This scenario uses the IMF’s Global Economy Model to trace the global macroeconomic implications of slower potential growth and temporarily higher risk premiums. For the United States and the euro area, this scenario assumes that annual potential output growth is ½ percentage point below baseline over the WEO horizon, whereas for Japan, growth is ¼ percentage point lower than baseline. For Latin American and all remaining countries, it is assumed that potential growth is ½ percentage point below baseline. It takes until mid-2015 before it becomes clear that potential growth will be lower until end-2017. For advanced economies, this raises debt-sustainability concerns, and sovereign risk premiums rise by 50 basis points by 2016 before gradually returning to baseline. As sovereign risk premiums rise, advanced economies gradually tighten fiscal policy. The fiscal balance improves by 1 percent of GDP by 2016, and then gradually returns to baseline once the debt-to-GDP ratio declines and risk premiums moderate. In emerging market and developing economies, lower growth prospects raise concerns about the viability of some private investment, and corporate risk premiums rise, particularly in the tradable sector. In this sector, corporate risk premiums peak roughly 200 basis points above baseline in 2016 in emerging Asia and about 150 basis points above baseline in Latin America. In the G3 (euro area, Japan, United States), monetary policy is constrained by the zero bound on nominal policy interest rates. For the first few years, interest rates cannot ease at all relative to the baseline, and beyond that, there is only limited scope for easing.

GDP growth in all regions is well below the WEO baseline between 2013 and 2016, with global growth roughly 2 percentage points lower in 2015. Eventually, advanced economies have scope to ease monetary policy, which helps support growth toward the end of the WEO horizon and bring inflation back toward the baseline. Lower global growth translates into weaker demand for commodities, and the price of oil falls by roughly 30 percent after three years, with non-oil commodities falling by roughly 20 percent.