Global growth is projected to slow to 3.1 percent in 2016 before recovering to 3.4 percent in 2017. The forecast, revised down by 0.1 percentage point for 2016 and 2017 relative to April, reflects a more subdued outlook for advanced economies following the June U.K. vote in favor of leaving the European Union (Brexit) and weaker-than-expected growth in the United States. These developments have put further downward pressure on global interest rates, as monetary policy is now expected to remain accommodative for longer. Although the market reaction to the Brexit shock was reassuringly orderly, the ultimate impact remains very unclear, as the fate of institutional and trade arrangements between the United Kingdom and the European Union is uncertain. Financial market sentiment toward emerging market economies has improved with expectations of lower interest rates in advanced economies, reduced concern about China’s near-term prospects following policy support to growth, and some firming of commodity prices. But prospects differ sharply across countries and regions, with emerging Asia in general and India in particular showing robust growth and sub-Saharan Africa experiencing a sharp slowdown. In advanced economies, a subdued outlook subject to sizable uncertainty and downside risks may fuel further political discontent, with anti-integration policy platforms gaining more traction. Several emerging market and developing economies still face daunting policy challenges in adjusting to weaker commodity prices. These worrisome prospects make the need for a broad-based policy response to raise growth and manage vulnerabilities more urgent than ever.

The current outlook is shaped by a complex confluence of ongoing realignments, long-term trends, and new shocks. These factors imply a generally subdued baseline for growth, but also substantial uncertainty about future economic prospects. The main unforeseen development in recent months was the U.K. vote in favor of leaving the European Union. Brexit is very much an unfolding event—the long-term shape of relations between the United Kingdom and the European Union, and the extent to which their mutual trade and financial flows will be curtailed, will likely become clear only after several years. Adding to the uncertainty is the impact of the referendum results on political sentiment in other EU members, as well as on global pressure to adopt populist, inward-looking policies.

Important ongoing realignments—particularly salient for emerging market and developing economies—include rebalancing in China and the macroeconomic and structural adjustment of commodity exporters to a long-term decline in their terms of trade. Slow-moving changes that are playing an important role in the outlook for advanced economies (as well as for some emerging market economies) include demographic and labor-market trends, but also an ill-understood protracted slowdown in productivity, which is hampering income growth and contributing to political discontent.

In the World Economic Outlook (WEO) baseline scenario, global growth is projected to decline to 3.1 percent in 2016, and to rebound next year to 3.4 percent. The 2016 forecast reflects weaker-than-expected U.S. activity in the first half of the year as well as materialization of an important downside risk with the Brexit vote. Although financial market reaction to the result of the U.K. referendum has been contained, the increase in economic, political, and institutional uncertainty and the likely reduction in trade and financial flows between the United Kingdom and the rest of the European Union over the medium term is expected to have negative macroeconomic consequences, especially in the United Kingdom. As a result, the 2016 growth forecast for advanced economies has been marked down to 1.6 percent.

Growth in emerging market and developing economies is expected to strengthen slightly in 2016 to 4.2 percent after five consecutive years of decline, accounting for over three-quarters of projected world growth this year. However, the outlook for these economies is uneven and generally weaker than in the past. While external financing conditions have eased with expectations of lower interest rates in advanced economies, other factors are weighing on activity.
These include a slowdown in China, whose spillovers are magnified by its lower reliance on import- and resource-intensive investment; commodity exporters’ continued adjustment to lower revenues; spillovers from persistently weak demand in advanced economies; and domestic strife, political discord, and geopolitical tensions in several countries. While growth in emerging Asia and especially India continues to be resilient, the largest economies in sub-Saharan Africa (Nigeria, South Africa, Angola) are experiencing sharp slowdowns or recessions as lower commodity prices interact with difficult domestic political and economic conditions. Brazil and Russia continue to face challenging macroeconomic conditions, but their outlook has strengthened somewhat relative to last April.

The recovery is projected to pick up in 2017 as the outlook improves for emerging market and developing economies and the U.S. economy regains some momentum, with a fading drag from inventories and a recovery in investment. Although longer-term prospects for advanced economies remain muted, given demographic headwinds and weak productivity growth, the forecast envisages a further strengthening of growth in emerging market and developing economies over the medium term. But as noted in previous WEOs, this forecast depends on a number of important assumptions:

- A gradual normalization of conditions in economies currently under stress, with a general pickup in growth in commodity exporters, albeit to levels more modest than in the past
- A gradual slowdown and rebalancing of China’s economy with medium-term growth rates that—at close to 6 percent—remain higher than the average for emerging market and developing economies
- Resilient growth in other emerging market and developing economies

Both economic and noneconomic factors threaten to keep these assumptions from being realized and imperil the baseline outlook more generally. In particular, some risks flagged in recent WEOs have become more prominent in recent months. The first is political discord and inward-looking policies. The Brexit vote and the ongoing U.S. presidential election campaign have highlighted a fraying consensus about the benefits of cross-border economic integration. Concerns about the impact of foreign competition on jobs and wages in a context of weak growth have enhanced the appeal of protectionist policy approaches, with potential ramifications for global trade flows and integration more broadly. Concerns about unequal (and widening) income distribution are rising, fueled by weak income growth as productivity dynamics remain disappointing. Uncertainty about the evolution of these trends may lead firms to defer investment and hiring decisions, thus slowing near-term activity, while an inward-looking policy shift could also stoke further cross-border political discord.

A second risk is stagnation in advanced economies. As global growth remains sluggish, the prospect of an extended shortfall in private demand leading to permanently lower growth and low inflation becomes ever more tangible, particularly in some advanced economies where balance sheets remain impaired. At the same time, a protracted period of weak inflation in advanced economies risks unmooring inflation expectations, causing expected real interest rates to rise and spending to decline, eventually feeding back to even weaker overall growth and inflation.

Other risks flagged in previous WEOs remain important potential influences on the outlook. China’s ongoing adjustment and associated spillovers continue to be pertinent, even as near-term sentiment regarding China has appeared to recover from the acute anxiety at the start of the year. The economy’s transition away from reliance on investment, industry, and exports in favor of greater dependence on consumption and services could become bumpier than expected at times, with important implications for commodity and machinery exporters as well as for countries indirectly exposed to China through financial contagion channels. That risk is heightened by the current short-term growth-promoting measures on which China is relying, as a still-rising credit-to-GDP ratio and lack of decisive progress in addressing corporate debt and governance concerns in state-owned enterprises raise the risk of a disruptive adjustment. More generally, although financial conditions in emerging markets have continued to improve in recent months, underlying vulnerabilities remain among some large emerging market economies. High corporate debt, declining profitability, weak bank balance sheets—together with the need to rebuild policy buffers, particularly in commodity exporters—leave these economies still exposed to sudden shifts in investor confidence. A range of additional noneconomic factors continues to influence the outlook in various regions—the protracted effects of a drought in eastern and southern Africa; civil war and domestic
conflict in parts of the Middle East and Africa and the tragic plight of refugees in neighboring countries and in Europe; multiple acts of terror worldwide; and the spread of the Zika virus in Latin America and the Caribbean, the southern United States, and southeast Asia. If these factors intensify, they could collectively take a large toll on market sentiment, hurting demand and activity.

Upside developments include the orderly repricing in financial markets after the initial shock of the Brexit vote; sustained improvements in the U.S. labor market; and a modest recent uptick in commodity prices, which should ease some of the pressure on commodity exporters. These developments point to the possibility of a better-than-envisaged pickup in momentum, which could be even stronger if countries adopt comprehensive frameworks to lift actual and potential output.

While the baseline forecast for the global economy points to a pickup in growth over the rest of the forecast horizon from its subdued pace this year, the potential for setbacks to this outlook is high, as underscored by repeated growth markdowns in recent years. Against this backdrop, policy priorities differ across individual economies depending on the specific objectives of improving growth momentum, combating deflation pressures, or building resilience. But a common theme is that urgent action relying on all policy levers is needed to head off further growth disappointments and combat damaging perceptions that policies are ineffective in boosting growth or that the rewards accrue only to those at the higher end of the income distribution.

In advanced economies, output gaps are still negative, wage pressures are generally muted, and the risk of persistent low inflation (or deflation, in some cases) has risen. Monetary policy therefore must remain accommodative, relying on unconventional strategies as needed. But accommodative monetary policy alone cannot lift demand sufficiently, and fiscal support—calibrated to the amount of space available and oriented toward policies that protect the vulnerable and lift medium-term growth prospects—therefore remains essential for generating momentum and avoiding a lasting downshift in medium-term inflation expectations. In countries facing rising public debt and social entitlement outlays, credible commitments to medium-term consolidation can generate additional space for near-term support. And fiscal policy should concentrate outlays on uses that most strongly support demand and longer-term potential growth. More broadly, accommodative macroeconomic policies must be accompanied by structural reforms that can counteract waning potential growth—including efforts to boost labor force participation, improve the matching process in labor markets, and promote investment in research and development and innovation. As discussed in Chapter 3 of the April 2016 WEO, comprehensive policies that combine demand support with reforms targeting a country’s structural needs, anchored in coherent and well-communicated policy frameworks, can fire up both short-term activity and medium-term potential output.

Across emerging market and developing economies, the broad common policy objectives are continued convergence to higher incomes by reducing distortions in product, labor, and capital markets and giving people a better chance in life by investing wisely in education and health care. These goals can only be realized in an environment safe from financial vulnerability and the risk of reversals. Economies with large and rising non-financial debt, unhedged foreign liabilities, or heavy reliance on short-term borrowing to fund longer-term investments must adopt stronger risk management practices and contain currency and balance sheet mismatches.

For countries hardest hit by the slump in commodity prices, adjustment to reestablish macroeconomic stability is urgent. This implies fully allowing the exchange rate to absorb pressures for countries not relying on an exchange rate peg, tightening monetary policy where needed to tackle sharp increases in inflation, and ensuring that needed fiscal consolidation is as growth friendly as possible.

Low-income developing economies must rebuild fiscal buffers while continuing to spend on critical capital needs and social outlays, strengthen debt management, and implement structural reforms—including in education—that pave the way for economic diversification and higher productivity.

While essential at the country level, these policies for all country groups would be even more effective if adopted broadly throughout the world, with due attention to country-specific priorities.

With growth weak and policy space limited in many countries, continued multilateral effort is required in several areas to minimize risks to financial stability and sustain global improvements in living standards. This
effort must proceed simultaneously on a number of fronts. Policymakers must address the backlash against global trade by refocusing the discussion on the long-term benefits of economic integration and ensuring that well-targeted social initiatives help those who are adversely affected and facilitate, through retraining, their absorption into expanding sectors. Effective banking resolution frameworks, both national and international, are vital, and emerging risks from nonbank intermediaries must be addressed. A stronger global safety net is more important than ever to protect economies with robust fundamentals that may nevertheless be vulnerable to cross-border contagion and spillovers, including strains that are not economic.