularly those related to state-owned enterprises (October 2024 *Fiscal Monitor*). Governments should provide clear, detailed, and timely information about debt, including creditor composition and exposure to

risks—such as interest rate and exchange rate risks. This transparency, which would benefit from sound legal underpinnings (Vasquez and others 2024), fosters scrutiny and accountability and reduces dependence on nontraditional debt instruments. Strengthening expenditure controls and implementing active cash management can help prevent overspending.

Advancing fiscal and structural reforms is essential for reigniting medium-term economic growth (Georgieva 2024) and mitigating growth-debt sustainability trade-offs. Well-designed fiscal reforms following a structural and coherent path can enhance employment, investment, and growth (IMF 2015). Targeted tax incentives can stimulate private investment and productivity through research and development (Chapter 2 of the April 2024 *Fiscal Monitor*). Strengthening spending efficiency—especially in health, education, and infrastructure investment—can raise an economy's production capacity.

Timely and orderly debt restructuring alongside fiscal adjustments is essential for countries facing debt distress. Recent initiatives by the international community have streamlined sovereign debt restructuring and reduced timelines. There has been ongoing progress on the functioning of the Common Framework for countries such as *Ethiopia* and *Ghana*. Strengthening these processes further is vital for effective debt restructuring. International cooperation and coordinated efforts to provide concessional financing to low-income developing countries are vital to avoid undue fiscal tightening and human suffering and distress and sustain development efforts in these countries.

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