

Economic growth

Global Economic Outlook Shows Modest Change Amid Policy Shifts and Complex Forces

Dialing down uncertainty, reducing vulnerabilities, and investing in innovation can help deliver durable economic gains

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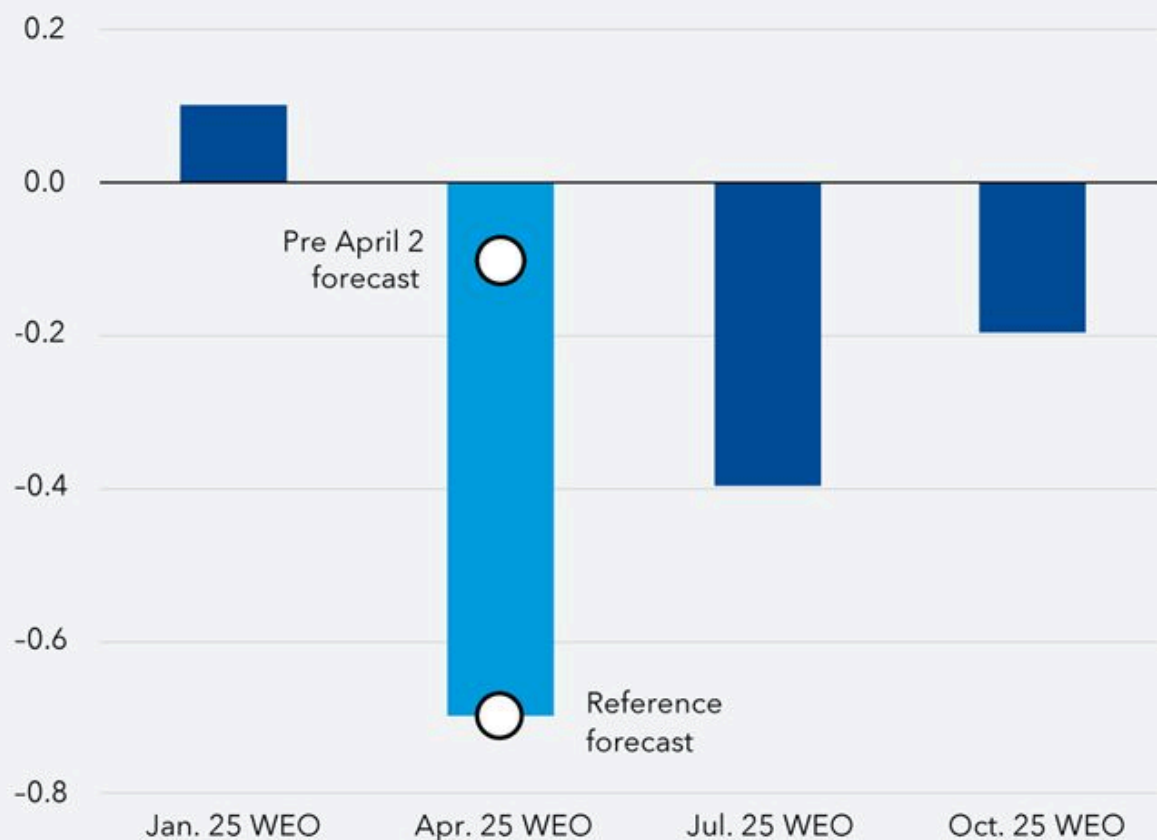
In April, the United States shook global trade norms by announcing sweeping tariffs. Given the complexity and fluidity of the moment, our April report offered a range of estimates for the growth downgrade, from modest to significant, depending on the ultimate severity of the trade shock.

Six months on, where are we? The good news is that the growth downgrade is at the modest end of the range. The reasons are clear. The United States negotiated trade deals with various countries and provided multiple exemptions. Most countries refrained from retaliation, keeping instead the trading system largely open. The private sector also proved agile, front-loading imports and speedily re-routing supply chains.

As a result, the increase in tariffs and its effect has been smaller than expected so far. [We now project](#) global growth at 3.2 percent this year and 3.1 percent next year, a cumulative downgrade of 0.2 percentage point since our forecast a year earlier.

The global economic growth outlook is evolving as trade policy changes

World growth revision, relative to October 2024 World Economic Outlook; cumulative 2025-26; percentage point



Sources: IMF, October 2025 World Economic Outlook; and IMF staff calculations.

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Should we conclude that the shock triggered by the tariff surge had no effect on global growth? That would be both premature and incorrect.

Premature because the US statutory effective tariff rate remains high and trade tensions continue to flare up with no guarantee yet on lasting trade agreements. Past experience suggests that it may take a long time before the full picture emerges. So far, the incidence of the tariffs seems to fall squarely on US importers, with import prices (excluding tariffs) mostly unchanged, and limited retail price increases. But they may still pass costs onto US consumers, as some have started to do, and trade may reroute permanently, leading to global efficiency losses.

Incorrect because other economic forces besides trade policy are simultaneously at play. In the United States, tighter immigration policies are shrinking the foreign-born labor supply—another negative supply shock on top of that from tariffs. So far, this has been

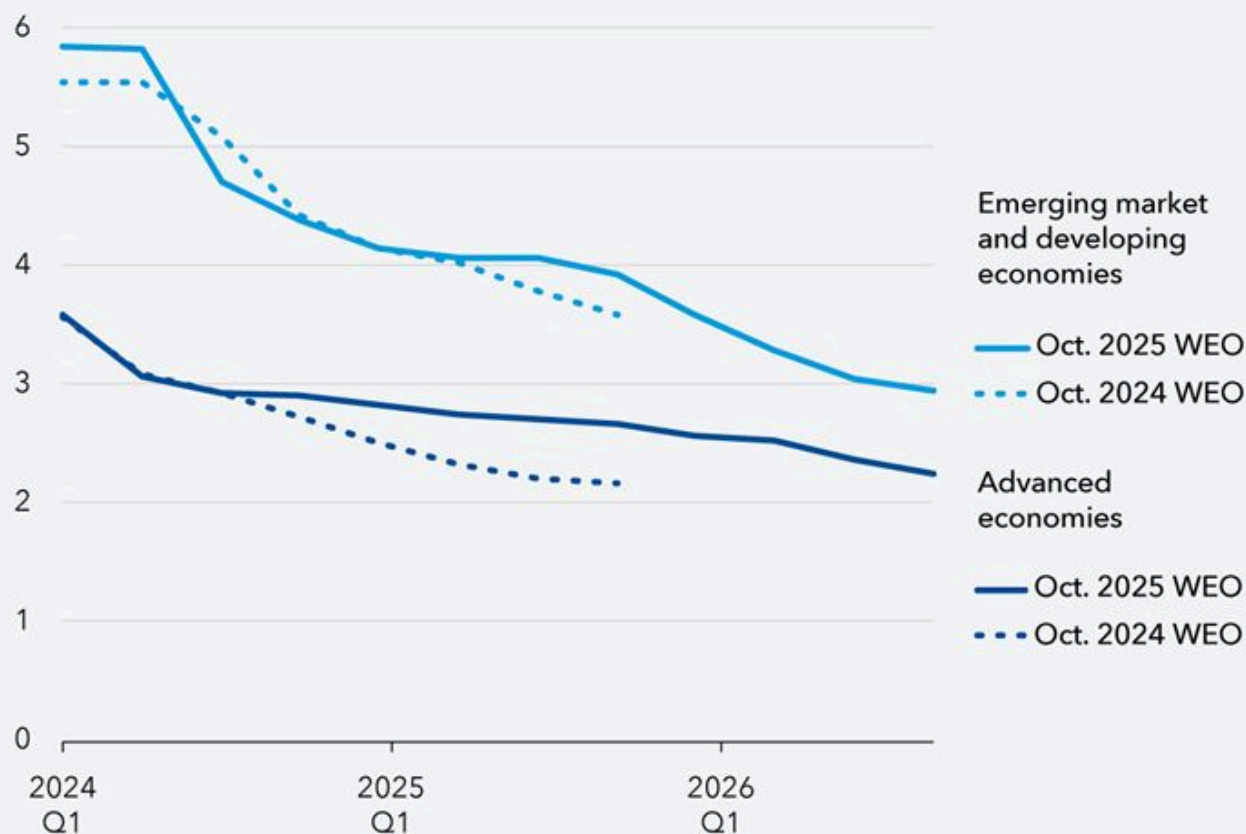
offset by cooling labor demand, keeping unemployment steady. Financial conditions remain loose, the dollar has softened in the first half of the year, and AI-driven investment is booming. These demand-side forces are supporting activity, while adding further to the price pressures from the negative supply shocks.

In tariff-hit economies, other dynamics are helping to cushion the blow. China is weathering higher tariffs with a weaker real exchange rate, redirected exports to Asia and Europe, and fiscal support. Germany's fiscal expansion is lifting euro area growth. Emerging market and developing economies benefitted from easier global financial conditions thanks in part to the depreciation of the US dollar, and they continue to demonstrate strong resilience reflecting in part hard-earned gains from [stronger policy frameworks](#).

Still, despite multiple offsetting drivers, the tariff shock is further dimming already lackluster growth prospects. We expect a slowdown in the second half of this year, with only a partial recovery in 2026, and, compared to last October's projections, inflation is expected to be persistently higher. Even in the United States, growth is weaker and inflation higher than we projected last year—hallmarks of a negative supply shock.

Global core inflation is projected to stay persistently higher than previously projected

Percent; annual change; PPP-weighted



Sources: IMF, October 2025 World Economic Outlook; and IMF staff calculations.
Note: Emerging market and developing economies excludes Argentina.

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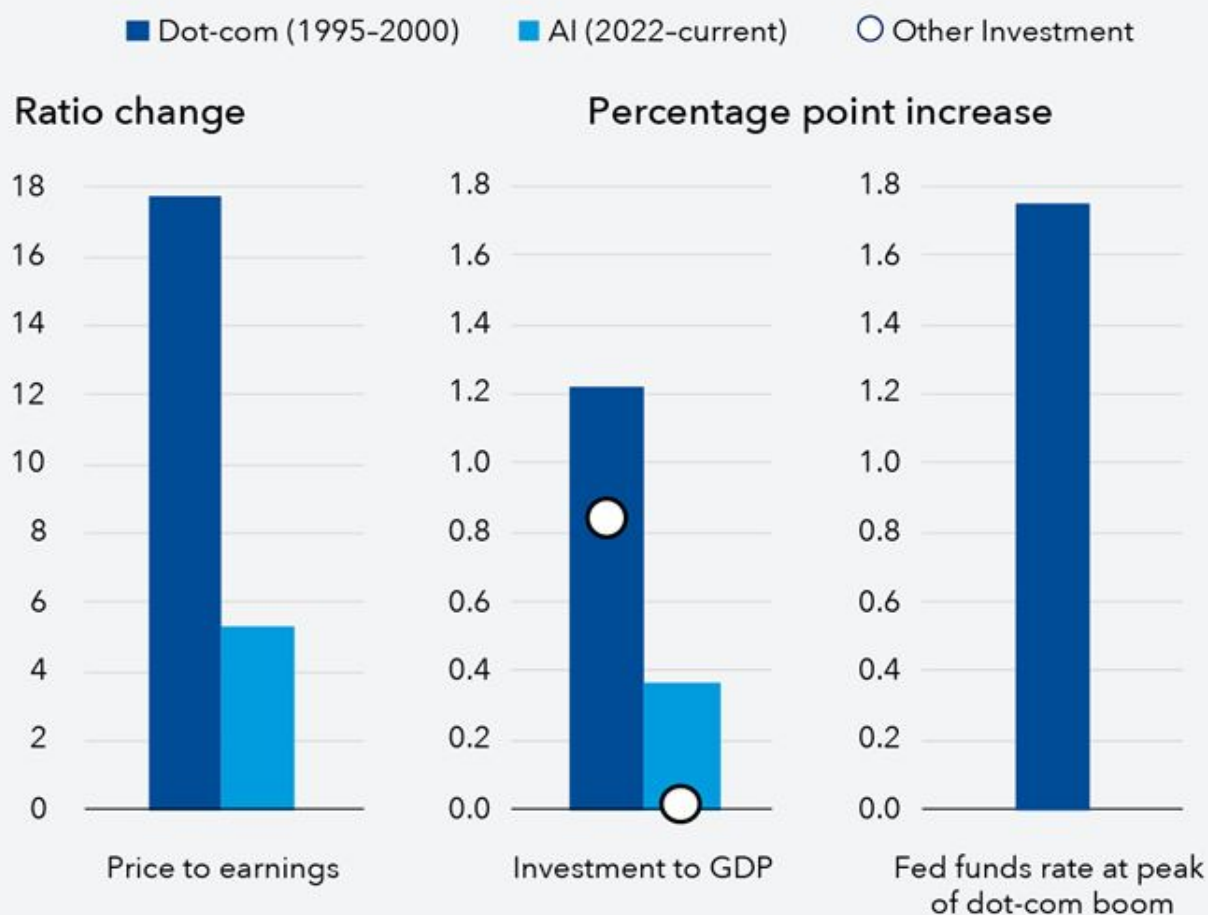
Overall, despite a steady first half, the outlook remains fragile, and risks remain tilted to the downside. The main risk is that tariffs may increase further from renewed and unresolved trade tensions, which, coupled with supply chain disruptions, could lower global output by 0.3 percent next year. Apart from this, four simmering downside risks are especially worrying:

1. The AI surge, promise or peril?

Today's surging investment in artificial intelligence echoes the dot-com boom of the late 1990s. Optimism is fueling tech investment, lifting stock valuations, and boosting consumption via capital gains. This could push the real neutral interest rate upwards. Continued exuberance may require tighter monetary policy just as in the late 1990s.

But there is also a flip side. Markets could reprice sharply, especially if AI fails to justify lofty profit expectations. That would dent wealth and curb consumption, with adverse effects potentially reverberating through the financial system.

AI investment surge in the US reminiscent of dot-com boom, could pose risks



Sources: Haver Analytics; and IMF staff calculations. Note: Dot-com boom start date is 1995 and AI surge start date is 2022. Fed funds rate hike is at peak of boom, between 1999 and 2000. First panel reflects S&P 500 cyclically adjusted price-earnings ratio. Other investment is comprised of non-residential investment excluding technology and AI.

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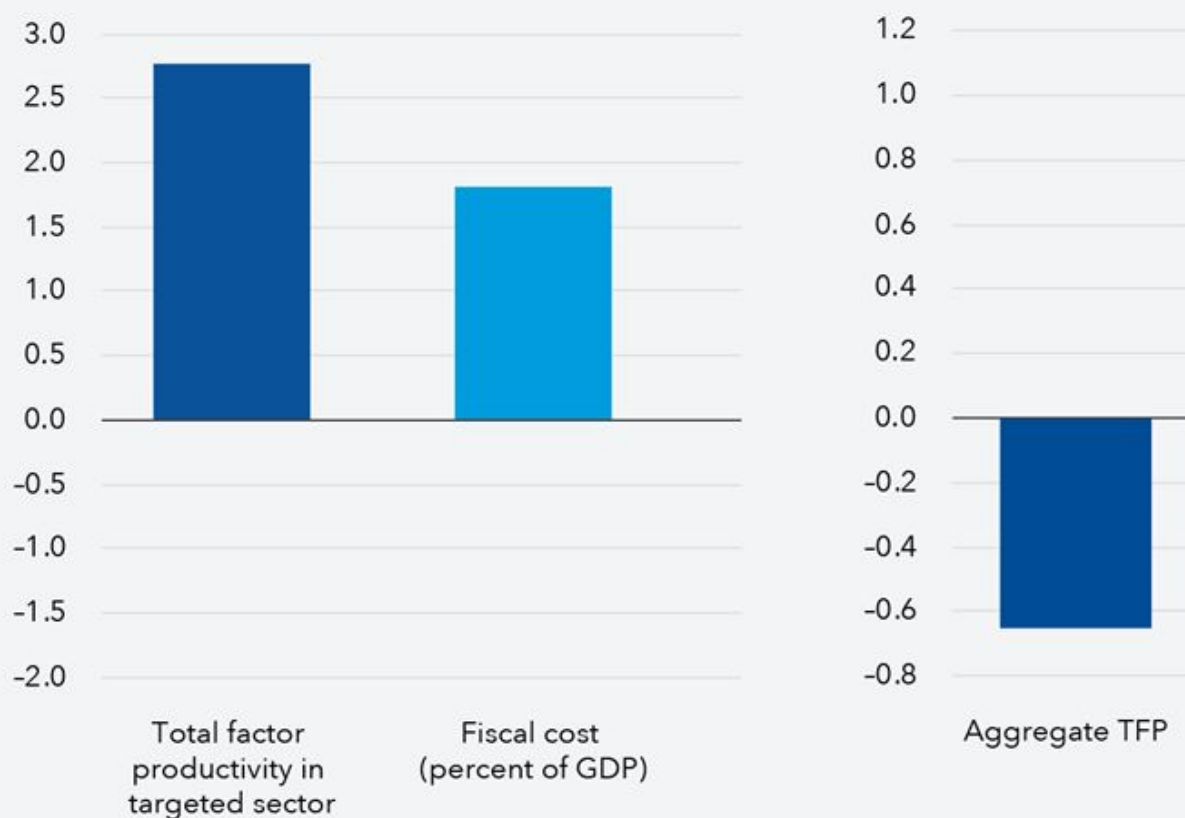
2. China's structural struggles

The outlook remains worrisome in China, where the property sector is still on shaky footing four years after its property bubble burst. Financial stability risks are elevated and rising as real estate investment continues to contract, overall [credit demand remains weak](#), and the economy teeters on the edge of a debt-deflation trap. Manufacturing exports have buoyed growth, but it is hard to see how this could last.

Even the pivot toward investment in new strategic sectors such as electric vehicles and solar panels through the use of large-scale subsidies, while boosting productivity in these sectors, may have contributed to a significant overall misallocation of resources and lackluster aggregate productivity gains. Across different countries, industrial policy can help boost production in targeted sectors but should be [handled with care](#) as it often brings significant fiscal, hidden costs, and potential spillovers.

Scenario implementing industrial policies in energy sector: Many tradeoffs

Change in percentage point or percent of GDP relative to baseline



Sources: IMF, October 2025 World Economic Outlook, Chapter 3; and IMF staff calculations.

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3. Mounting fiscal pressures

Many governments, including some major advanced economies, face growing fiscal strains and have achieved only limited progress in rebuilding fiscal space. Without immediate action, slower economic growth, higher real interest rates, coupled with elevated debt and new spending needs—for defense, economic security, climate—will further tighten the fiscal vise. Low-income countries are especially vulnerable, despite

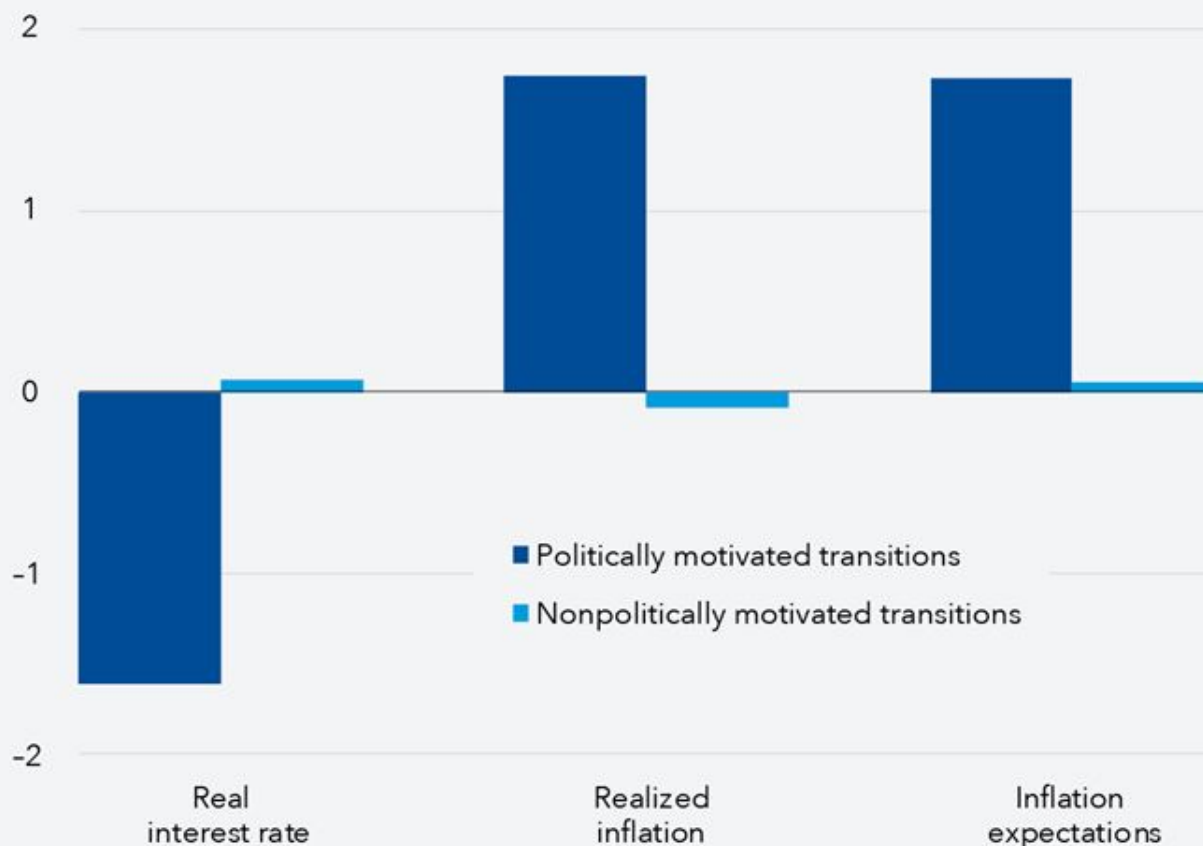
efforts to improve their primary balances, as they face the prospect of significantly reduced aid flows. Many poorer countries remain scarred by the shocks of the last five years. Limited opportunities could fuel social unrest, particularly among unemployed youth.

4. Institutional credibility at risk

As fiscal constraints become more binding, many institutions face rising political pressure. For central banks, pressures to ease monetary policy, whether to support the economy at the expense of price stability, or to lower debt servicing costs, always backfire. While it may lower real interest rates in the short term, inflation and inflation expectations ultimately increase more than desirable. Trust in central banks helps anchor inflation expectations—especially amid shocks, as seen during the recent cost-of-living crisis. As independence erodes, decades of hard-won credibility will vanish, imperiling macroeconomic and financial stability.

Central bank independence is key for preserving economic and financial stability

Outcomes following governor transitions after six months, percentage points



Sources: IMF, October 2025 World Economic Outlook, Chapter 2; and IMF staff calculations.

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The right policies can help

While downside risks dominate, a few important developments could quickly brighten the outlook. First, resolving policy uncertainty would provide a significant lift to the global economy. Clearer and more stable bilateral and multilateral trade agreements can raise global output by 0.4 percent in the very near term. A return to low tariffs that prevailed before January 2025 based on these agreements adds even more upside, about 0.3 percent. Second, beyond its effects on investment, AI could raise total factor productivity. Under modest assumptions, the combined effects of lower uncertainty, lower tariffs, and AI could raise global output by about 1 percent in the near term.

This underscores how policies that help restore confidence and predictability can improve our growth prospects. For trade policy, the objective should be to reduce

uncertainty and set clear, transparent rules that reflect the changing nature of trade relations, looking to deepen trade ties where possible. That most countries have so far avoided retaliation and sought to forge better trade deals offers a glimmer of hope.

This needs to be paired with improved domestic policies which will also go a long way in [reducing global imbalances](#). Where needed, fiscal policy should aim to reduce vulnerabilities. This should be done gradually and credibly, but governments must not delay further. Improving the efficiency of public spending is an important way to encourage [private investment](#). Monetary policy should remain independent, transparent and tailored with a key objective to maintain price stability.

Beyond short-term stability, we must *invest more in the future*. Governments should empower private entrepreneurs to innovate and thrive. Productivity fuels sustainable growth, and the progress of AI, with the right guardrails, can help lift medium-term prospects. While sectoral industrial policies are increasingly tempting policymakers, policies to support education, public research, infrastructure, governance, financial stability, and smart regulation that balances innovation with risk management offer a better and less costly path.

A pragmatic and adaptive multilateral system that fosters cooperation can help us meet these challenges.

–This blog is based on Chapter 1 of the October 2025 World Economic Outlook, "[Global Economy in Flux, Prospects Remain Dim](#)."