

FOREWORD

In less than seven years, the global economy has been subjected to an exceptional sequence of events. The pandemic and the ensuing disruptions to global supply chains; the wars in Ukraine and the Middle East, with the consequent sharp increases in the prices of energy and other commodities; and significant changes in trade barriers and trading relations have tested the resilience of households, firms, financial markets, and governments. Individually, each of these major developments would have been considered unlikely. Their confluence over such a short period of time is even more extraordinary.

Yet, despite this barrage of shocks, the global economy has held up. Labor markets have remained unexpectedly strong; financial systems have broadly withstood the shocks and the sharpest monetary tightening in half a century; and inflation has receded from its peaks in many economies, although it remains persistent in some cases.

This resilience is reflected in our latest global growth forecast, which remains broadly unchanged from April, despite a more persistent energy market disruption than anticipated. Global activity is projected to grow at 3.1 percent in 2026 and 3.4 percent in 2027. Global headline inflation is projected to rise to 4.7 percent this year, reflecting primarily higher commodity prices, and to fall back to 4.1 percent in 2027; the pass-through to core inflation is expected to be limited.

What has helped the global economy withstand this latest shock? There are two main sets of factors.

First, the rerouting of energy supplies; increased energy production in other countries; inventory drawdowns; substitution to other sources of energy, including renewables; and higher energy efficiency have all helped cushion the impact on energy markets. Without these margins of adjustment, the oil disruption alone would have significantly reduced global growth in 2026.

Second, the investment boom triggered by artificial intelligence has provided impetus to global activity and supported international trade. Investment has continued to rise in anticipation of higher expected returns and real incomes (reflected in stock valuations).

However, this resilience is under strain. Without shoring up supply capacity and replenishing policy buffers, the global economy could soon test the limits of resilience. Inventories in energy markets are dwindling and additional geopolitical shocks could still transmit rapidly through prices and supply disruptions. Other commodity markets also face risks. Low-income countries and households remain especially vulnerable to higher food prices from transport disruptions, higher fertilizer costs, export restrictions, and extreme weather events. Technology-related investment, while an important boon against the energy shock, is concentrating risks: With gains clustered in a small number of firms, sectors, and economies, global expansion is heavily reliant on a narrow set of technological and financial conditions. More generally, resilience has been uneven, varying noticeably with economies' exposure to the war and the AI boom, and causing divergent outcomes.

Policy constraints are also more binding now. Borrowing costs have risen sharply in major advanced economies, owing to both supply- and demand-driven price pressures, along with fiscal and credit risks. Public debt is high in many economies, and fiscal buffers that could otherwise have helped meet rising spending pressures from aging populations, climate change, and national security needs have instead been used to absorb the repeated shocks. The interaction of higher financing costs with elevated debt levels exposes a key margin of vulnerability. Strong and deliberate actions are required to rebuild buffers and shore up the capacity to withstand future shocks—new or the same.

Fiscal policy must be restrained and help contain demand pressures at a time of heightened inflationary risks. While monetary policy tightened significantly in the aftermath of the pandemic, primary deficits have remained elevated and are significantly larger than before the pandemic in many countries. Importantly, the increase in borrowing costs and its implications for fiscal sustainability make the need for fiscal adjustment all the more urgent. Chapter 1 of this report considers a risk scenario in which there is a loss of fiscal and monetary credibility in major economies, in addition

to commodity price increases. In that scenario, global growth in 2027 would be materially lower than in the baseline projections, with inflation significantly higher; the shock would have tangible spillovers for emerging market and developing economies. To prevent such a scenario, public debt levels need to be put back on a durably sustainable path. Chapter 2 underscores that, in cost-of-living crises, measures that preserve price signals and rely primarily on temporary and targeted income support for the most vulnerable households are both effective and efficient. Chapter 3 shows that corporate income tax policy can help from the revenue side but has important domestic and cross-border implications: Debt-financed tax cuts may support activity in the short term but can crowd out investment elsewhere, while the reduction in tax revenues can constrain public investment and productive capacity over time.

In turn, monetary policy should remain firmly focused on price stability, in line with central banks' mandates. The policy stance should be sufficiently restrictive to return inflation to target in a timely fashion, preventing second-round effects. Where commodity price increases and technology-related investment (or other factors) add to persistent inflationary pressures, monetary policy will need to tighten further. Starting levels of inflation, labor market tightness, and technology and commodity exposures remain key policy guideposts. The appropriate stance will differ across countries, but the objective is the same: to ensure price stability. Central bank independence is instrumental in achieving that goal.

Over the medium term, a comprehensive strategy to guarantee supply-side resilience is essential in an environment marked by virulent weather events and heightened geopolitically induced disruptions. Such a strategy should rest on three mutually reinforcing pillars. The first is *technological diversification*: greater investment in critical technologies and inputs for which substitutes are limited. Energy is a clear example. Diversification means continuing to expand sources of energy, including renewables. Progress is already underway, with clean energy generation rising rapidly. But the transition must go further. The second

pillar is *trade diversification*. More diversified trade relationships reduce exposure to individual input suppliers and buyers and can lower volatility. Reshoring is not a viable solution for most countries; it is often inefficient and can increase the concentration of risks in the domestic economy. The third pillar, complementing the previous two, is *stronger supply buffers* in critical sectors, such as energy, water, food, and other essential inputs. A well-designed strategy must encompass both the public and private sectors, with the latter bolstered by structural reforms to boost entrepreneurship and business dynamism. Its objective should be not only to help economies cope with shocks *ex post*, but also to reduce exposure *ex ante*; limit abrupt and costly adjustments; and strengthen economies' ability to grow.

Last but not least, international cooperation remains indispensable. Many of the shocks weighing on the global economy cross borders, and so must the response. In a more shock-prone and still interconnected world, resilience cannot be built by countries acting alone. Transparent and predictable trade rules can facilitate long-term planning and enhance investment. Cooperation on energy security and critical supply chains can make adjustment less disruptive when shocks occur. As artificial intelligence reshapes production and trade, policymakers must work together to prudently harness and broaden the gains and manage the risks from technological transformation. The benefits of innovation should help raise living standards and make growth more durable and inclusive.

The task ahead is to move from coping to rebuilding: rebuilding supply-side resilience, restoring fiscal space, lifting growth potential, and ensuring that the next decade is defined by growth and shared prosperity.

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