

EXECUTIVE SUMMARY

The global economy is again proving resilient, but unevenly so and with rapidly narrowing margins of adjustment in the near term. Activity in the first half of 2026 held up better than expected despite the dragging war in the Middle East and continuing strains from trade tensions. The technology cycle has provided a demand impulse, driven by strong investment in artificial intelligence (AI). The interaction of these forces—geopolitics and technology—has produced a split global economy: Favorable terms of trade or technology-related exports and investment give some countries a cushion, whereas others face higher import bills and weaker demand. Use of buffers and adaptability have helped economies weather the negative shocks so far. Flexible supply responses, rerouting of shipments, inventory drawdowns, fiscal support measures, and lower energy intensity than in previous decades have helped contain the hit to activity from the war. Private firms have continued to adjust to repeated shocks, including geopolitical risk and shifts in trade policy, while financial markets have maintained a broadly benign view of the challenges, also buoyed by exuberance in the technology segment. Yet these margins of adjustment are not unlimited. Inventories have been drawn down, commodity markets remain vulnerable, fragmentation could become a greater drag on efficiency, prolonged uncertainty could eventually weigh more heavily on confidence, constraints on energy could impair the AI-led impetus, and financing conditions could change abruptly for any number of reasons, including fiscal sustainability concerns.

Global growth is projected at 3.1 percent in 2026 and 3.4 percent in 2027, unchanged for 2026 and revised moderately upward for 2027, relative to the projections in the April 2026 *World Economic Outlook* (WEO). Global headline inflation is projected to increase to 4.7 percent in 2026 before easing to 4.1 percent in 2027, marking a cumulative upward revision of 0.7 percentage point with the temporary increase driven mainly by energy and food prices.

The stable global aggregate masks a reallocation of growth across economies. Countries with limited direct

exposure to the war shock and strong participation in the technology upturn are seeing activity hold up or strengthen. Energy exporters outside the immediate conflict zone benefit from favorable terms of trade. Conversely, energy-importing economies with little connection to the technology value chain face the most difficult configuration: higher import costs and exchange rate pressures, weaker real incomes, more constrained fiscal space, and fewer offsetting demand impulses. Many low-income and vulnerable countries belong to this latter group, increasing the risk that recent shocks will widen income gaps across and within countries.

World trade volume growth is projected to slow in 2026 and stabilize in 2027, reflecting the drag from tariffs, adjustment in production chains, and continued strength in technology-related trade. Global imbalances are expected to decline only modestly over the medium term, as large fiscal deficits, limited domestic rebalancing, technology-driven capital flows, and differing demand compositions across major economies under current policies continue to sustain external gaps. The medium-term growth outlook remains lackluster by historical standards and uneven across countries, in part reflecting varying degrees of AI preparedness and robustness of the energy mix.

Risks are skewed to the downside. A prolonged stalemate or further escalation in the Middle East could keep energy and food prices elevated and volatile, revive inflationary pressures, worsen fiscal and external balances, and weigh on growth. Further disruptions to energy infrastructure, cyberattacks, or extreme weather events could amplify these effects. As the Commodity Special Feature shows, price increases driven by physical supply disruptions have larger and more persistent macroeconomic effects than those driven by geopolitical risks. A reassessment of AI-related profitability and productivity prospects could sharply reduce investment, trigger equity market corrections, and tighten financial conditions, with spillovers to economies integrated into technology supply chains and stakes in technology stocks.

Fiscal vulnerabilities and renewed trade tensions could further weaken growth. Upside risks are also evident: AI-related investment could prove more persistent, productivity gains could materialize faster than assumed, new trade arrangements could improve predictability and resilience, and higher fossil fuel prices could accelerate investment in energy security.

Policy needs to navigate competing forces without losing sight of medium-term stability. Given elevated debt, rising sovereign yields, and pressing spending needs, a renewed focus on rebuilding fiscal space is increasingly urgent. Governments should implement credible fiscal adjustment plans that combine enhancements on the revenue side with spending rationalization, supported by institutional improvements. Any support to ease the impact of higher energy and food prices should be temporary, targeted, and nondistortionary, and should not jeopardize fiscal sustainability goals. Monetary policy needs to be tailored to circumstances, in line with central banks' mandates, considering initial conditions before the war, inflation expectations and broader underlying inflation gauges, and the level of the policy rate relative to its neutral level. The case for maintaining a cautious stance is strongest in energy importers outside the technology value chain with inflation at or below target, while the case for tightening is strongest in economies that are plugged into stronger demand pressures from the technology value chain,

where inflation was already above target before the twin shocks and remains so, and where broader price pressures are expected to remain elevated. At a structural level, strengthening energy security, improving AI readiness, and maintaining open channels for trade and cooperation are essential to raising resilience in a world where shocks are increasingly frequent and asymmetric.

The analytical chapters of this report provide insights on fiscal frameworks that could deliver better results when dealing with disruptive shocks and building policy space through revenue measures. As Chapter 2 demonstrates, when faced with cost-of-living crises, governments should preserve price signals and rely primarily on temporary, targeted income support for the most vulnerable, underscoring the importance of investing in stronger social protection systems that can be rapidly scaled up during crises. As Chapter 3 shows, the global effects of changes in corporate income tax (CIT) policy depend on how governments' budgets adjust: Debt-financed tax cuts support domestic activity but can crowd out investment in other economies and generate negative spillovers in the short term. In the long term, spillovers can be positive, owing to cross-border knowledge transfers, while presenting trade-offs domestically if lower revenues constrain public investment and productive capacity, notably for emerging market and developing economies, which rely more heavily on CIT revenues.