

Box 2.2**Medium-term economic outlook of major economies**

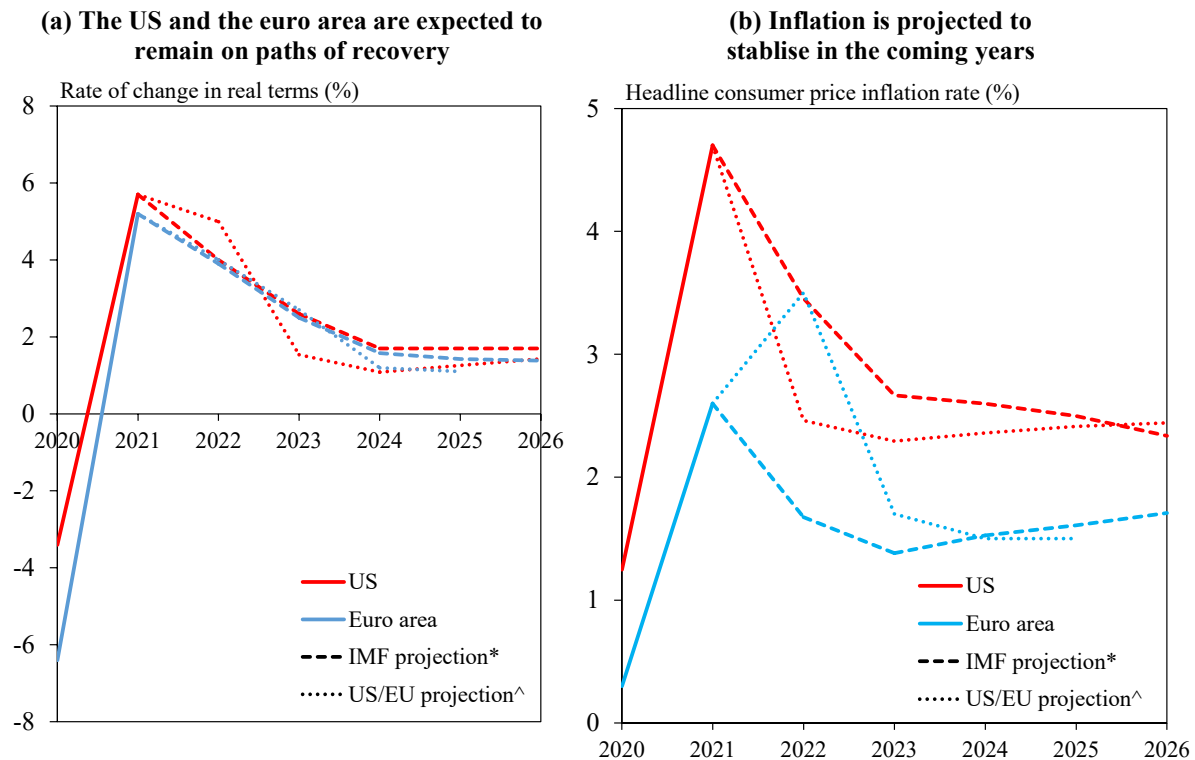
The global economy was dealt a severe blow by the COVID-19 pandemic, contracting by 3.1% in 2020 according to the International Monetary Fund (IMF), the worst recession since the Great Depression in the 1930s. Major economies deployed large-scale fiscal and monetary policy measures to alleviate the economic pains and financial market strains. In 2021, the threat of the pandemic receded alongside the availability of vaccines and governments became more experienced at handling the spread of the virus, enabling global economy to bounce back more notably, by 5.9%. Yet, with the emergence of more contagious variants in many places, particularly Omicron, the pandemic development remains fluid and continues to weigh on the pace of economic revival. Inflation has also been higher and more broad-based than expected. Meanwhile, the path of monetary policy tightening by major central banks, geopolitical tensions, and other longer-term headwinds such as population aging and elevated public debts, constitute other sources of uncertainty surrounding the outlook for major economies over the next few years.

The Mainland economy showed vibrant growth of 8.1% in 2021, despite some moderation in the second half of the year. With the ample room for policy manoeuvring, the Mainland economy is expected to attain further solid growth in 2022. In the medium term, the new development pattern of “dual circulation” with an emphasis on domestic circulation should render support to domestic demand and open up new room for investment across different sectors, particularly those related to innovation and technology. Structural reforms implemented by the Mainland authorities should help further enhance economic fundamentals and foster the transition towards high-quality development. The IMF forecast that the Mainland economy will grow by 4.8% in 2022 and 5.1% per annum in 2023-2026. This puts the Mainland on track to exceed the World Bank’s threshold for high-income economies in the coming years. The IMF expected consumer price inflation in the Mainland to average 1.8% in 2022 and 2.0% per annum in 2023-2026.

The US economy rebounded strongly in 2021. The labour market likewise saw significant improvement, which should render support to private consumption in the near term. Nonetheless, it remains to be seen whether pandemic-induced supply bottlenecks will persist, which may constrain the strength of economic revival. Fiscal and monetary policy support is also expected to diminish relative to last year amid elevated inflation and increasing resistance to new fiscal measures. The IMF forecast that the US economy will grow by 4.0% in 2022. Beyond 2022, economic growth of the US is likely to moderate further alongside the normalisation of monetary policy, though infrastructure plans could provide some boost to productivity. The IMF forecast that the US economy will grow at an average annual rate of 1.9% in 2023-2026, while the US Congressional Budget Office (CBO) projected 1.3% (*Chart 1*). Inflation, currently running hot, is expected to recede as supply catches up with demand. The IMF and CBO expected inflation to fall back to 2.3% and 2.4% respectively by 2026.

Box 2.2 (Cont'd)

Chart 1 : GDP and inflation projections for the US and the euro area



Sources: (*) IMF World Economic Outlook October 2021 and January 2022 update.

(^) Congressional Budget Office 10-Year Economic Projections, July 2021; European Commission Winter 2022 Economic Forecast; European Commission Debt Sustainability Monitor 2020.

The euro area economy also saw a visible recovery in 2021. While further growth is expected for 2022 amid support from still-accommodative monetary policy and the Next Generation EU recovery fund, the pace of recovery will hinge crucially on the development of the pandemic and how supply bottlenecks in raw materials and transportation evolve. For the medium term, Next Generation EU grants and loans should provide some boost to the outlook. Meanwhile, the European Central Bank considered that monetary accommodation would still be needed to attain its 2% inflation target over the medium term. Overall, economic growth in the euro area will likely gradually converge to its long-run potential in coming years. The IMF forecast that the euro area economy will grow by 3.9% in 2022 and 1.7% per annum in 2023-2026. The European Commission projected average annual growth of 3.3% in 2022-2023, falling to 1.1% by 2025. Both institutions expect inflation to recede in the short run, then pick up to closer to 2% toward the end of the projection period (*Chart 1*).

Box 2.2 (Cont'd)

In Asia, Japan's economic recovery was comparatively modest in 2021 as the epidemic relapsed, fiscal stimulus faded and exports were affected by supply chain disruptions. Japan's economy should show some catch-up growth in 2022, while the Bank of Japan noted in January that short-term inflation expectations had picked up and headline consumer price inflation was likely to increase moderately in the short run, reflecting the rise in energy prices. In the medium term, structural issues such as population ageing and elevated public debt continue to pose challenges, while inflation is expected to pick up further. The IMF forecast that Japan's economy will grow by 3.3% in 2022 and 0.9% per annum in 2023-2026. The IMF expected inflation in Japan to pick up to 0.5% in 2022 and average 0.9% in 2023-2026. In developing Asian economies, trading and production activities generally continued to recover, though some economies were more affected by the pandemic. Nevertheless, if the epidemic is put under control, domestic demand and regional trade flows should revive further and support solid growth over the medium term. The IMF forecast that ASEAN-5 economies⁽¹⁾ will grow by 5.6% in 2022 and also 5.6% per annum in 2023-2026, notably above the average of advanced economies, while consumer price inflation is expected to average 2.8% over the same period.

While major economies are expected to stay on their growth paths over the medium term, the shift in monetary policy stances of advanced economies in response to elevated inflation is likely to induce some ripple effects across the global economy. Higher interest rates will strain public finances, especially for economies that have borrowed heavily in foreign currencies. Some developing economies might be subject to higher financial uncertainty, especially if major central banks tighten their monetary policy stances more quickly than anticipated. Moreover, though some fiscal consolidation is expected in the coming few years, post-pandemic debt burdens will remain elevated. Notwithstanding these challenges, the Mainland and other Asian economies are expected to sustain relatively faster growth and remain important growth drivers for the global economy over the medium term.

(1) Indonesia, Malaysia, the Philippines, Thailand, and Vietnam.