

Fiscal Policy under Pressure: High Debt, Rising Risks

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EXECUTIVE SUMMARY

Global public debt dynamics did not improve in any material way in 2025, and the outbreak of war in the Middle East has added a new source of fiscal pressure to an already strained global landscape. The conflict has material global reach, disrupting energy supplies, tightening financial conditions, and forcing governments to choose between shielding their populations from price spikes and preserving fiscal space. Its fiscal impact is highly asymmetric. Energy-importing countries, particularly low-income developing countries, face the largest costs, while the pool of potential beneficiaries is narrower than in past energy shocks, as major Gulf exporters are themselves directly affected by the conflict.

The sharp surge in policy uncertainty that dominated the economic outlook a year ago has receded from its peak, but underlying fiscal and geopolitical pressures have not eased. Although the global economy showed resilience, the fiscal picture has worsened. Global gross government debt rose to nearly 94 percent of GDP in 2025, and on current trajectories, it will reach 100 percent by 2029, a level previously reached only in the aftermath of World War II.

A central concern is not only the elevated level of global debt but also the trajectory implied by current fiscal settings. Higher interest rates and heightened market sensitivity to fiscal news suggest that the space to accommodate this trajectory is narrowing. The global fiscal gap—the difference between projected primary balances and the levels needed to stabilize the debt ratio—has all but disappeared, from a cushion of more than 1 percent of GDP a decade ago to near zero today. The shift represents a deterioration that is structural—that is, it reflects policy choices that have expanded permanent spending on entitlements or reduced revenues, particularly in some of the largest economies. Even in countries where debt dynamics have improved, public debt levels in many cases remain above their peaks during the COVID-19 crisis. In addition, interest payments have risen sharply in just four years, from 2 percent to nearly 3 percent of global GDP as governments refinance maturing debt at today's higher rates. With borrowing costs expected to remain elevated, the combination of weak primary positions and rising debt-service burdens leaves no room for complacency.

The *United States* is running a general government deficit of 7 percent to 8 percent of GDP despite operating near full capacity, with no debt consolidation plan in sight, and its gross debt is projected to reach 142 percent of GDP by 2031. *China's* near-term fiscal expansion, aimed at supporting domestic demand amid deflationary pressures, has widened the country's overall deficit to nearly 8 percent of GDP, and persistent large deficits are expected to push its debt toward 127 percent of GDP by 2031. The global fiscal challenge extends well beyond these two economies. In *Japan*, higher inflation, GDP growth, and smaller primary deficits are improving debt dynamics, but sovereign yields have climbed to record highs, with potential spillover effects for other countries. In *Europe*, several members of the *European Union* have activated escape clauses from the union's rules regarding deficits to accommodate increasing defense spending. The outlays for this spending will likely prove persistent and highlight the fiscal trade-offs faced by countries with limited fiscal space. Emerging and frontier market economies generally enjoyed favorable market access in 2025, helped by a weaker dollar, but debt levels in these markets remain elevated, with issuance volumes halved and maturities shortened sharply for lower-rated borrowers. Among the world's poorest countries, interest payments have reached historic highs relative to revenue, and declining amounts of aid are creating gaps that some countries have been unable to finance. The war in the *Middle East* threatens to reinforce adverse financial and commodity price dynamics—through higher global interest rates, dollar appreciation, and energy price surges—exacerbating macroeconomic pressures in emerging market and developing economies.

The fiscal outlook has deteriorated further since the April 2025 *Fiscal Monitor*. Global debt-at-risk three years ahead now stands near 117 percent of GDP, with a gap of roughly 20 percentage points between the median projection and the right tail, underscoring heightened downside risks. Several reinforcing forces could weigh on the fiscal outlook. The conflict in the *Middle East* could further strain government finances through higher food and fuel prices, tighter financial conditions, lower activity, and rising defense outlays; in a scenario of prolonged conflict, global debt-at-risk could increase by an additional 4 percentage points. Separately, a correction in artificial intelligence–related asset valuations, in which US stocks fall by 20 percent with spillovers to global financial conditions, could raise global debt-at-risk by a further 2.4 percentage points.

Protectionist pressures and geoeconomic fragmentation continue to push governments toward industrial subsidies and trade-related support that have uncertain payoffs in terms of productivity, raising the risk that primary balances will fall short of debt-stabilizing levels if growth underperforms. Domestic instability further heightens fiscal pressures: Within countries, social unrest has increased across income groups, and surges in such unrest are associated with lower growth and wider primary deficits. At the same time, pressures on the independence of central banks, whether overt or implicit, can lift inflation expectations and risk premiums even for highly rated economies, eroding the credibility that keeps borrowing costs contained.

The structure of markets for sovereign debt is also shifting in ways that amplify vulnerabilities, with these changes most evident in advanced economies. As central banks unwind their balance sheets, private (and often leveraged) investors have become the marginal buyers of government bonds. Hedge funds now play a larger role in intermediation, absorbing issuance through trades that can unravel quickly when volatility spikes. By contrast, a selected group of major emerging markets has moved in a different direction, increasingly relying on local currency issuance absorbed by domestic investors (October 2025 *Global Financial Stability Report*). The increase in the US Treasury security supply is compressing the safety premium that US Treasuries have traditionally commanded—an erosion that pushes up borrowing costs globally. Some governments, notably those of systemic economies such as the *United States*, have also shortened the maturity profiles of their debt to manage near-term interest bills, increasing exposure to sudden shifts in short-term funding conditions. The transmission is global: Supply-driven increases in US yields spill over almost one for one to foreign bond markets, disproportionately affecting countries reliant on external financing.

The window for orderly fiscal adjustment is narrowing. Advanced economies with large debt loads need concrete, well-sequenced consolidation measures, not aspirational medium-term targets. For the *United States*, the arithmetic is inescapable: Stabilizing the country's debt path will require action on both revenue and expenditure, including spending on the major entitlement programs. European governments must reconcile defense commitments with aging-related pressures through tangible shifting of spending priorities.

Emerging markets should address contingent liabilities, phase out fiscally draining fuel subsidies, and broaden tax bases as central elements of credible medium-term fiscal plans. For *China*, near-term fiscal expansion focused on boosting consumption and supporting the property sector should continue until reflation is durable. Stabilizing *China's* debt will require significant consolidation over time, tax and social security reforms, and debt restructuring of local government financing vehicles. For low-income countries, declining levels of external aid make domestic revenue mobilization essential, and evidence suggests that well-executed reforms to tax administrations can deliver meaningful gains.

Given already depleted fiscal buffers, policy responses to higher energy costs should be tightly calibrated, targeted to vulnerable households and viable firms, and consistent with monetary policy efforts to

CHAPTER 1 Fiscal Policy under Pressure: High Debt, Rising Risks

contain inflation. Broad-based price subsidies should be avoided where they carry large fiscal costs, are difficult to unwind, or suppress domestic price signals in ways that spill over to global commodity markets. Domestic fuel and gas prices should continue to reflect international price movements and support demand adjustment, even when temporary targeted support is in place.

Across all country groups, fiscal policy must become more forward-looking and structurally anchored as countries manage the effects of the energy price shock. Safeguarding the independence of central banks and the integrity of fiscal frameworks is essential for both advanced and emerging market economies. Clear communication of fiscal realities and enhanced transparency can help anchor expectations and build support for needed adjustment.

Introduction

For global public finances, the accumulation of shocks is increasingly testing fiscal resilience. Governments had been managing the fiscal consequences of the COVID-19 pandemic, the 2022 energy crisis, and major trade disruptions when a war in the *Middle East* introduced an additional and consequential source of pressure. The war has material global reach and, as this chapter shows, poses meaningful risks to public finances across country groups. Even under relatively benign scenarios, the conflict threatens fiscal positions through multiple—and reinforcing—channels. The most immediate is higher commodity prices, which constitute an adverse supply shock with direct budgetary implications. Tightening financial conditions and elevated uncertainty further weaken growth and revenues, compounding pressures on fiscal balances. In many countries, policy choices to cushion households and firms from energy price spikes risk adding substantially to budgetary costs, with durable effects on deficits and debt.

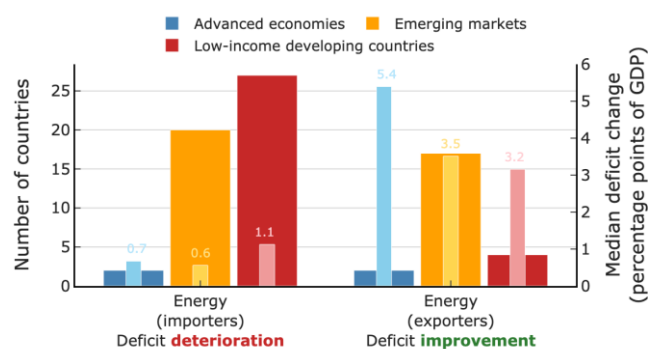
Historical experience underscores the scale of these risks. Energy price shocks have consistently generated large and unequal fiscal effects. Low-income developing countries have typically faced the sharpest deterioration, as higher energy import bills strain already limited fiscal space (Figure 1.1). Other energy importers are not spared: Fiscal balances may deteriorate materially during energy price booms. By contrast, energy exporters have historically seen their fiscal positions improve.

This time, however, the distribution of outcomes may be less favorable. Logistical disruptions and damage to production infrastructure across parts of the Gulf region—home to many of the world’s major energy exporters—could constrain supply responses and limit fiscal windfalls. As a result, the distribution of fiscal outcomes is likely to be skewed: Pressures on public finances may be widespread, while upside gains are more uncertain and narrowly concentrated. Understanding these dynamics is essential for calibrating an effective policy response.

In 2025, a series of policy-induced shocks kept global uncertainty at the forefront, with no tangible progress in addressing global public debt dynamics. Countries contended with a global push toward protectionism, testing the resilience of international trade and capital markets. Policy uncertainty—particularly in the trade domain—has receded from recent sharp spikes (Figure 1.2) but remains well above historical norms.

Despite severe policy disruptions, global output grew by 3.4 percent in 2025, although this headline figure masks a significant divergence in performance across regions. Global headline inflation continued its descent, moderating to 4.1 percent (April 2026 *World Economic Outlook*), but these figures offer little room

Figure 1.1. Government Deficit Effects during Energy Price Booms, 1991–2025
(Number of countries and percentage points of GDP)



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

Note: Energy booms defined as 2002–08 (commodity supercycle, +272 percent), 2009–14 (post-global-financial-crisis oil rebound, +49 percent), and 2020–22 (pandemic rebound and war in Ukraine +227 percent). Deficit change is the total change from one year after boom start to boom peak, then averaged across the three episodes. Narrow bars (right scale) show the median change in percentage points of GDP, computed not across all countries but only across energy importers whose deficits deteriorated and energy exporters whose deficits improved.

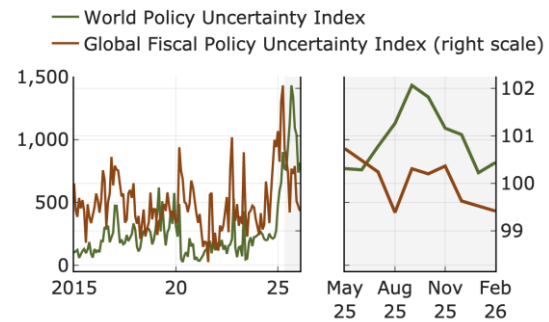
for complacency: Growth remains noticeably below the historical (2000–19) average of 3.9 percent, and the global fiscal outlook has worsened over the past year.

The global fiscal deficit remained broadly unchanged at 5 percent of GDP in 2025 (Table 1.1), and gross public debt climbed to 93.9 percent of GDP, an increase of nearly 2 percentage points from the 2024 figure (Table 1.2). These estimates bear the imprint of the reaction of countries’ fiscal policy to tariffs and other geopolitical shocks, as several countries implemented specific trade-related fiscal measures in 2025.¹

Another key driver of the global fiscal deficit has been the rising burden of interest expenditures, which have climbed from 2 percent to nearly 3 percent of GDP in only four years. Financing costs continue to adjust upward as governments refinance maturing long-term debt at markedly higher market rates. Despite the normalization of monetary policy, long-term yields in advanced economies remain at multidecade highs. While upward pressures had largely abated year to date—with the notable exception of Japan—the war in the *Middle East* triggered a renewed increase (Figure 1.3, panel 1). Since late February 2026, government bond yields across advanced economies have risen noticeably—by as much as 60 basis points in the case of the *United Kingdom*—reflecting higher inflation expectations and markets’ reassessment toward a less accommodative monetary policy.²

Figure 1.2. Global Policy Uncertainty Indices

(Index, January 2015 = 100)

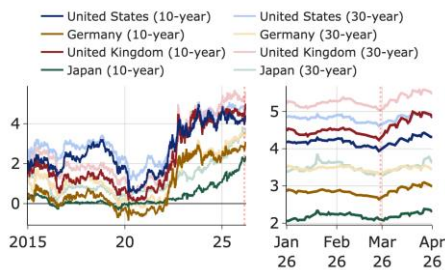


Sources: Ahir, Bloom, and Furceri 2022; Hong, Nguyen, and Ke 2024; and IMF staff calculations.

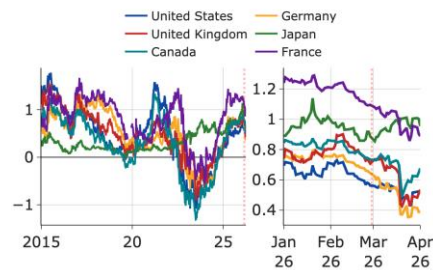
Note: The shaded region in the left subpanel corresponds to the period depicted in right (zoom-in) subpanel.

Figure 1.3. Interest Rates in Advanced Economies

1. Long-Term Bond Yields in Advanced Economies (Percent)



2. Term Spreads in Selected Advanced Economies (Percentage points)



Source: Bloomberg Finance L.P.

Note: The red dashed vertical lines denote the onset of the war in the Middle East. Last observation: April 1, 2026. Panel 2 shows the difference between the yields of 2- and 10-year bonds for each economy.

Term spreads, measured as the difference between the yields of 2- and 10-year government bonds, have stayed elevated (Figure 1.3, panel 2), largely reflecting higher-term risk premiums. This persistence

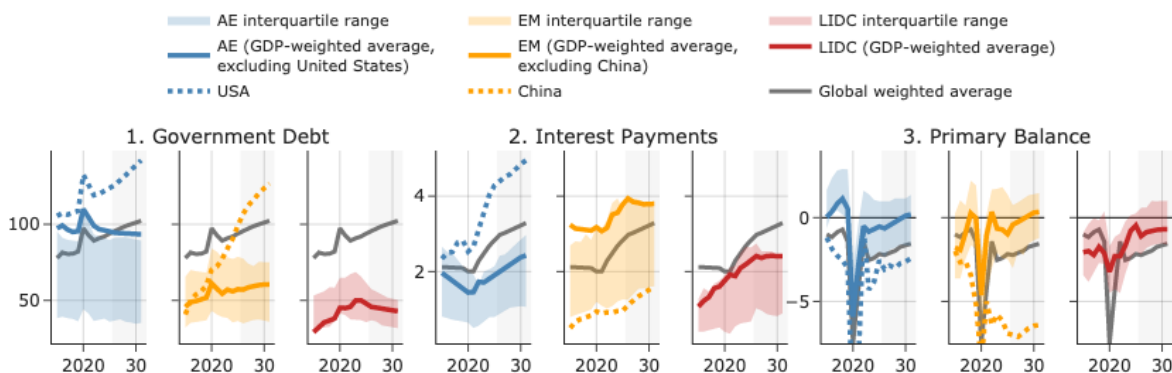
¹ Analysis tracking these developments shows that the response has been substantial in some cases, with announced measures reaching close to 1 percent of GDP in selected countries. The estimates encompass both the revenue and expenditure sides of the budget, as well as below-the-line instruments. They capture the cumulative scale of announced measures over time and should not be interpreted as having fully materialized in 2025.

² The UK 10-year gilt yield climbed from 4.23 percent on the eve of the war (February 27, 2026) to 4.83 percent on April 1, 2026—the latest observation at the time of drafting.

reflects broader systemic risks, including uncertainty surrounding trade developments, fiscal policy trajectories, and long-term debt sustainability. The term spreads compressed, however, around mid-March 2026 despite rising 10-year yields, as a faster move higher in short-term rates reflects increased inflation concerns and expectations of a restrictive monetary policy.

Figure 1.4. Main Fiscal Variables in Advanced Economies, Emerging Markets, and Low-Income Developing Countries

(Percent of GDP)



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

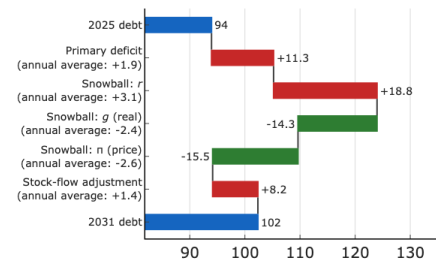
Note: The primary balance is defined as the overall fiscal balance excluding gross interest payments, which are displayed in panel 2. Shaded areas show the forecast horizon (2026–31). AE = advanced economy; EM = emerging market; LIDC = low-income developing country.

The fiscal outlook offers little respite. Although the global primary-deficit-to-GDP ratio is projected to narrow modestly by 2031 by about half a percentage point from its current level of 2.2 percent (Figure 1.4), that expected improvement is insufficient to stabilize the debt ratio, much less put debt on a downward path. Over the forecast horizon (through 2031), global debt is projected to rise by an additional 8 percentage points, reaching the 100 percent threshold in 2029 (Table 1.2), one year before the projections in the April 2025 *Fiscal Monitor*. Although the interest-growth differential remains favorable, its margin is narrow given countries' relatively high interest burdens, and persistent primary deficits offset that margin (Figure 1.5, panel 1). The projected increase in global debt largely reflects the increase in debt in the world's two largest economies, *China* and the *United States* (Figure 1.5, panel 2), whose respective projected debt increases are also higher than projections in the April 2025 *Fiscal Monitor*. By contrast, declining debt ratios in selected countries—most notably *Japan*, by about 14 percentage points, supported by strong nominal growth—provide only a modest counterweight to the broader upward trajectory of global indebtedness.

Figure 1.5. Evolution of Global Government Debt, 2025–30

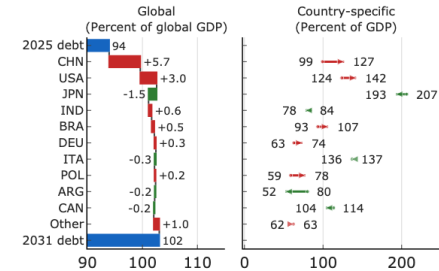
1. Drivers of the Increase in Global Government Debt

(Percent of global GDP)



2. Country Decomposition of the Increase in Global Government Debt

(Percent of GDP)



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

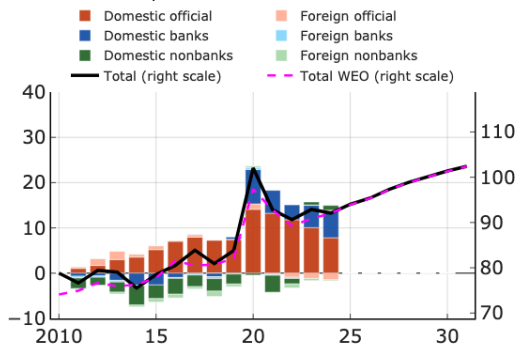
Note: Panel 1 decomposes the change in the global debt-to-GDP ratio between 2025 and 2031 into its primary drivers: the cumulative primary deficit, components of the snowball effect (effective interest rate, real GDP growth, and deflator GDP growth), and stock-flow adjustments. The snowball effect refers to the automatic change in the debt-to-GDP ratio arising from the components of the interest rate–growth rate differential applied to the existing debt. In panel 2, the contribution of each entity to global government debt depends on the projected change in its debt and its economic weight (using GDP in dollars). Positive values indicate contributions that increase the global debt ratio. A country may show a positive contribution even if its domestic debt ratio is falling if its weight in global GDP is projected to increase significantly (compositional effect). Data labels in the figure use International Organization for Standardization (ISO) country codes.

Beyond headline debt aggregates, the shifting composition of buyers and the shortening maturity structure of public debt are adding new layers of fiscal vulnerability. Since 2010, the domestic official sector has absorbed much of the increase in global debt, primarily through central bank purchases of assets (Figure 1.6, panel 1). As monetary policy continues to normalize and central bank balance sheets unwind, countries must increasingly place new issuance, and even rollover maturing debt, with private investors. This shift in holders of governments’ debt heightens their exposure to market conditions (April 2026 *Global Financial Stability Report*).

Figure 1.6. Structure of Global Government Debt

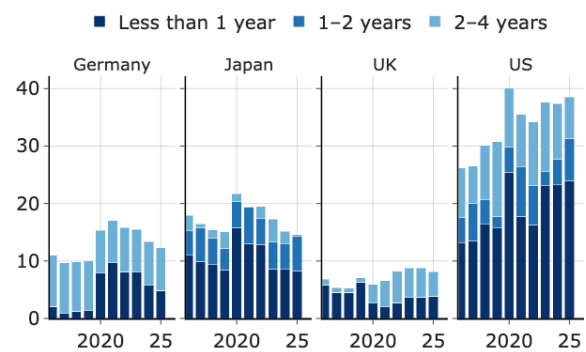
1. Evolution of Decomposition of Ownership of Global Debt

(Percent of GDP)



2. Short-Term Debt in Advanced Economies

(Percent of total outstanding)



Sources: Arslanalp and Tsuda Debt Database (Arslanalp and Tsuda 2014); Bloomberg Finance L.P.; IMF, World Economic Outlook database; and IMF staff calculations.

Note: In panel 1, definitions of general government debt differ between the databases of the *World Economic Outlook* (WEO) and Arslanalp and Tsuda, with the latter using narrower coverage. As a result, debt levels may differ across the two databases, whereas trends remain broadly comparable. Projections from the Arslanalp and Tsuda database are obtained by applying changes projected by the WEO database to the latest available observation from the Arslanalp and Tsuda database.

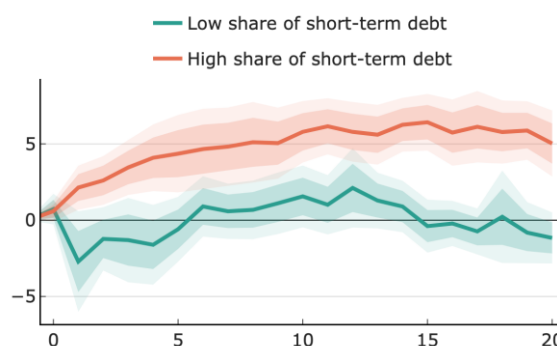
Compounding these vulnerabilities is the increased reliance on short-term issuance in some economies, most notably the United States, which has risen over the past decade (Figure 1.6, panel 2). Initially undertaken to contain near-term borrowing costs, this shift has compressed refinancing cycles and

increased the frequency with which governments must return to markets. Empirical estimates for the United States show the heightened sensitivity of debt ratios to monetary policy shocks when a government’s debt composition has a high share of short-term instruments (Figure 1.7).

The fiscal outlook is subject to unusually high economic and policy uncertainty (Ahir, Bloom, and Furceri 2025; April 2026 *World Economic Outlook*). After a brief period of relative calm, financial market volatility has increased since late February, as the conflict in the Middle East pushed global bond yields higher and weakened emerging market assets and currencies amid a strengthening dollar (April 2026 *Global Financial Stability Report*).

The challenges of fiscal management in an environment marked by trade fragmentation, intensifying geopolitical tensions, the evolving structure of markets for sovereign debt, and the buildup of structural vulnerabilities are amplifying the resulting pressures (see the section “Risks to the Fiscal Outlook”).

Figure 1.7. Effects of Monetary Policy on the Government Debt-to-GDP Ratio
(Percentage points of GDP)

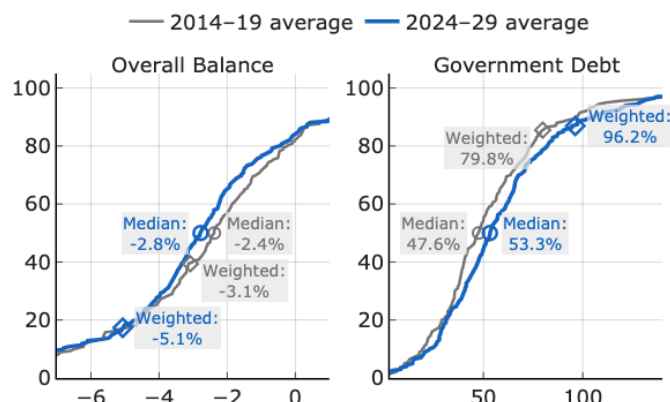


Source: Bettarelli and others, forthcoming.
Note: The figure shows the response of the debt-to-GDP ratio to a monetary policy shock of one standard deviation, estimated using smooth-transition local projections based on US quarterly data (from the first quarter of 2001 to the third quarter of 2023). Scenarios depict high (low) shares of Treasury bills in countries’ total outstanding public debt. Levels 20 quarters after the shock (about 21.5 percent) are above the median (that is, at the 55th percentile) in the distribution over the sample period and imply an effect of 4.07 percentage points of GDP. The lines in the figure represent estimated impulse responses; shaded areas denote 68 percent and 90 percent confidence intervals.

A Precarious Pivot in Global Fiscal Policy

Even before the current energy shock, fiscal outcomes were being shaped increasingly by structural rather than cyclical factors. Despite largely closed output gaps, the unwinding of pandemic-era support, and subsiding inflation, fiscal deficits have remained excessive. The new shock adds further complexity but does not obscure this underlying and sobering reality. A comparison of the outlook for 2024–29 with conditions in the period prior to the pandemic (2014–19) is revealing. On a median basis, the deterioration in overall balances appears modest, from 2.4 percent to 2.8 percent of GDP (Figure 1.8). However, the weighted global average paints a far more concerning picture, with the deterioration widening sharply from 3.1 percent to 5.1 percent of GDP.

Figure 1.8. Global Cumulative Distribution of Overall Balance and General Government Debt
(Percent)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: Panel 1 is restricted to a range of –7 percent to 1 percent of GDP for clarity. Panel 2 focuses on the central part of the distribution.

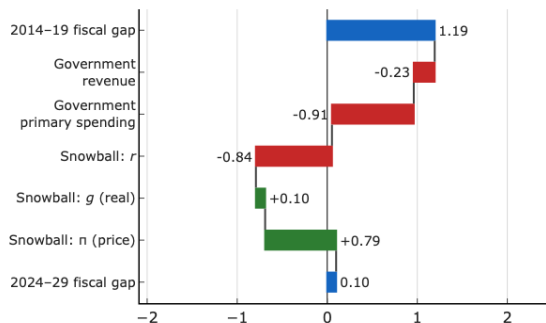
A similar divergence is evident in the dynamics of public debt. Whereas the median economy exhibits a manageable increase, the weighted global average debt ratio rises from 79.8 percent to 96.2 percent of GDP. These divergences underscore the outsized influence of the world’s largest economies in shaping global fiscal aggregates and highlight how headline figures can obscure substantial underlying heterogeneity.

The “global fiscal gap”—the distance between the actual global primary balance and the debt-stabilizing global primary balance—can be used to assess the (un)sustainability of this policy pivot. This indicator, which a decade ago provided a comfortable margin, has now narrowed to near zero. Whereas the global fiscal gap averaged 1.2 percent of GDP during the 2014–19 period, estimates for 2024–29 point to a gap of 0.1 percent (Figure 1.9).³ A decomposition shows that dynamics involving primary balances (reflecting higher primary spending and weaker revenue performance) are almost entirely driving this deterioration. The interest-growth component remains largely neutral despite elevated costs of interest for servicing debt. If the costs of the conflict in the Middle East materialize more severely than projected, they would aggravate the fiscal gap.

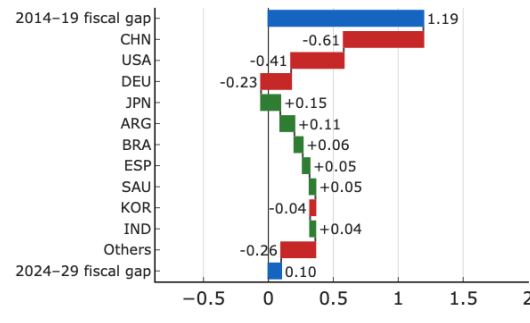
Figure 1.9. Change in Global Fiscal Gap, 2014–19 versus 2024–29

(Percent of global GDP)

1. Drivers of Change



2. Country Contributions to Change



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

Note: The fiscal gap is defined as the primary balance minus the debt-stabilizing primary balance (with a positive gap indicating that the primary balance is above the level needed to stabilize debt excluding stock-flow adjustments). Positive bars indicate factors that increase the fiscal gap (increasing debt sustainability), and negative bars indicate factors that reduce it. “Snowball” effects represent the contribution of changes in effective interest rates, real GDP growth, and the GDP deflator to the debt-stabilizing primary balance. Data labels in the figure use International Organization for Standardization (ISO) country codes.

Even within this global picture, however, national trajectories vary widely. *Germany* is expected to experience a pronounced reversal, with its fiscal gap shifting from 3.6 percent to –1.5 percent of GDP (Figure 1.10, panel 1). An increase in primary spending following the landmark reform of *Germany’s* debt brake fiscal rule to finance public investment and other national priorities has almost entirely driven this change. By contrast, *Japan’s* fiscal gap is projected to rise to 4 percent of GDP from about zero a decade ago (Figure 1.10, panel 2). Although this improvement reflects stronger government revenues and markedly higher inflation relative to rates in the previous decade—factors that increase the primary balance and reduce the debt-stabilizing primary balance respectively—the country’s underlying fiscal

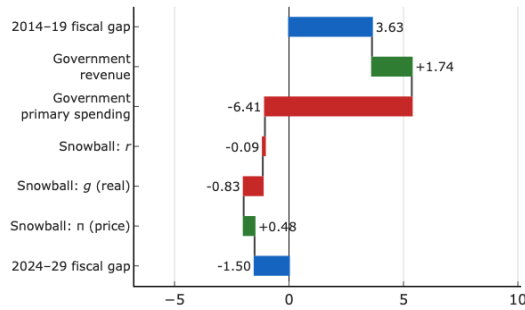
³ Estimates exclude stock-flow adjustments. These adjustments tend to have positive values, so including them would worsen estimates of the fiscal gap for both periods analyzed. The aggregation of nominal and real rates of output growth relies on GDP in dollars without an adjustment for purchasing power parity, unlike official *World Economic Outlook* global aggregates.

position remains challenging.⁴ Slightly more than half of countries—mainly emerging markets and low-income developing countries—experienced improvements in the fiscal gap between 2014–19 and 2024–29. Yet debt levels for the majority remain above prepandemic levels.

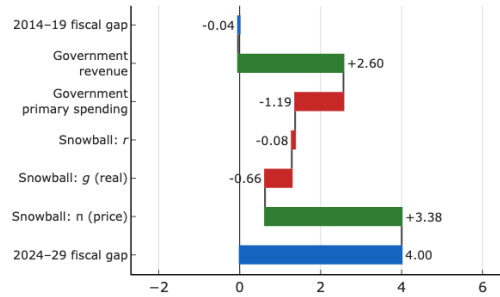
Figure 1.10. Drivers of Change in the Fiscal Gaps of Germany and Japan, 2014–19 versus 2024–29

(Percent of GDP)

1. Germany



2. Japan



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

Note: The fiscal gap is defined as the primary balance minus the debt-stabilizing primary balance (with a positive gap indicating that the primary balance is above the level needed to stabilize debt excluding stock-flow adjustments). Positive bars indicate factors that increase the fiscal gap (increasing debt sustainability), and negative bars indicate factors that reduce it. “Snowball” effects represent the contribution of changes in effective interest rates, real GDP growth, and the GDP deflator to the debt-stabilizing primary balance.

⁴ Japanese debt dynamics present a mixed picture. Within the projection horizon, they appear favorable, as higher inflation supports adjustment, and the prevalence of long-term debt in the composition of the country’s debt portfolio slows the pass-through of higher interest rates to effective financing costs. However, beyond this period, these positive effects wane as debt gradually rolls over at higher rates and pressures from spending on health and other long-term spending intensify.

Table 1.1. General Government Fiscal Balance, 2019–31: Overall Balance
(Percent of GDP, unless noted otherwise)

	2019	2020	2021	2022	2023	2024	2025	Projections					
								2026	2027	2028	2029	2030	2031
World	-3.5	-9.5	-6.3	-3.7	-5.0	-5.1	-5.0	-5.2	-5.1	-5.1	-4.9	-4.9	-4.8
Advanced Economies	-3.0	-10.2	-7.3	-2.9	-4.9	-4.9	-4.4	-4.8	-4.7	-4.7	-4.6	-4.6	-4.5
Advanced Economies excl. US	-1.0	-7.5	-4.4	-2.3	-2.5	-2.5	-2.4	-2.6	-2.5	-2.4	-2.3	-2.3	-2.3
Canada	0.0	-10.9	-3.1	0.6	-0.2	-2.1	-1.8	-2.7	-2.5	-2.2	-2.0	-1.7	-1.5
Euro Area	-0.5	-7.0	-5.1	-3.4	-3.5	-3.1	-3.0	-3.3	-3.4	-3.2	-3.1	-3.0	-3.0
France	-2.4	-8.9	-6.6	-4.7	-5.4	-5.8	-5.1	-4.9	-4.8	-4.3	-3.8	-3.4	-2.9
Germany	1.3	-4.4	-3.2	-1.9	-2.5	-2.7	-2.7	-3.8	-4.2	-4.1	-3.9	-3.8	-3.7
Italy ¹	-1.5	-9.4	-8.9	-8.1	-7.1	-3.4	-3.1	-2.8	-2.6	-2.4	-2.5	-2.5	-2.7
Spain ²	-3.0	-10.0	-6.7	-4.6	-3.3	-3.2	-2.5	-2.1	-2.3	-2.2	-2.2	-2.2	-2.2
Japan	-3.0	-9.0	-6.3	-4.2	-2.4	-1.7	-1.1	-2.0	-2.4	-2.9	-3.3	-3.7	-4.0
United Kingdom	-2.4	-12.9	-7.5	-4.6	-6.0	-6.1	-5.4	-3.9	-3.1	-2.6	-2.0	-1.7	-1.6
United States	-5.8	-14.1	-11.5	-3.7	-7.9	-7.9	-6.8	-7.5	-7.4	-7.6	-7.5	-7.5	-7.4
Other Advanced Economies	-0.1	-4.7	-1.1	0.7	-0.2	-0.5	-0.8	-1.1	-0.9	-0.9	-0.8	-0.8	-0.8
Emerging Market and Developing Economies	-4.3	-8.4	-4.9	-4.8	-5.2	-5.4	-5.9	-5.8	-5.8	-5.6	-5.3	-5.2	-5.2
Emerging Market and Middle-Income Economies	-4.4	-8.6	-5.0	-4.8	-5.3	-5.5	-6.1	-6.0	-5.9	-5.7	-5.5	-5.4	-5.4
Emerging Markets excl. China	-3.1	-7.8	-4.1	-2.8	-4.2	-4.3	-4.7	-4.4	-4.1	-3.9	-3.6	-3.5	-3.5
Excluding MENA Oil Producers	-4.6	-8.7	-5.3	-5.6	-5.8	-5.9	-6.3	-6.3	-6.2	-6.0	-5.8	-5.7	-5.7
Asia	-5.6	-9.5	-6.3	-7.0	-6.4	-6.6	-7.1	-7.4	-7.4	-7.3	-7.1	-7.0	-7.0
China ³	-6.0	-9.6	-5.9	-7.3	-6.7	-7.1	-7.9	-8.2	-8.4	-8.2	-8.0	-8.0	-8.0
India	-7.9	-13.2	-9.7	-9.2	-8.4	-7.9	-7.4	-7.4	-7.3	-7.1	-6.9	-6.7	-6.6
Vietnam	-0.4	-2.9	-1.4	0.7	-1.7	-1.5	-2.2	-2.0	-1.6	-1.4	-1.3	-1.3	-1.3
Europe	-0.6	-5.4	-1.7	-2.3	-4.1	-4.1	-4.7	-3.9	-4.1	-3.9	-3.3	-3.2	-3.2
Russia	1.9	-4.0	0.8	-1.3	-2.2	-1.6	-3.9	-2.0	-2.4	-3.1	-2.4	-2.5	-2.8
Latin America	-3.7	-8.2	-3.9	-3.6	-5.1	-4.7	-5.2	-4.7	-4.1	-3.5	-3.4	-3.3	-3.3
Brazil	-4.9	-11.6	-2.6	-4.0	-7.7	-6.2	-8.1	-7.7	-6.9	-6.2	-6.0	-6.1	-6.1
Mexico	-2.3	-4.3	-3.7	-4.3	-4.3	-5.8	-4.9	-4.4	-3.5	-3.0	-3.0	-3.0	-3.0
MENA	-2.2	-8.0	-1.7	3.5	0.0	-1.6	-3.1	-2.9	-2.3	-2.1	-1.5	-1.3	-1.2
Saudi Arabia	-4.0	-10.2	-2.0	2.2	-1.8	-2.5	-5.8	-3.5	-3.4	-3.6	-3.3	-3.2	-3.2
South Africa	-5.1	-9.6	-5.5	-4.2	-5.6	-5.7	-5.8	-4.9	-4.3	-4.4	-4.1	-3.9	-3.9
Low-Income Developing Countries	-3.7	-5.0	-4.2	-4.2	-3.8	-3.0	-2.8	-3.5	-3.2	-3.2	-3.1	-3.1	-3.1
Kenya	-7.4	-8.1	-7.2	-6.0	-5.6	-5.7	-6.4	-6.4	-6.0	-6.0	-6.1	-6.2	-6.3
Nigeria	-3.3	-4.0	-4.0	-4.0	-3.1	-1.3	-1.8	-4.4	-2.9	-2.3	-2.2	-2.1	-1.9
Oil Producers	0.0	-7.1	-0.6	3.0	0.5	-0.7	-2.2	-1.4	-1.4	-1.6	-1.2	-1.1	-1.1
Memorandum													
World Output (Real, percent)	3.0	-2.7	6.7	3.8	3.3	3.4	3.4	3.1	3.2	3.2	3.2	3.1	3.1

Source: IMF staff estimates and projections.

Note: The estimates and projections are based on statistical information available through April 1, 2026, but may not reflect the latest published data in all cases. For the date of the last data update for each economy, please refer to the notes provided in the online World Economic Outlook database.

All country averages are weighted by nominal GDP converted to US dollars (adjusted by purchasing power parity only for world output) at average market exchange rates in the years indicated and based on data availability. Projections are based on IMF staff assessments of current policies. For country-specific details, see "Data and Conventions" and Tables A, B, C, and D in the Methodological and Statistical Appendix. excl. = excluding; MENA = Middle East and North Africa.

¹ The 2025 figure is preliminary and subject to revision.

² Including financial sector support.

³ China's deficit and public debt numbers presented in this table cover a narrower perimeter of the general government than the IMF staff estimates in China Article IV reports (see IMF 2026 for a reconciliation of the two estimates).

Recent Fiscal Developments and Outlook

The following discussion of the global fiscal outlook accounts for the war in the Middle East but assumes a relatively short-lived conflict. Consistent with the assumptions underlying the April 2026 *World Economic Outlook*, the projections assume that the conflict is limited in duration and scope, with related disruptions fading by mid-2026 and production and exports in the region normalizing thereafter.

Beyond entrenched fiscal trends, the outlook is influenced by three key factors: (1) higher commodity prices; (2) second-round effects from rising inflation expectations; and (3) tighter financial conditions, reflected in rising bond yields. The ultimate fiscal impact of the conflict is highly uncertain and depends critically on both the scale and duration of disruptions. The section “Risks to the Fiscal Outlook” considers a scenario in which the conflict is more prolonged and severe, tracing the transmission channels to the global economy and assessing the resulting implications for the global debt-to-GDP ratio.

A. The Two Largest Economies: Outsized Drivers of the Global Fiscal Position

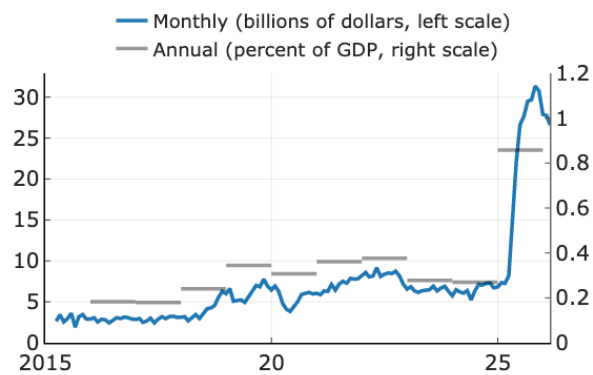
The fiscal footprints of the world’s two largest economies, the *United States* and *China*, continue to fundamentally define the evolution of the global fiscal outlook.

United States

Large deficits and the rollout of several major policy measures marked 2025 in the United States. The general government deficit closed the year at 6.8 percent of GDP, an improvement from 7.9 percent in 2024. This narrowing occurred despite continued growth in interest expenditures, which rose to 4.3 percent of GDP—0.3 percentage point higher than in the previous year and 1.5 percentage points above the 2019 level.⁵ Primary spending remained broadly unchanged as a share of GDP, reflecting efforts to strengthen government efficiency but limited room for further compression.

The reduction in the US primary deficit stemmed in part from a sharp increase in federal revenue, driven by a surge in customs duties following the introduction of broad new tariff schedules. Tariff receipts reached \$264 billion (0.9 percent of GDP) in 2025, an increase of 230 percent relative to the previous year (Figure 1.11). However, the sustainability of this revenue stream remains uncertain following the Supreme Court’s February 2026 ruling on the legality of the tariffs. The US government also shut down for 43 days in 2025, but although this event temporarily disrupted monthly expenditure patterns, it had little effect on aggregate annual fiscal outcomes.

Figure 1.11. Evolution of US Customs Revenue

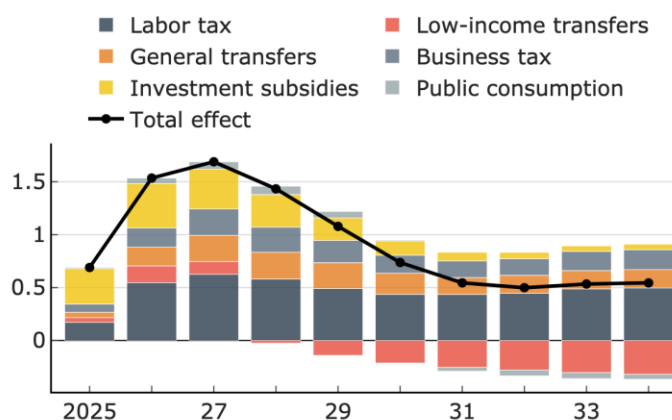


Sources: IMF, World Economic Outlook database; US Department of the Treasury, Monthly Treasury Statement; and IMF staff calculations.

⁵ The 2025 deficit reduction includes a one-time accounting credit of about \$131 billion (0.4 percent of GDP) resulting from the One Big Beautiful Bill Act. This legislation mandated substantial cuts to student loan subsidies and the elimination of the Grad PLUS program. US rules governing the federal budget required immediate recognition of the lifetime cost savings associated with these changes, temporarily improving the country’s fiscal balance.

The passage of the One Big Beautiful Bill Act in July 2025 further shaped the US fiscal outlook. The legislation makes most of the country's 2017 tax cuts permanent and introduces new deductions for tips, overtime pay, and interest on automobile loans, thereby locking in structurally lower federal revenues. To partly offset the costs of these cuts, the act includes reductions in entitlement spending (for example, spending on Medicaid and the Supplemental Nutrition Assistance Program), student loan subsidies, and green energy tax credits. Nevertheless, the US Congressional Budget Office estimates indicate that the One Big Beautiful Bill Act will add above half a percent of GDP to the US primary deficit each year over the long term (Figure 1.12).

Figure 1.12. Impact of the One Big Beautiful Bill Act on the US Fiscal Deficit (Percent of GDP)



Sources: US Congressional Budget Office; and IMF staff calculations.

Medium-term projections point to persistently high deficits—remaining in the range of 7 percent–8 percent of GDP for the general government—as interest payments continue to rise, approaching 5 percent of GDP by 2031. These sustained deficit levels would be unprecedented in peacetime, with an output gap that is broadly closed. As a result, gross debt is expected to climb steadily, increasing from 123.9 percent of GDP in 2025 to about 142 percent by 2031. Should high debt and large deficits place upward pressure on long-term interest rates (Furceri, Goncalves, and Li 2025), which are currently assumed to be nonincreasing, borrowing costs could rise more than projected, leading to an even weaker fiscal trajectory.

The structure of US public debt has evolved significantly alongside its sharp increase. In the past decade and a half, the Federal Reserve and foreign investors absorbed a large amount of the increase in US government debt—about \$11 trillion between the two of them (Figure 1.13, panel 1) (April 2026 *Global Financial Stability Report*). In the past few years, however, the Federal Reserve's debt holdings have begun to decline as monetary policy has normalized. Meanwhile, private domestic investors—including mutual funds, hedge funds, and other nonbank financial intermediaries—have assumed a larger role, absorbing almost \$5 trillion in US public debt since 2022.

The composition of instruments of federal debt has also changed markedly. After a decade of relative stability, issuance of short-term Treasury bills has surged since 2020, with a pronounced uptick beginning in 2023 (Figure 1.13, panel 2) (April 2026 *Global Financial Stability Report*). Since the COVID-19 pandemic, Treasury bills have added nearly \$5 trillion to the stock of outstanding federal debt. Although this shift has helped meet near-term financing needs by reducing reliance on longer-term notes and bonds, it has noticeably shortened the average maturity of the US debt portfolio, increasing the frequency of rollover and overall gross financing needs.⁶

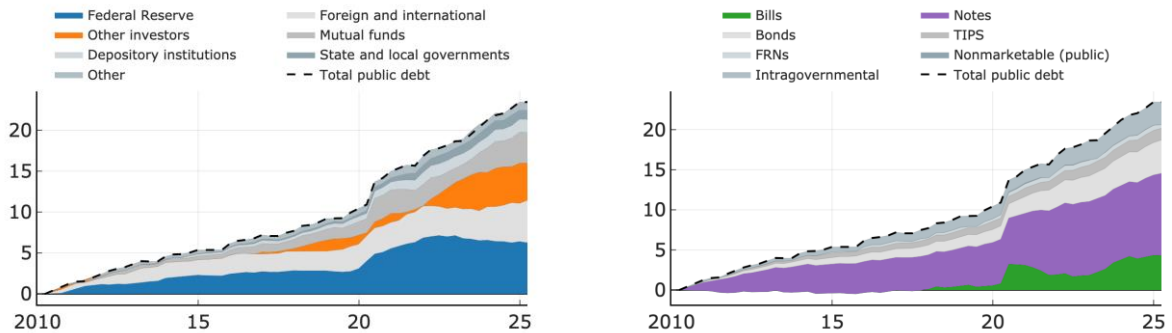
⁶ The Guiding and Establishing National Innovation for US Stablecoins (GENIUS) Act of 2025 requires issuers of stablecoins to back their tokens one for one with high-quality liquid assets, principally short-dated Treasury bills, potentially creating a new source of structural demand for short-term government debt.

Figure 1.13. Shifts in the Market for US Treasuries

(Trillions of dollars)

1. Cumulative Change in Holders of US Public Debt since the First Quarter of 2010

2. Cumulative Change in US Public Debt by Instrument since the First Quarter of 2010



Sources: US Department of the Treasury, Monthly Statement of the Public Debt, and Treasury Bulletin, Table OFS-2.
 Note: In panel 1, “Other investors” includes individuals, government-sponsored enterprises, brokers and dealers, and corporate and noncorporate businesses; “Other” includes savings bonds, insurance companies, and pension funds. In panel 2, “Bills” have maturities of one year or less; “Notes” have maturities of 2–10 years; “Bonds” have maturities longer than 10 years; “Nonmarketable” refers to savings bonds and other nontraded public debt; and “Intragovernmental” covers debt held by federal trust funds and other government accounts. FRNs = floating-rate notes; TIPS = Treasury inflation-protected securities.

China

The fiscal landscape in *China* in 2025 was characterized by marked expansion. The country’s overall deficit widened to 7.9 percent of GDP, and the official headline deficit breached the long-standing “3 percent threshold,” reaching 4 percent.⁷ The expansion, which amounted to slightly less than 1 percent of GDP, reflected the cumulative effect of several modest initiatives to support domestic consumption, amplified by a structural shortfall in nontax and property revenues. These measures included an enhanced program for trading in appliances, an expansion of minimum urban-rural resident pensions and health insurance schemes, and a new nationwide subsidy for children younger than three. Individually, the contribution of each of these measures amounted to less than 0.1 percent of GDP, and taken together, they provided modest overall support to consumption and the country’s social safety net (Box 1.1).

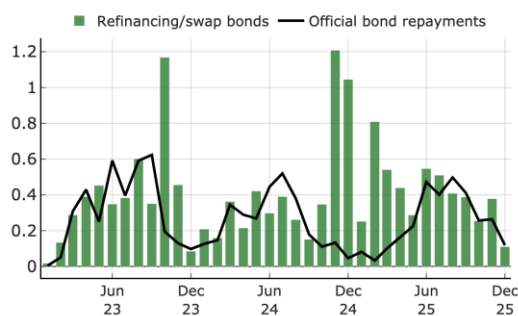
A central pillar of *China’s* 2025 fiscal outturn was the continued rollout of the country’s landmark multiyear debt swap program for local governments, amounting to RMB 10 trillion (about 7 percent of GDP) (Figure 1.14). The program enables local governments to exchange high interest “hidden” debt, much of it accumulated through local government financing vehicles, for official local government bonds at lower interest rates. It has significantly alleviated near-term servicing pressures on local government budgets and, together with increased vertical transfers from the central government, has provided temporary breathing room (April 2026 *Global Financial Stability Report*). Nevertheless, the country’s underlying vertical fiscal imbalance remains substantial, particularly as revenues from land sales continue to weaken, leaving local governments structurally constrained despite the short-term relief provided by the debt swaps.

The medium-term outlook for China points to high fiscal deficits, with spending pressures expected to remain elevated as the population ages and traditional investment-driven growth models lose traction.

⁷ The “3 percent” refers to the long-standing practice of using a 3 percent of GDP figure as an informal guidepost when setting China’s headline official government budget deficit.

General government debt is projected to increase sharply from 99.2 percent of GDP in 2025 to almost 127 percent by 2031, nearly 11 percentage points above the April 2025 *Fiscal Monitor* projections for 2030, even as reforms to the country’s retirement age partly ease long-term pressures exerted by pensions.⁸ A central feature of this trajectory is the persistence of large primary deficits, which are forecast to remain in the range of 6 percent–7 percent of GDP even in the absence of a sizable negative output gap (Figure 1.15). Although interest-growth differentials are projected to remain favorable, they will be insufficient to offset the scale of the primary deficits. As a result, *China’s* fiscal space could narrow over time, limiting the government’s capacity to respond to future shocks and weighing on overall prospects for debt sustainability.

Figure 1.14. China: Redemptions of Local Government Debt and the Effect of Debt Swaps
(Trillions of renminbi)

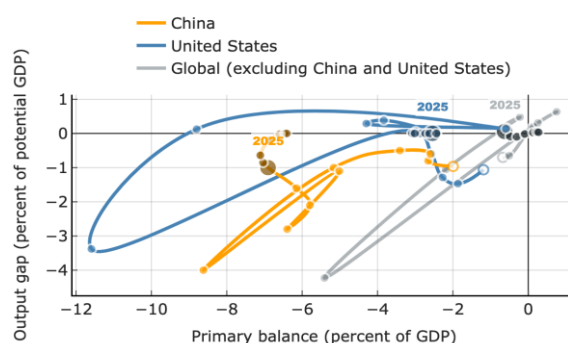


Sources: China Electronic Local Government Bond Market Access; China Ministry of Finance; and EUROPACE AG/Haver Analytics.
Note: The massive increase in issuance of refinancing bonds in late 2024 was designed to cover peaking maturities of local government financing vehicles, effectively moving “hidden” debt into official bonds to reduce interest costs. The more the bars in the figure exceed the graph line, the faster this hidden debt is being moved.

B. Advanced Economies (Excluding the United States): New Drivers of Debt Dynamics

In 2025, the headline deficit for advanced economies excluding the *United States* held broadly steady at 2.4 percent of GDP. The debt-to-GDP ratio for these economies fell only marginally to 95.3 percent, effectively unchanged from its 2019 level prior to the COVID-19 pandemic. The *United Kingdom* recorded a notable improvement, reducing its deficit to 5.4 percent of GDP, with the change driven by tax increases, tax threshold freezes, and the expiration of temporary measures for energy support. *Canada* and *Japan* also posted gains, reflecting spending restraint. These gains were partly offset by the use of some fiscal space by countries with historically strong fiscal positions, such as *Korea* and *The Netherlands*.

Figure 1.15. Evolution of the Fiscal Balance, 2015–31



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: Each circle represents a year. Lines show the trajectory from 2015 (empty circles) to 2025–30 (darkened circles).

⁸ The upward revision in the debt ratio relative to the April 2025 *Fiscal Monitor* largely reflects a methodological change, with fiscal figures for local government financing vehicles now based on different data (IMF 2026). A 2024 reform to *China’s* retirement age may help ease some of the pressures from slowing long-term growth and rising expenditure pressures, increasing GDP growth by 0.2 percentage point annually and reducing pension spending from a projected 15.3 percent to 11.9 percent of GDP by 2050 (Bonhuis, Cao, and Freudenberg 2026).

Aggregate figures suggest relative stability in the medium term but mask uneven underlying dynamics. The group’s overall deficit is projected to narrow only modestly from the current level, as an increase of roughly half a percentage point in interest-to-GDP ratios offsets a gradual move toward a balanced primary position. Gross public debt is projected to stabilize at about 94 percent of GDP. However, fiscal trajectories diverge sharply. Debt ratios in *Spain* and *Japan* are projected to fall by 10 to 14 percentage points by 2031 as a result of favorable interest-growth dynamics. By contrast, both *Belgium* and *Korea* are projected to see significant increases in their debt ratios, although from markedly different levels—by 2031, debt is set to exceed 122 percent of GDP in *Belgium* and reach 63 percent in *Korea*. *Germany* is also projected to shift from its historically conservative stance, with debt rising to nearly 74 percent of GDP to accommodate the country’s investment and defense priorities.

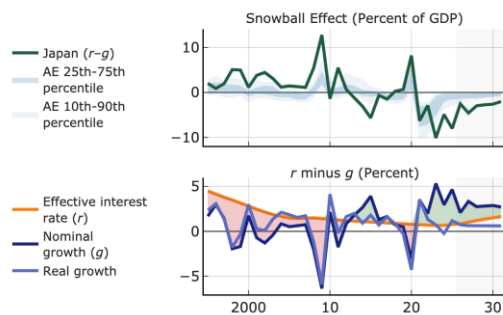
A key driver of the projected decline in *Japan’s* debt in the reference scenario is interest costs remaining below nominal GDP growth (Figure 1.16, panel 1). The recent increase in *Japan’s* inflation rate has lifted the country’s nominal GDP appreciably, whereas the effective interest rate on outstanding government debt has adjusted only gradually owing to the long average maturity of the country’s public debt. Given *Japan’s* large stock of legacy debt, even small favorable differentials between growth and interest rates generate large mechanical changes in the debt ratio.

The outlook could become less favorable, however, because *Japanese* bond yields have risen to decade-high levels, with 10- and 30-year yields reaching 2 percent and 3.4 percent, respectively, in December 2025—and staying above those levels ever since. The decomposition of the yields suggests that risk compensation as well as expectations of a higher path for the policy rate have driven recent increases in borrowing costs (Figure 1.16, panel 2).⁹ The debt-reducing effect will diminish over time as older low-cost debt gradually matures and is refinanced at significantly higher prevailing rates. *Japan’s* open capital account, large government debt market, and sizable net international investment position allow developments in the Japanese government bond market—including rising yields—to spill over to sovereign borrowing costs abroad, especially where Japanese investors are more active (Carrière-Swallow, Kindberg-Hanlon, and Smirnov 2025).

Figure 1.16. Japan: Debt Dynamics and the Long-Term Interest Rate

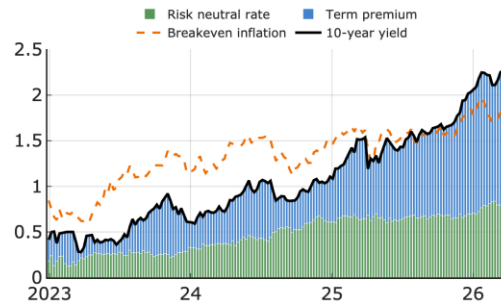
1. Snowball Effect

(Percent of GDP and percent)



2. Decomposition of 10-Year Yield

(Percent)



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

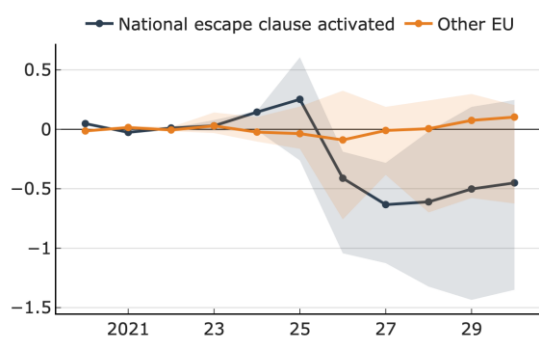
Note: The pink shading in the bottom subpanel of panel 1 highlights periods in which $r > g$ (that is, an unfavorable snowball effect contributes to debt increases), and the green shading highlights periods in which $g > r$ (that is, a favorable snowball effect contributes to debt decreases). The snowball effect refers to the automatic change in the debt-to-GDP ratio arising from the interest rate–growth rate differential applied to the existing debt. The shaded vertical region (2026–31) in both subpanels indicates projections. Panel 2 includes the breakeven inflation rate as a reference to illustrate market expectations for average inflation over the period. Last observation: March 27, 2026. AE = advanced economy.

⁹ A decomposition of yield dynamics suggests that the recent increase in rates represents higher expected policy rates as well as a contribution from term premiums amid global trade tensions, heightened political uncertainty surrounding elections, and market perceptions of increased fiscal policy risk.

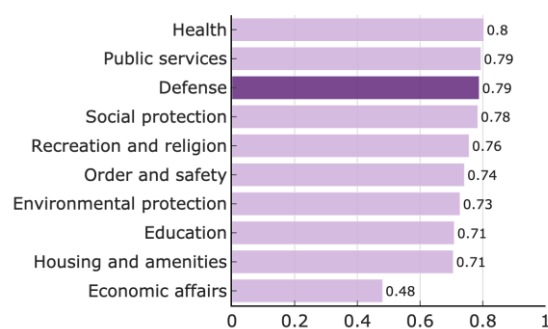
In *Europe*, tension between reformed *European Union* (EU) governance rules and mounting spending pressures, most notably with regard to defense, increasingly shapes fiscal policy. Sixteen EU member states have invoked the national escape clause under the EU's Stability and Growth Pact that allows for temporary deviations from their net expenditure paths to accommodate security-related needs. Fiscal projections reflect this flexibility: Balances for these countries have been revised downward by about 0.5 percentage point of GDP relative to those in the April 2025 *Fiscal Monitor* (Figure 1.17, panel 1).

Figure 1.17. Europe: Fiscal Flexibility and Persistence of Spending

1. Overall Revisions to Balances for European Union Countries Activating National Escape Clauses (Percentage points of GDP)



2. Rigidity of Functional Spending Categories (Autocorrelation coefficients)



Sources: Eurostat Classification of the Functions of Government database; IMF, World Economic Outlook database; and IMF staff calculations.

Note: Revisions in panel 1 are calculated as the difference between projections in the April 2025 and April 2026 *World Economic Outlooks*. Lines show simple averages. Bands represent the interquartile ranges (25th–75th percentiles). “National escape clause activated” includes Belgium, Bulgaria, Croatia, the Czech Republic, Denmark, Estonia, Finland, Germany, Greece, Hungary, Latvia, Lithuania, Poland, Portugal, the Slovak Republic, and Slovenia. Panel 2 measures rigidity using the first-order autoregressive coefficient, estimated over 1995–2023 and averaged across countries. EU = European Union.

The fiscal loosening in *Europe* is unlikely to be transitory, as defense constitutes one of the most rigid components of public expenditure (Figure 1.17, panel 2). In this context, the recent surge in military outlays among European countries signals a structural, rather than a temporary, commitment. Although investments in the military can support activity, particularly in economies characterized by efficiency in public investment and low borrowing costs (Ben Zeev, Pappa, and Scola Gagliardi 2025; Sarasa Flores, Serrador, and Arriza 2025; Furceri and others 2026), they risk exerting upward pressure on debt and prices, and potentially monetary policy, unless offset by credible spending reprioritization or revenue measures. This risk presents the most acute challenge for countries with high levels of debt and limited fiscal space, where sustained debt-financed spending increases vulnerability to adverse shocks and heightens the risk of fiscal distress (Acalin and others 2025). The risk also interacts with sizable longer-term spending pressures from aging through pensions and health care and from investment for adaptation to climate change (Eble and others 2025).

C. Emerging Markets (Excluding China): Beyond Universal Resilience

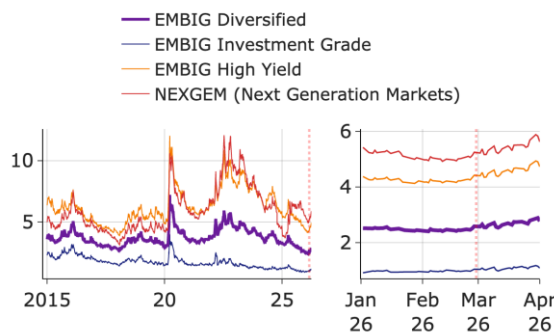
In 2025, the fiscal deficit for emerging markets excluding *China* widened by about half a percentage point of GDP to 4.7 percent of GDP. Both rising interest payments—which reached 3.8 percent of GDP, with a particularly sharp increase in *Brazil*—and a deterioration in the primary balance contributed roughly equally to this widening. *Russia* and *Saudi Arabia* experienced notable fiscal weakening as a result of a marked expansion in primary spending and declining government revenues, respectively. On the other

hand, *India*, *Mexico*, and *Türkiye* recorded improvements supported by restraint in primary spending.¹⁰ The aggregate debt-to-GDP ratio for the group climbed slightly to 57.5 percent, although several major economies continued to carry elevated levels, with ratios exceeding 84 percent in *India* and 93 percent in *Brazil*.

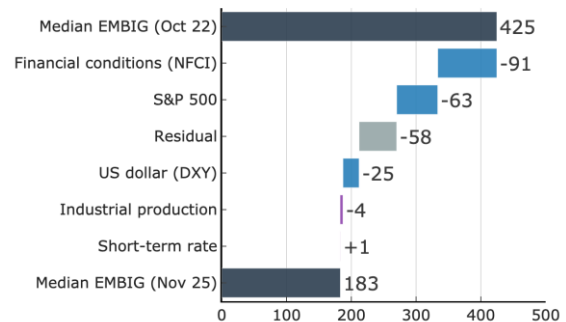
Before the surge in market volatility since February 2026, emerging market economies experienced generally favorable access to capital markets in 2025, albeit with important distinctions across credit tiers. Investment-grade sovereign spreads fell to record lows, while those for frontier markets stayed elevated (Figure 1.18, panel 1). Issuance of sovereign bonds reached an all-time high (Figure 1.19, panel 1), with compression of sovereign spreads in emerging markets reflecting a combination of accommodative global financial conditions, strong performance of equity markets, and a weakening dollar (Figure 1.18, panel 2). Overall, issuance volumes were sufficient to cover upcoming redemptions comfortably for most issuers in emerging markets. Since mid-February 2026, spreads have widened materially, particularly for lower-rated issuers (a 50 basis point increase for B-rated economies, as depicted by composite indices). This broad-based tightening of financial conditions, together with a strengthening US dollar, threatens to undermine the favorable market access conditions observed earlier (*April 2026 Global Financial Stability Report*).

Figure 1.18. Emerging Markets: Sovereign Bond Spreads

1. Global Sovereign Spreads in Emerging Market Bond Index
(Percentage points)



2. Compression in Emerging Market Bond Index Spreads
(Basis points)



Sources: Bloomberg Finance L.P.; EUROPACE AG/Haver Analytics; JPMorgan; and IMF staff calculations.

Note: In panel 1, the red dashed vertical lines denote the onset of the war in the Middle East. Last observation: April 1, 2026. Panel 2 decomposes the median compression in sovereign spreads in emerging markets using a hybrid machine-learning econometric framework. Key predictors are selected through machine-learning methods (lasso and random forest), and their effects are estimated using fixed-effects panel regressions. Country-level contributions are aggregated into global (blue) and domestic (purple) components. DXY = Federal Reserve US Dollar Index; EMBIG = JPMorgan Global Bond Index—Emerging Market; NFCI = Federal Reserve Bank of Chicago National Financial Conditions Index.

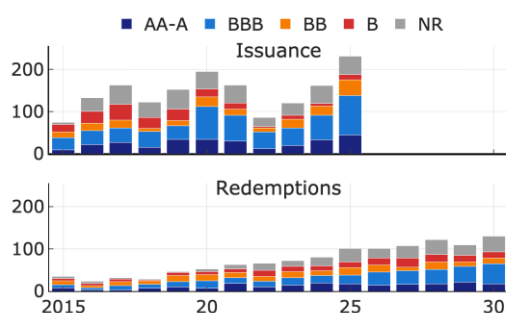
The record volumes of bond issuance in 2025, however, mask a divergence among credit segments. Whereas investment-grade issuers continue to benefit from robust access to markets, lower-rated issuers have not shared these favorable conditions. For economies whose sovereign bonds are rated B, market participation has thinned, with total issuance falling to nearly one-third of its 2017 level (Figure 1.19,

¹⁰ Alongside spending restraint, Türkiye also recorded robust revenue growth in 2025.

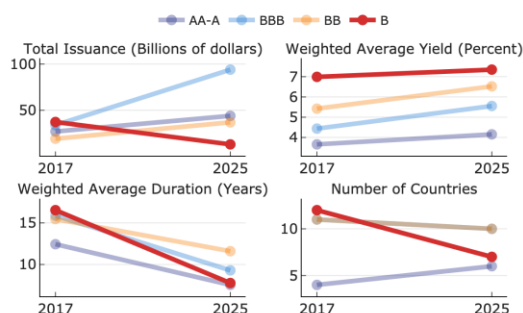
panel 2).¹¹ Borrowing terms have also worsened, with average maturities shortening from 16 years to just 8 years, reflecting lower appetite for risk among investors and higher rollover premiums. This combination of compressed maturities and elevated borrowing costs heightens refinancing pressures, leaving sovereigns with lower-rated bonds exposed. The widening of bond spreads for low-rated frontier economies since the escalation of tensions in the *Middle East* will further exacerbate this divergence.

Figure 1.19. Emerging Markets: Sovereign Bond Dynamics and Changing Market Characteristics

1. Issuance and Redemptions of Sovereign Bonds by Emerging Markets (Billions of dollars)



2. Characteristics of Sovereign Bond Issuance by Emerging Markets (2017 versus 2025)



Sources: Bond Radar; and IMF staff calculations.

Note: Rating categories in panel 1 follow typical market nomenclature: AA–A (high-grade to upper-medium-grade), BBB (investment-grade or lower-medium-grade), BB (high-yield or non-investment-grade), B (highly speculative or frontier), and NR (nonrated). In panel 2, yields and durations are weighted by issuance size. The reference year is 2017, as it represents a historical peak in issuance of sovereign bonds among emerging markets matched only by the 2025 outturn (the COVID-19 pandemic period is excluded).

The medium-term outlook points to a gradual narrowing of the overall deficit in emerging markets to about 3.5 percent of GDP by 2031, with the narrowing driven by a transition toward primary surpluses as governments put increasing priority on spending restraint. Despite the improvement represented by this narrowing, gross debt for the group is forecast to breach 60 percent of GDP in 2028, reflecting positive stock-flow adjustment, including valuation effects and debt-creating financial operations.

This aggregate picture, however, masks widening disparities across economies. Debt ratios are projected to decline or stabilize in *Argentina* and *India*, for example, supported by strong nominal growth dynamics and ongoing fiscal consolidation. By contrast, a number of other major emerging markets—including *Brazil*, *Poland*, *Romania*, *Russia*, and *Saudi Arabia*—are set to carry sizable fiscal deficits well into the medium term. Furthermore, production disruptions and infrastructure destruction in the *Middle East* are expected to impose significant costs on Gulf economies, reflecting substantial forgone revenues from energy and energy-intensive exports, with persistence that is highly uncertain.

D. Low-Income Developing Countries: Navigating the Withdrawal of Global Aid

In 2025, increased mobilization of revenue more than offset rising borrowing costs in low-income developing countries, keeping the headline deficit in the group just below 3 percent of GDP. Tax revenues in these countries increased to 11.3 percent of GDP (from 10.7 percent in 2024), reflecting

¹¹ Using 2017 rather than 2019 as the benchmark provides a more meaningful comparison for emerging market conditions in 2025. Both 2017 and 2025 featured synchronized global growth, a shift away from outperformance among US assets, and generally supportive external conditions for emerging markets. In contrast, the Federal Reserve’s policy reversal after the market correction in late 2018 largely shaped 2019, making it a less comparable reference point.

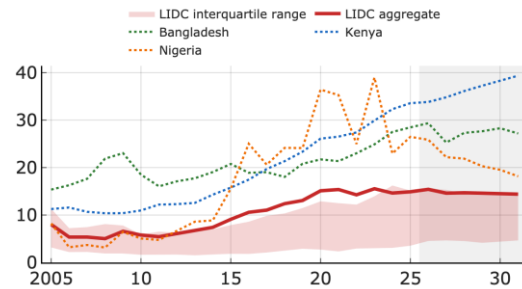
sustained administrative and policy-driven efforts; these gains offset declining receipts of grant money. However, interest payments reached a historic high of 2.3 percent of GDP, or nearly 15 percent of total

revenue, a sharp increase of more than 5 percentage points relative to their 2015 level (Figure 1.20). Despite these pressures, a favorable interest-growth differential that contributed about 4 percentage points to debt reduction, together with narrow primary deficits, lowered the group’s aggregate debt-to-GDP ratio by about 2 percentage points in 2025, to 48.2 percent.¹²

Notable declines in official development assistance (ODA) compounded fiscal challenges in low-income developing countries in 2025, although effects varied widely among individual countries in the group. Survey data across 58 economies indicate that aggregate ODA fell from 1.8 percent of GDP in 2024 to 1.5 percent in 2025 (Figure 1.21, panel 1).¹³ The decline was particularly severe in *sub-Saharan Africa*, where *Burundi*, the *Central African Republic*, *Lesotho*, and *Somalia* reported ODA losses exceeding 4 percent of GDP. By contrast, smaller economies, notably some Pacific island economies (*Kiribati*, *Tonga*, and *Tuvalu*) recorded increases in ODA.

Limited fiscal space, uncertainty around the timing and scope of off-budget ODA cuts, and long-standing structural constraints, including weak capacity to replace or redesign canceled programs, have hamstrung countries’ fiscal responses to these reductions (April 2026 *Regional Economic Outlook: Sub-Saharan Africa*). According to survey results for a subset of countries, nearly half of the decline in ODA is expected to translate directly into a financing shortfall (Figure 1.21, panel 2).

Figure 1.20. Interest Payments in Low-Income Developing Countries
(Percent of total revenue)



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

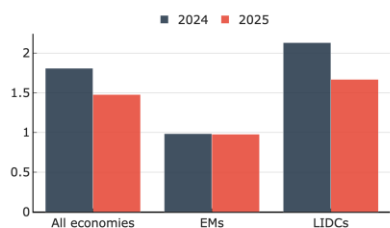
Note: Individual countries depicted in the figure are those that increase the weighted average. The area shaded in gray indicates projections. LIDC = low-income developing country.

¹² Extreme values in Sudan (–137 percent of GDP) and Zimbabwe (–32 percent), both of which experienced very high inflation in 2025, heavily influence the favorable interest-growth differential for the low-income developing country aggregate. When these two countries are excluded, the aggregate differential falls to about 3 percent of GDP, which is more representative of a typical country in this income group.

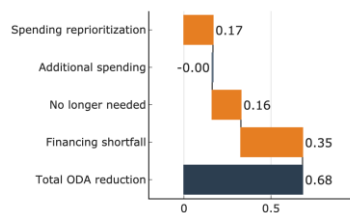
¹³ Data are drawn from an in-depth country survey conducted by IMF country desks for economies receiving official development assistance (ODA). The survey covered 58 economies—19 emerging market and middle-income economies and 39 low-income developing countries. Of these, 44 provided responses on ODA flows (Figure 1.21, panel 1), and 14 offered detailed explanations on the implications of ODA cuts (Figure 1.21, panel 2).

Figure 1.21. Recent Cuts in Official Development Assistance and the Fiscal Response (Percent of GDP)

1. Total Flows of Official Development Assistance, 2024–25



2. Fiscal Response to Cuts in Development Assistance, 2024–25

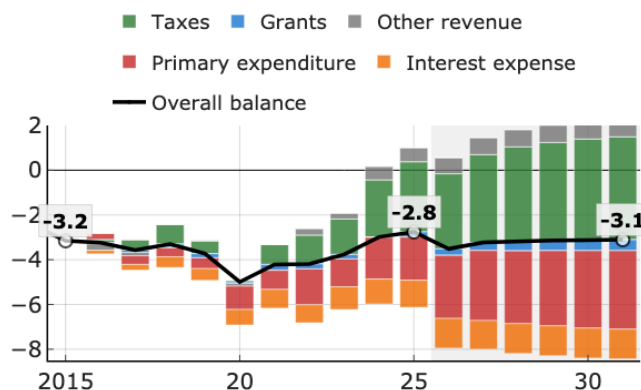


Sources: IMF country desks, ODA survey; and IMF staff calculations.

Note: Panel 1 plots estimated flows of official development assistance (ODA) for 44 emerging markets (EMs) and low-income developing countries (LIDCs). For 14 EMs and LIDCs that provided this information, panel 2 decomposes their response to the reduction in ODA flows into “Spending reprioritization” (countries redirecting government spending), “Additional spending” (countries increasing spending in their budgets), “No longer needed” (reflecting a change in the needs of countries’ populations), and “Financing shortfall” (the amount of the reduction that countries cannot finance).

The medium-term outlook suggests that deficits in low-income developing countries will remain near 3 percent of GDP. With aggregate aid flows for the group expected to decline in the coming years, gaps in external financing are becoming increasingly structural. The patterns in 2025, when robust tax gains offset rising interest costs, growing primary spending needs, and declining grant amounts, are expected to persist (Figure 1.22). Although the favorable interest-growth snowball effect is projected to moderate toward the end of the decade, it is expected to remain sufficiently positive to support a gradual reduction in the aggregate public-debt ratio among low-income developing countries to 44 percent of GDP by 2031.

Figure 1.22. Evolution of Revenue and Spending Sides of Budgets in Low-Income Developing Countries (Percent of GDP)



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

Note: The bars show changes compared with 2015. Expenditure components enter the contributions with a negative sign. The shaded area indicates projections.

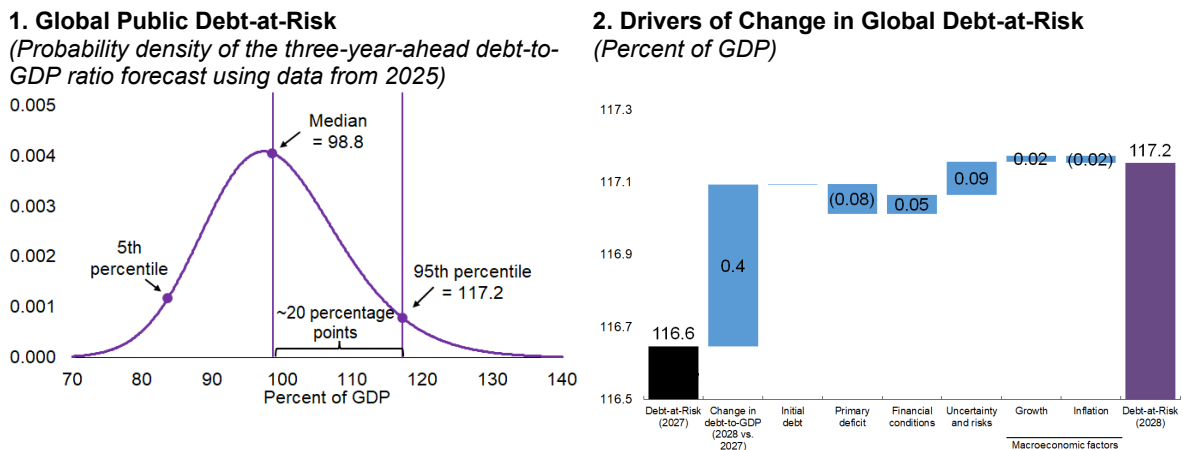
The global environment is likely to keep some low-income developing countries under considerable pressure. Tightening immigration policies point to declining remittances, equity inflows from foreign direct investment remain below levels prior to COVID-19, and external debt flows have recently weakened. At the same time, large shocks related to weather—floods, cyclones, droughts—have become more frequent, with fiscal costs in some cases exceeding 3 percent of GDP. As external financing has tightened, many low-income developing countries—particularly fragile and conflict-affected states—have shifted toward domestic debt markets. Although this reduces foreign exchange risk, it raises borrowing costs and can deepen sovereign-bank linkages and crowd out private credit. The war in the *Middle East* compounds these pressures through multiple reinforcing channels, including higher food, energy, and

fertilizer import costs and tighter financing conditions, that risk simultaneously widening fiscal deficits, raising inflation, and deepening debt vulnerabilities in countries with the least capacity to respond.

Risks to the Fiscal Outlook

Since the *April 2025 Fiscal Monitor*, fiscal risks have evolved in nature and complexity, while remaining heavily tilted to the downside. Projected global debt-at-risk three years ahead—the 95th percentile of the projected debt distribution—now stands at 117.2 percent of GDP for 2028, up from 116.6 percent reported in the *April 2025 Fiscal Monitor* (Figure 1.23, panel 1). The 0.6 percentage point increase is driven almost entirely by higher debt levels for 2028 compared with 2027 projected in the *April 2026 World Economic Outlook* (Figure 1.23, panel 2). Meanwhile, upside debt risks—the gap between the 95th percentile and the baseline *World Economic Outlook* projection (98.8 percent of GDP)—have stabilized but remain elevated at about 20 percentage points of GDP, as the impact of tighter financial conditions and higher uncertainty in 2025 was partially offset by an improved global primary balance.

Figure 1.23. Global Public Debt-at-Risk, 2028, and Drivers of Changes, 2027–28



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

Note: Panel 1 displays the probability density function for the three-year-ahead forecast for the debt-to-GDP ratio using data from 2025, which is estimated using panel quantile regressions of that ratio on various political, economic, and financial variables. The global sample is composed of 49 countries accounting for more than 90 percent of global debt. Filled circles indicate the predicted 5th, 50th (median), and 95th percentiles of the debt-to-GDP ratio (Furceri and others 2025). Panel 2 decomposes the change in debt-at-risk from the estimate in the *April 2025 Fiscal Monitor* (black bar) to the current estimate based on the *April 2026 World Economic Outlook* (purple bar). The blue bars show the contributions to higher levels of debt-at-risk from both the increase in debt projected for 2028 versus 2027 and the conditioning variables used to estimate the debt-at-risk model.

A major new source of fiscal risk is the outbreak of armed conflict in the Middle East, which has disrupted approximately 20 percent of global oil supplies transiting the Strait of Hormuz, destroyed critical infrastructure, and triggered a sharp increase in energy prices. Further intensification of the conflict and broader geopolitical tensions would pose additional downside fiscal risks that are highly asymmetric across country groups, depending on their energy trade (and food) balance, reliance on fuel subsidies, and exposure to external financing conditions.

In addition, three layers of downside risk warrant attention. First, the dramatic change in economic policy—through trade barriers, industrial subsidies, and resource reallocation driven by national security considerations—imposes fiscal costs with uncertain returns in productivity. It also constrains policy flexibility by, among other effects, intensifying pressures on central banks to accommodate fiscal needs. Second, structural shifts in markets for sovereign debt, particularly the growing role of leveraged

nonbank financial intermediaries and the erosion of the US Treasury's traditional convenience yield, increase vulnerability to sudden repricing even as headline volatility falls. Third, slow-moving structural pressures continue to accumulate: aging-related costs where reforms lag; contingent liabilities from state-owned enterprises (SOEs) that are politically difficult to restructure; and, for low-income developing countries, declining development assistance as donors adjust their priorities away from such assistance.

On the upside, if productivity gains related to artificial intelligence (AI) materialize sooner than expected, stronger potential growth could improve debt dynamics if real interest rates do not react much. The 5th percentile of the debt-at-risk distribution—85 percent of GDP, roughly 14 percentage points below the median—indicates meaningful scope for positive surprises.

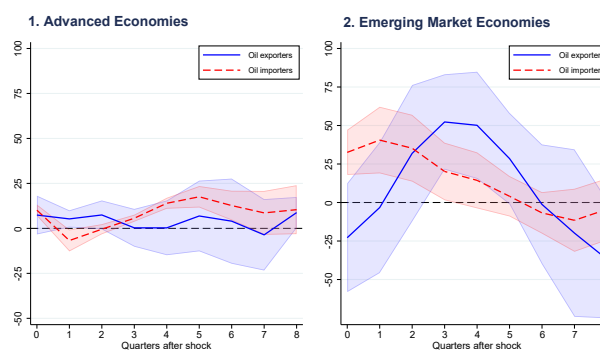
Prolonged War in the Middle East

A protracted war in the Middle East would strain government finances through multiple reinforcing channels. Expenditure pressures would rise sharply. Governments with fuel subsidy regimes would face higher subsidy costs, as governments intervene through subsidies, tax adjustments, administered pricing, and the absorption of losses by SOEs to shield consumers. These measures shift the cost of global price shocks directly onto public finances (Nguyen and Thévenot, forthcoming). Fiscal exposure is particularly acute in the *Middle East* and *North Africa* and in *sub-Saharan Africa*, where pass-through is lowest and subsidy bills reached 2 percent–4 percent of GDP in some countries during the 2022 commodity price surge. Additional pressures could arise from higher fertilizer prices, which would further raise food-related public spending in some emerging market and low-income developing countries.

On the revenue side, weaker activity—estimated to reduce global GDP level by 2.3 percent in 2027 in a severe scenario (April 2026 *World Economic Outlook*)—would erode tax bases in oil-importing economies. For Gulf Cooperation Council exporters, the net fiscal impact would likely be negative, as higher prices may not be sufficient to offset production shut-ins and constrained export capacity. Net energy exporters outside the conflict zone, such as *Canada*, *Norway*, and *Russia*, would likely experience fiscal windfalls.

The stagflationary combination of higher inflation and weaker growth would further complicate debt dynamics. While inflation mechanically lowers debt-to-GDP ratios, supply-driven inflation tends to limit tax revenue gains by compressing real household incomes and corporate profits. At the same time, tighter monetary policy raises sovereign borrowing costs, particularly in economies with significant short-term or floating-rate debt. For oil-importing countries, higher interest rates and slower growth are likely to outweigh the debt-reducing effects of inflation.

Figure 1.24. Impact of Oil Price Shock on Sovereign Spreads
(Basis points)



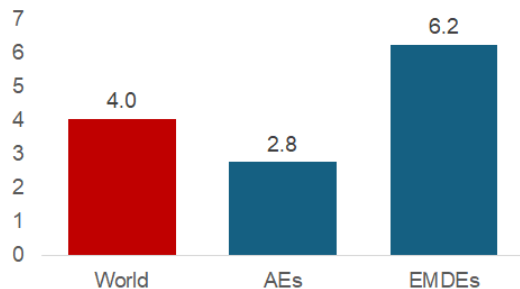
Source: IMF staff calculations.

Note: The figure uses local projections with ordinary least squares regressions, with Känzig (2021) oil news shock as instrument, to estimate the impact of oil supply shock on sovereign spreads over time. The impulse response functions are normalized to a one-standard-deviation oil news shock, which corresponds to a rise in actual West Texas Intermediate oil prices of about 10 percent. The sovereign spreads shown are measured as the difference between 10-year interest rates and US Treasury bonds of the same maturity.

Spikes in oil prices could also translate into divergent sovereign financing conditions, reinforcing the asymmetric fiscal impact of energy shocks. IMF staff analysis finds a one-standard-deviation oil supply shock raises sovereign spreads for oil-importing emerging markets by roughly 40–50 basis points over several quarters, while spreads for oil-exporting emerging markets do not show a statistically significant change (Figure 1.24). The spread response is relatively muted for net oil-importing advanced economies but could be larger in the current context of elevated public debt levels and thwarted market expectations of policy rate cuts.

Incorporating the severe scenario for the Middle East conflict from the April 2026 World Economic Outlook into the debt-at-risk framework illustrates the potential fiscal consequences. A prolonged conflict that reduces global GDP levels by 2.3 percent and raises inflation by 2.6 percentage points by 2027 would increase the 95th percentile of the global debt distribution by 4.0 percentage points of GDP relative to the reference forecast (Figure 1.25). The impact would fall disproportionately on emerging market and developing economies, where debt-at-risk rises by 6.2 percentage points, compared with 2.8 percentage points for advanced economies.

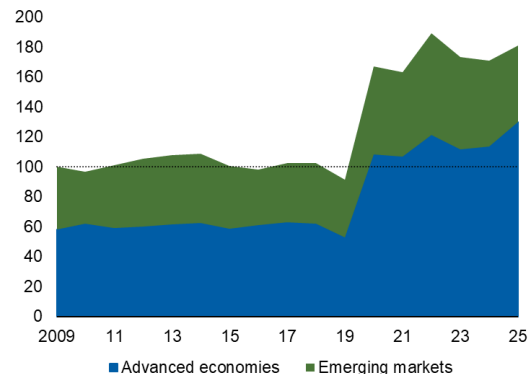
Figure 1.25. Change in Three-Year-Ahead Debt-at-Risk Based on WEO Severe Scenario Impact of Middle East Conflict
(Percentage points of GDP)



Source: IMF staff calculations.

Note: The figure shows the change in three-year-ahead upside debt risks from a prolonged conflict in the Middle East under the severe scenario of the April 2026 World Economic Outlook. Upside debt risks are defined as the difference between the 95th percentile of predicted debt-to-GDP and the April 2026 World Economic Outlook median reference forecast for 2028. Under the severe scenario, the level of global GDP would be lower by 2.3 percent and global inflation higher by 2.6 percentage points by 2027. AEs = advanced economies; EMDEs = emerging market and developing economies. For more information, see the April 2026 World Economic Outlook.

Figure 1.26. Rising Protectionism
(Number of new policy interventions characterized as harmful)



Sources: Global Trade Alert; and IMF staff calculations.

Note: The Global Trade Alert defines a measure as “harmful” if it almost certainly discriminates against foreign commercial interests, thereby worsening their treatment relative to that of domestic rivals. The counts in the figure include traditional instruments such as import tariffs and quotas, as well as behind-the-border measures such as state aid, export incentives, and local-content requirements. The values represent the number of distinct interventions. Numbers are normalized to the total count of measures in 2009.

Goeconomic Fragmentation and Political Instability

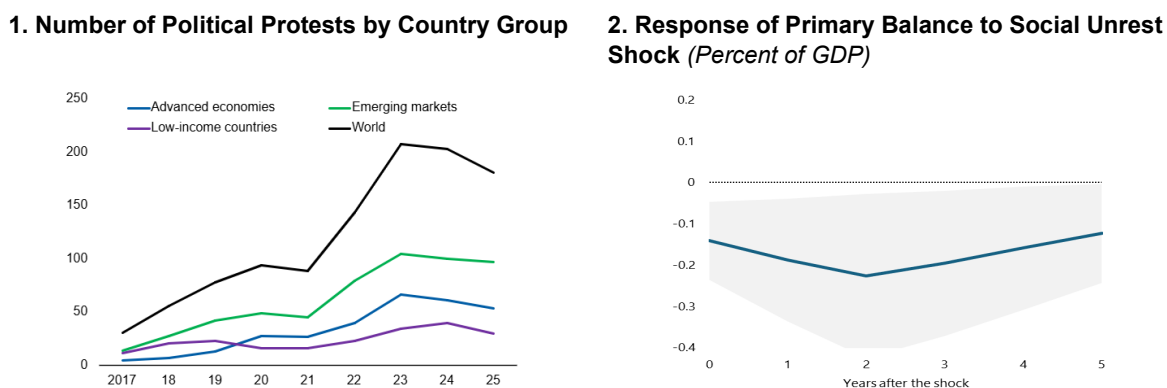
Trade policy uncertainty remains at historically high levels, with the number of protectionist measures 50 percent higher than before the COVID-19 pandemic (Figure 1.26). Intensified trade tensions resulting from tariffs, retaliation, and nontariff barriers continue to pose downside fiscal risks. Tariffs and related

policy shifts reduce investment and growth through multiple channels by raising input costs, reducing productivity through misallocation, weakening competitive pressures, and disrupting supply chains, with effects that materialize gradually as trade relationships adjust. Historical evidence links tariff hikes to higher levels of unemployment (Barnichon and Singh 2025), and US tariff increases in 2018–19 are estimated to have reduced the level of real GDP by approximately 2 percent over two years (Boer and Rieth 2024), exacerbating debt ratios. Industrial subsidies to counter trade barriers are fiscally costly and, if poorly targeted, risk widening deficits and diverting resources from more productive uses (Garcia-Macia and Sollaci 2024; October 2025 *World Economic Outlook*). De-escalating trade tensions and better targeting industrial policy could improve outcomes.

Geopolitical tensions amplify fiscal pressures arising from protectionist measures. Armed conflicts can impose large and sudden fiscal costs, as illustrated by the ongoing conflict in the Middle East (April 2026 *World Economic Outlook*). More broadly, countries’ fiscal priorities are shifting toward security, with strategic considerations driving defense and industrial policies, diverting resources from spending that has clearer returns in terms of productivity. IMF staff analysis indicates that a one-standard-deviation shock to the Geopolitical Fragmentation Index is associated with an increase in public debt ratios of about 1.5 percentage points of GDP in the medium term (Furceri, Poplawski-Ribeiro, and Prifti, forthcoming). Emerging markets are hit harder than advanced economies by year 5—about 5 percentage points of GDP more—because of larger output losses and widening sovereign spreads. Geopolitical frictions can also affect foreign demand for sovereign debt, compounding the vulnerabilities related to market structure discussed later in the chapter.

Domestic political instability also weighs on fiscal outcomes. Anti-government protests have increased across countries in all income groups in recent years (Figure 1.27, panel 1), peaking in 2023. New analysis suggests that a one-standard-deviation increase in social unrest in a country is associated with lower real GDP growth for the average economy by about 0.5 percentage point and with a higher primary deficit by 0.2 percentage point (Figure 1.27, panel 2; Online Annex 1.4).

Figure 1.27. Increasing Political Instability and Its Fiscal Impact



Sources: Carnegie Endowment for International Peace, Global Protest Tracker; and IMF staff calculations. Note: Panel 1 reports, for each year depicted, the number of new and ongoing political protests. Protests are assessed as political (and thus counted in the total) according to their motivation rather than by individual events held. Panel 2 shows impulse response functions from a panel vector autoregression estimating the dynamic effects of a one-standard-deviation increase in the Reported Social Unrest Index on primary fiscal balances (percent of GDP). The sample covers 28 countries from 1990 to 2024. The model employed for the regression attenuates the endogenous relationship between growth and both fiscal balances and social unrest using country fixed effects. The shaded area in panel 2 represents 90 percent confidence bands. See Online Annex 1.4 for details.

Erosion of Central Bank Independence

A specific manifestation of domestic instability is government interference in independent economic institutions, often driven not by exogenous political shifts but by the fiscal pressures of high debt itself, as rising debt-service costs sharpen incentives for monetary accommodation. Eroding independence of central banks, whether actual or perceived, can increase inflation expectations and widen risk premiums even for highly rated sovereigns, even if political pressure for monetary accommodation may lower short-term rates (*October 2025 World Economic Outlook*). Prolonged conflicts in the Middle East would sharpen this tension, as supply-driven inflation calls for tighter monetary policy, while deteriorating fiscal positions intensify political pressure for accommodation. More broadly, uncertainty around the stability of policy frameworks—fiscal rules, independent agencies, and statistical standards—undermines the credibility that allows governments to borrow at favorable rates. This is a distinctly political source of increasing fiscal risk.

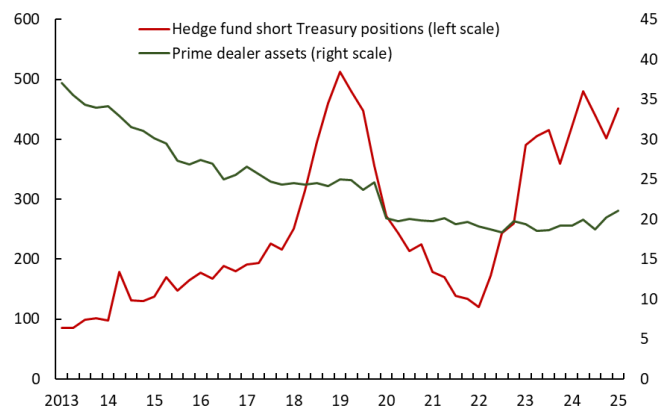
Shifting Structure of Sovereign Debt Markets

The ongoing shift in the ownership of sovereign bonds toward nonbank financial intermediaries has introduced new fragilities in the market structure. In the *United States*, whereas debt volumes have surged, the balance sheet capacity of primary dealers—which are traditional shock absorbers—has declined relative to issuance (*Figure 1.28*). In the place of primary dealers, hedge funds have become critical intermediaries, absorbing supply through cash-futures basis trades (*April 2026 Global Financial Stability Report, Box 1.3*).

The liquidity that hedge funds supply through such trades can be prone to flight, as it is backed by more-leveraged investors: A spike in volatility or financing costs can trigger forced unwinding, amplifying price dislocations (*Barth and Kahn 2025*). Similar patterns have emerged elsewhere. In *Canada*, hedge fund participation in government bond auctions has surged since 2020, filling the gap left by capacity-constrained dealers, with repo-financed trading strategies creating comparable fragilities (*Sandhu and Vala 2023; Epp and Gao 2025*).

At the same time, the scale of bond issuance is eroding the structural convenience yield of US Treasuries, that is, their safety and liquidity premium (*Du, Keerati, and Schreger 2025; Jiang, Richmond, and Zhang 2025*). The spread between yields for AAA-rated corporate and Treasury bonds has compressed, and the international convenience yield versus Group of 10 (G10) peers has also remained negative recently. In

Figure 1.28. Shifting Structure of the Market for US Treasuries
(Percent of marketable Treasuries outstanding)



Sources: Federal Reserve Bank of New York, Primary Dealer Statistics; US Office of Financial Research, Hedge Fund Monitor; and IMF staff calculations.

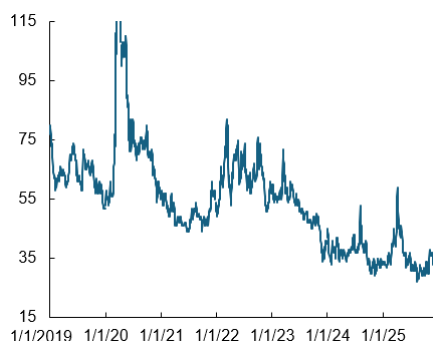
Note: The figure illustrates a structural change in US Treasury market intermediation. The green line signals the declining capacity of regulated dealers to absorb growing government debt issuance relative to the market's size. Hedge fund short Treasury positions proxy leveraged cash-futures basis trade.

other words, Treasuries now offer a higher yield than the synthetic-dollar equivalents for hedged G10 sovereign bonds (Figure 1.29).¹⁴ As the safety premium of US Treasuries decreases, the global risk-free benchmark effectively increases, raising financing costs worldwide.

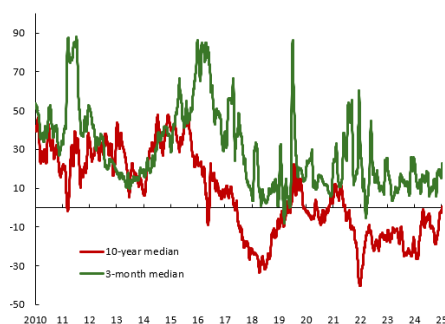
Figure 1.29. Declining Convenience Yield of US Treasuries

(Basis points)

1. Domestic Convenience Yield versus AAA Corporate Bonds



2. International Convenience Yield versus G10 Sovereign Bonds



Sources: Bloomberg Finance L.P.; Federal Reserve Bank of St. Louis, Federal Reserve Economic Data; LSEG Datastream; and IMF staff calculations.

Note: Panel 1 displays the option-adjusted spread between yields of AAA-rated US corporate bonds and US Treasury yields; a narrowing spread implies that the premium investors pay for the safety and liquidity of Treasuries (relative to high-grade corporate debt) is compressing. Panel 2 defines the international convenience yield as the difference in the deviation from covered interest parity between Group of 10 (G10) sovereign bonds and US Treasuries. The daily spread is calculated as $(y_{\text{For}} - \rho) - y_{\text{UST}}$, where y_{For} is the yield for foreign government bonds, y_{UST} is the yield for US Treasuries, and ρ is the market-implied forward premium (the cost of hedging foreign currency back to US dollars through swaps). The 10-year series includes the British pound, Canadian dollar, euro, Japanese yen, New Zealand dollar, Norwegian krone, Swiss franc, and Swedish krona; the three-month series includes the British pound, Canadian dollar, Danish krone, euro, Japanese yen, New Zealand dollar, Swiss franc, and Swedish krona.

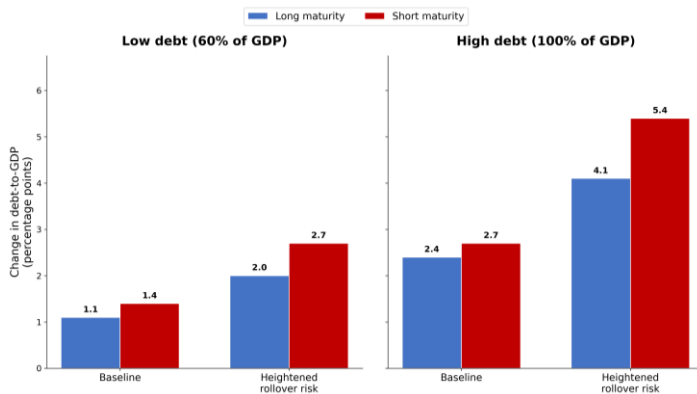
The recent shift in some economies toward short-term issuance, although it helps with the interest bill because the yield curve has a positive slope, brings additional vulnerabilities. When debt is concentrated at shorter maturities, governments must refinance more frequently, increasing their exposure to abrupt shifts in market conditions or investor sentiment. The fiscal risks from short-term debt stem primarily from the speed at which rising interest rates pass through to debt-servicing costs. Because a larger share of a government's obligations must be rolled over at prevailing higher market rates, the debt burden increases more rapidly than it would under a longer-maturity profile. The resulting rise in interest outlays can in turn constrain a country's fiscal space, potentially forcing procyclical spending cuts or tax increases that amplify the contractionary effect of rising interest rates on real activity and further worsen debt dynamics.

Elevated debt levels exacerbate these vulnerabilities and can make them self-reinforcing. If investors grow concerned about a country's rollover capacity, they may demand higher yields or step back from auctions of sovereign bonds altogether, validating the initial concern (Bocola and Dovis 2019; Cole and Kehoe 2000). The resulting political pressure to address rising costs of servicing debt may itself become a

¹⁴ Estimates of the US Treasury convenience yield are sensitive to methodological choices, including the measure of hedging costs, the basket of reference currencies and bonds, and the maturity of instruments considered. Some recent studies point to a more pronounced erosion than that depicted in Figure 1.28. For instance, Du, Keerati, and Schreger (2025) find that the convenience yield on three-month Treasuries turned negative starting in 2024, and they document a persistent downward trend in the 10-year convenience yield over the past decade. Jiang, Richmond, and Zhang (2025) reach broadly similar conclusions using swap spreads as an alternative measure of convenience yields.

source of uncertainty that markets price in (Blommestein and Turner 2012). Model simulations suggest that a debt portfolio tilted toward shorter maturities amplifies debt accumulation when financial conditions tighten, with the effect particularly pronounced at high debt levels and when rollover risk elevates short-term premiums (Figure 1.30; Online Annex 1.3).

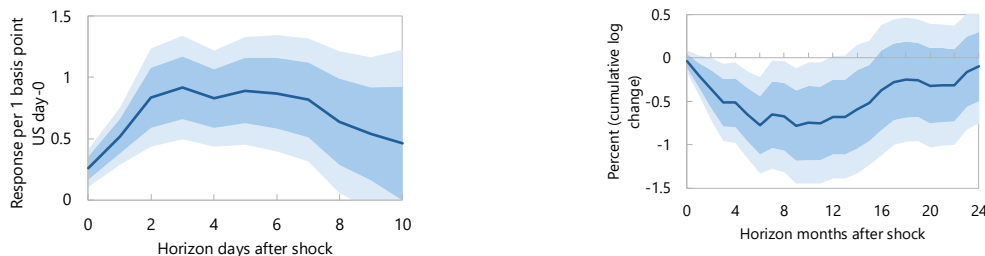
Figure 1.30. Simulated Change in the Debt-to-GDP Ratio One Year After an Increase in the Cost of Short-Term Borrowing
(Percentage points)



Source: IMF staff calculations.

Note: The figure displays a simulation from a New Keynesian model, featuring bonds-in-utility specifications of Alpanda and Kabaca (2020) and Mian, Straub, and Sufi (2025). The bond portfolio used in the simulation includes short-term bonds (one-year-maturity) and long-term bonds (five-year-maturity, on average). The shock in the simulation increases the short-term rate by 2 percentage points. A country’s debt portfolio is defined as short (long) maturity if 80 percent of the bonds in the portfolio are short-term (long-term) bonds. See Online Annex 1.3 for details.

Figure 1.31. International Spillovers from Shocks to the Supply of US Treasuries
1. Response of 10-Year Yield to Shock Arising from Treasury Auction
2. Response of Industrial Production to Shock Arising from Treasury Auction



Sources: Smirnov 2026; and IMF staff calculations.

Note: Panel 1 illustrates the impulse response function for bond market spillovers, showing how much foreign 10-year yields change for every movement of 1 basis point in US 10-year yields over a 10-day horizon as a result of the Treasury supply shock. Panel 2 shows the impulse response of foreign industrial production (in cumulative log change) over a 24-month horizon to a shock that raises the US 10-year yield by 1 basis point on the day of the shock. Shocks are identified using high-frequency futures price movements around US Treasury auction windows (Phillot 2025) and are then refined to isolate the debt-supply news component of the announcement. Shocks cover the period from October 21, 1998, to January 23, 2020, and spillovers are computed using a sample of 66 economies. Shaded areas represent 68 percent and 90 percent confidence intervals. See Online Annex 1.2 for details.

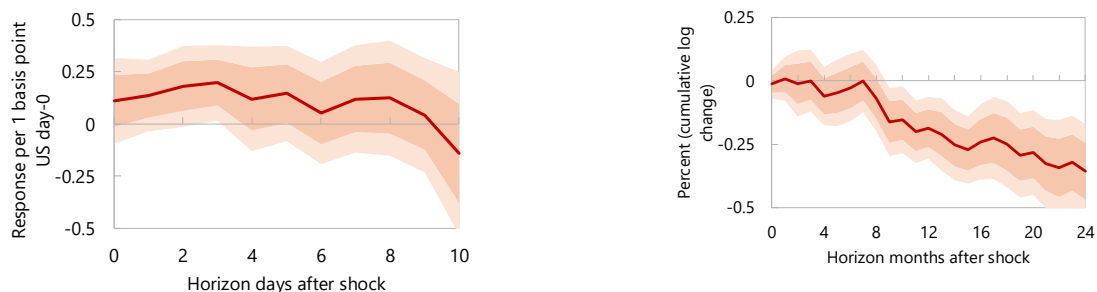
These shifts—changing intermediation, diminished convenience yield, and increased rollover exposure—amplify the global spillover of US Treasury stress. IMF staff analysis shows that a 1 basis point increase in US yields after an expansionary Treasury debt supply shock—that is, when new issuance of Treasuries exceeds what investors anticipated—raises foreign 10-year yields by 0.8–0.9 basis point and depresses foreign industrial production by about 0.4 percent after one year. This reflects both financial spillovers and trade effects operating through weaker US demand (Figure 1.31, panels 1 and 2; Online Annex 1.2).

Moreover, there is evidence that extreme sovereign bond reactions on auction days have become more pronounced than in the past (*April 2026 Global Financial Stability Report*). The composition of the creditor base is a critical amplifier: Countries at the 75th percentile of foreign-investor exposure experience a 10-year yield response about 0.15 basis point stronger than those at the 25th percentile, and industrial production falls about 0.2 percent more after one year (Figure 1.32; Online Annex 1.2).

Figure 1.32. International Spillovers from Shocks to the Supply of US Treasuries by External Financing Exposure

1. Response Differential of 10-Year Yield to Shock Arising from Treasury Auction (Between 75th and 25th percentiles of foreign holdings)

2. Response Differential of Industrial Production to Shock Arising from Treasury Auction (Between 75th and 25th percentiles of foreign holdings)



Source: IMF staff calculations.

Note: The panels present differences in response based on the share of sovereign debt held by nonresidents. Figures represent the estimated differential response between countries at the 75th percentile of foreign holdings (71 percent) and those at the 25th percentile (33 percent), based on a local-projection specification that interacts the shock with the nonresident-holding share. The light- and dark-shaded areas represent 68 percent and 90 percent confidence intervals, respectively. See Online Annex 1.2 for details.

Growth and Financial Market Risks Related to Artificial Intelligence

If productivity gains from AI were to materialize faster or more broadly than embedded in baseline projections, the resulting boost to potential growth would improve debt dynamics.¹⁵ At the same time, debt-financed investment and optimism about AI-driven productivity, combined with high equity concentrations, raise the risk of a disorderly correction in financial markets. Fiscal spillovers would transmit through real channels, affecting technology-exposed exporters (for example, *Korea* and *Taiwan Province of China*) and financial channels, as tighter conditions increase sovereign borrowing costs. The *April 2026 World Economic Outlook* models a reversal in expectations regarding the productivity of AI, which triggers a sharp drop in investment in technology and a repricing of risk assets. In a scenario where US equities fall by 20 percent (about half the size of the correction following the dot-com bubble in the early 2000s), with spillovers tightening global financial conditions, upside global debt risks rise by 2.4 percentage points of GDP (Figure 1.33).

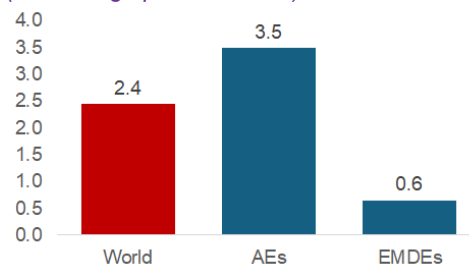
¹⁵ Current estimates of the medium-term economic impact span a wide range, from cumulative total factor productivity (TFP) gains of less than 1 percent over a decade to annual TFP growth increases of more than 1 percentage point, with some optimistic scenarios suggesting that global growth could be lifted by as much as 0.8 percentage point per year over the medium term (Aghion and Bunel 2024; Acemoglu 2025; Cerutti and others 2025).

IMF staff analysis also finds that sovereign spreads in emerging markets are highly sensitive to global conditions. Declines in the S&P 500 and tightening US financial conditions (as measured by the Federal Reserve Bank of Chicago’s National Financial Conditions Index) are associated with a significant widening of spreads. The response is asymmetric, with tightening effects roughly four times stronger than comparable easing (Online Annex 1.1).

Structural Vulnerabilities and Demographic Pressures

Slow-moving structural vulnerabilities remain a persistent source of fiscal risk. New analysis identifies the most prevalent fiscal risks identified by IMF staff reports across emerging market and developing economies (Figure 1.34, panel 1). The analysis shows that contingent liabilities from SOEs are the most frequently cited risk (68 percent), followed by natural disasters (52 percent) and vulnerabilities in the banking sector (47 percent). Commodity price volatility is identified in 37 percent of countries, while political instability (30 percent), public-private partnership liabilities (28 percent), and debt rollover risks (27 percent) are also prominent.

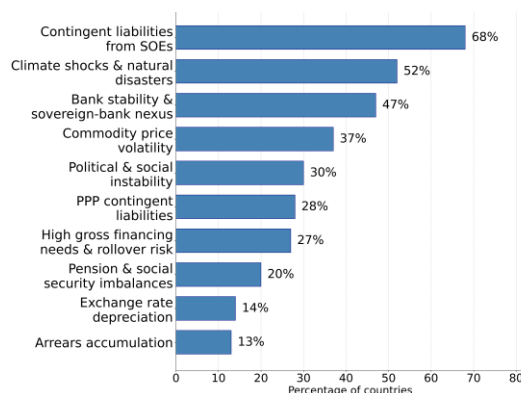
Figure 1.33. Debt-at-Risk with Shock to Growth from Artificial Intelligence
(Percentage points of GDP)



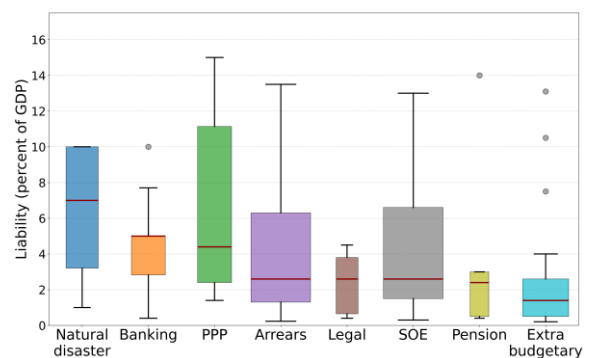
Source: IMF staff calculations.
Note: The figure shows the change in three-year-ahead upside debt risks in a scenario with an adverse shock to investment in artificial intelligence. Upside debt risks are defined as the difference between the 95th percentile of predicted debt-to-GDP and the baseline April 2026 *World Economic Outlook* median projection for 2028. The shock depicted in the figure is assumed to increase the Index of Financial Stress (Ahir and others 2023) by one standard deviation in all economies. For more information, see the April 2026 *World Economic Outlook*. AEs = advanced economies; EMDEs = emerging market and developing economies.

Figure 1.34. Fiscal Risks Identified in IMF Staff Reports on Emerging Market and Developing Economies

1. Top Fiscal Risks Identified (Percent of countries)



2. Potential Impact of Fiscal Risks on Debt (Percent of GDP)

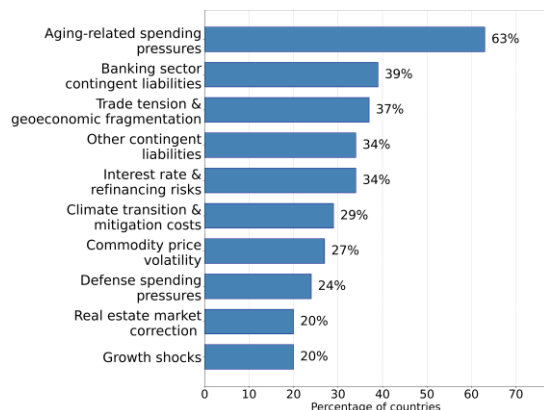


Source: IMF staff estimates based on data from 176 IMF staff reports on emerging market and developing economies published in 2025 using the *Fiscal Monitor AI Analyst*, a custom large-language-model pipeline.
Note: In panel 2, categories are sorted by median value, box widths are proportional to the number of available estimates, and outliers exceeding 17.5 percent of GDP are excluded for readability. PPP = purchasing power parity; SOE = state-owned enterprise.

Figure 1.34, panel 2 underscores the distinct nature of potential shocks. Natural disasters are probabilistic and their effects difficult to quantify, but their median estimated effects on debt are large (about 7 percent of GDP). Liabilities of SOEs also have sizable effects (a median of nearly 3 percent of GDP) and are highly right-skewed, implying much larger effects for a meaningful subset of countries.

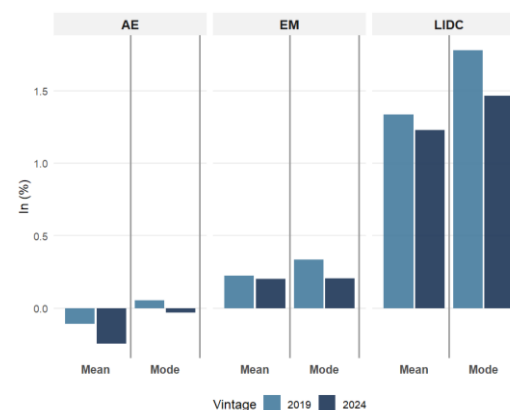
In advanced economies, demographic pressures are a dominant structural risk: 63 percent of IMF country reports for these economies cite risks associated with aging-related spending (Figure 1.35). By 2050, the old-age dependency ratio in member countries of the Organisation for Economic Co-operation and Development (OECD) is projected to increase to 52 per 100 workers (up from 33 in 2025), pushing pension and health spending upward by about 3 percent of GDP in 25 years (Koutsogeorgopoulou and Morgavi 2025; OECD 2025). Crucially, these pressures may be intensifying faster than expected. Comparing population data from the 2019 and 2024 editions of the United Nations’ World Population Prospects reveals a leftward shift in expected growth, particularly for advanced economies (Figure 1.36), implying higher dependency ratios and a shrinking revenue base. Although healthy aging may offer spending offsets, longer lifespans can also increase lifetime costs, particularly when end-of-life care remains expensive (Howdon and Rice 2018; Breyer and Lorenz 2021).

Figure 1.35. Top Fiscal Risks Identified in IMF Staff Reports on Advanced Economies
(Percent of countries)



Source: IMF staff calculations based on data from 32 IMF staff reports on advanced economies published in 2025 using the *Fiscal Monitor* AI Analyst, a custom large-language-model pipeline.

Figure 1.36. Evolution of Expected 2050 Population Growth: Comparison across Measures, 2019 versus 2024 Vintages
(Percent)



Sources: United Nations, World Population Prospects 2019 and 2024; and IMF staff calculations.

Note: The figure presents revisions to 2050 population growth forecasts of UN population projections. The sample excludes countries with populations below 1 million in 2024. AE = advanced economy; EM = emerging market; LIDC = low-income developing country; ln = natural logarithm.

Further Decline in International Aid

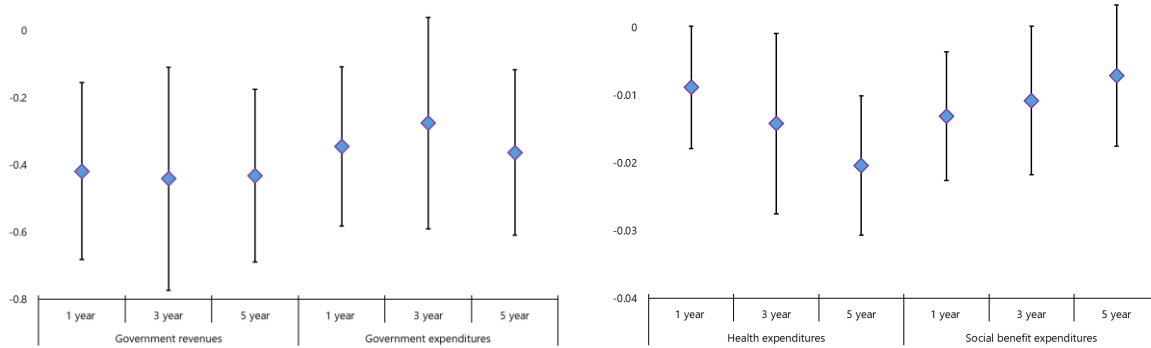
Although baseline projections incorporate declining levels of ODA, the risk of a sharper or more sudden withdrawal remains significant as donor countries adjust their spending priorities toward defense and domestic objectives amid a broader shift away from development assistance. IMF staff analysis shows that a decline in ODA of 1 percent of the recipient’s GDP reduces government revenues by 0.43 percent of GDP and expenditures by 0.36 percent after four years (Figure 1.37, panel 1; Online Annex 1.5). Because losses of revenue exceed cuts in spending, primary balances deteriorate in the near term. The adjustment falls disproportionately on public investment (−0.34 percent of GDP), suggesting that capital

formation is reduced to protect current spending. Health and social benefits also face reductions (Figure 1.37, panel 2), straining delivery of services in already underfunded systems.

Figure 1.37. Fiscal Impact of a Decline in Official Development Assistance

1. Impact of a Decline in Official Development Assistance on Government Revenues and Expenditures (Percent of GDP)

2. Impact of a Decline in Official Development Assistance on Expenditure on Health and Social Benefits (Percent of GDP)



Source: IMF staff calculations.

Note: The panels show coefficient estimates and 90 percent confidence intervals for the impact of a 1 percent of GDP decline in ODA expenditures at 1-, 3-, and 5-year horizons using local projections for an unbalanced panel of 56 low-income developing countries, allowing for asymmetric effects of ODA increases and decreases, with country and time fixed effects. The ODA measure excludes humanitarian aid, technical cooperation, and food aid. See [Online Annex 1.5](#) for full details. ODA = official development assistance.

Policy Conclusions

High debt, rising interest costs, less accommodating markets, and debt-at-risk projections near 120 percent of GDP have narrowed fiscal room for maneuver across the world. Goeconomic and political tensions have become a persistent feature of the fiscal landscape, and structural vulnerabilities and shifts in sovereign bond markets are amplifying countries’ exposure to changes in investor sentiment. In this setting, fiscal policy urgently needs to become more forward-looking, with well-designed adjustment plans to preserve stability and reduce the risk of disruptive market pressures.

The rising risk of sustained commodity price shocks from geopolitical tensions reinforces the case for allowing domestic energy prices to adjust where feasible, while avoiding discretionary fiscal interventions that blunt price signals under supply constraints. Where support is necessary and fiscal space exists, it should be temporary, well-targeted, and narrowly focused—channeled through existing transfers to vulnerable households and, where warranted, short-term liquidity support to viable energy-intensive firms—rather than broad-based measures that are fiscally costly, distortionary, and difficult to unwind. Fiscal responses should be carefully aligned with monetary policy efforts to contain second-round inflation effects: Overly expansionary measures risk prolonging price pressures and forcing a tighter monetary stance, compounding the drag on activity. Where fiscal space permits, automatic stabilizers should be allowed to operate; where it does not, budget-neutral reprioritization toward protecting the vulnerable is preferable to deficit-financed responses that could undermine market confidence. For commodity exporters benefiting from windfall revenues, resisting procyclical spending and channeling gains into fiscal buffers or sovereign wealth funds would strengthen resilience to future shocks.

For advanced economies with historically elevated debt burdens, broad or aspirational commitments to undertake fiscal consolidation are no longer sufficient. Credible adjustment, even if delayed until after better clarity emerges about the prospects of the war in the *Middle East*, requires specific measures, clear

sequencing, and medium-term frameworks resilient to political cycles. The pace and composition of adjustment are equally important. Rationalizing current spending, including industrial subsidies and trade-related support measures with uncertain productivity returns, transfers, and public wage bills, while preserving space for growth-enhancing public investment, offers a more durable path than uniform cuts across categories. A credible fiscal adjustment path can also open some fiscal space today. Safeguarding the legal and operational independence of central banks is critical, particularly where high debt levels sharpen incentives for monetary accommodation (*April 2026 World Economic Outlook*).

In the *United States*, the adjustment needed over the medium term will necessarily require both revenue and expenditure measures, given the persistence of primary spending and the scale of projected deficits. This underscores the importance of broadening the country's tax base, reducing tax expenditures, and addressing the long-term pressures stemming from Social Security and Medicare. Similar considerations apply across other advanced economies. In the *euro area*, where potential growth is projected at slightly more than 1 percent annually, deepening the single market could boost growth and ease the fiscal trade-offs that are constraining consolidation efforts. Similarly, in *Canada*, deepening internal market integration would lift productivity and strengthen the fiscal position over the long term. *Belgium's* ability to sustain public investment in green and digital infrastructure hinges on shifting priorities in current spending. In *Italy*, rationalizing tax expenditures, improving tax compliance, and linking fiscal consolidation with growth-enhancing initiatives, such as continued implementation of investments under the National Recovery and Resilience Plan, could help reduce high public debt and lift productivity. In the *United Kingdom*, adhering to established spending envelopes while strengthening the efficiency of value-added and property taxes is key to rebuilding buffers. Where political polarization complicates broad reforms, targeted efficiency initiatives, such as *Spain's* digital public administration reforms, can create fiscal space with fewer social and political costs. In *Japan*, although recent inflation and robust revenues have supported debt reduction, rebuilding buffers remains a priority. With the output gap positive and inflation stabilizing, a gradual fiscal adjustment is needed to manage mounting structural pressures from aging and rising interest payments while ensuring that debt remains firmly on a downward path and market conditions remain stable.

Across *Europe*, governments face increasingly difficult trade-offs among defense spending, aging-related spending, and investment. Rising security outlays require explicit reprioritization within constrained envelopes to avoid slippage. To address demographic pressures, health and pension reforms cannot be deferred. *France* will need to implement retirement-age reforms consistently and phase out early-retirement pathways. In *Finland* and *Portugal*, curbing automatic growth in health and pharmaceutical spending is essential to protect investment.

In *China*, continued near-term fiscal expansion, with a greater focus on boosting consumption and supporting the property sector, would help tackle deflationary pressures (*Box 1.1*). Fiscal policy should remain expansionary until the economy reflate durably. Over the medium term, ensuring fiscal sustainability will require strong policy effort, including significant fiscal consolidation, tax and social security reforms, and tackling the local government debt overhang. Gradually broadening the tax base through deeper reforms to the tax system will be essential to place public finances on a more sustainable footing. Scaling back poorly targeted industrial policies would help rebalance fiscal support toward households, lower fiscal costs, and raise productivity by reducing resource misallocation.

For other emerging market economies, policy resilience built over the past two decades remains a critical asset. The capacity of these economies to absorb shocks has materially improved as a result of independent central banks, inflation-targeting regimes, strengthened fiscal frameworks, and the development of local-currency bond markets (which have reduced reliance on foreign-currency

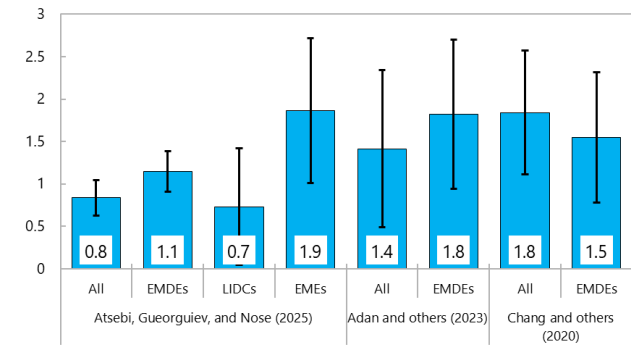
borrowing and expanded the domestic investor base) (*October 2025 World Economic Outlook*). Preserving these institutional gains is essential at a time when global risks remain elevated. Many countries will need to adhere more strictly to structural balance targets, relying more on administrative and compliance measures to close revenue gaps rather than optimistic projections, while also improving spending efficiency (*Chile*) and strengthening fiscal frameworks with binding medium-term anchors to reinforce credibility and sustainability (*Brazil*). Medium-term fiscal anchors will need to be reinforced to contain procyclical pressures. Existing fiscal rules should be legally enshrined to bolster credibility (*Argentina*).

The gap between resilient and vulnerable emerging market economies continues to widen. For countries facing tighter financing conditions, credible consolidation and predictable rules remain the foundation for regaining market confidence. Eliminating costly fuel subsidies (*Angola*) and mobilizing revenue by rationalizing tax expenditures and broadening the tax base (*Pakistan, Sri Lanka*) are central to credible medium-term fiscal plans. Addressing contingent liabilities is equally important: SOE reforms that limit government guarantees (*South Africa*), reduce transfers, and improve financial monitoring and reporting (*Barbados*) are critical to prevent future debt surprises, as are continued efforts to strengthen disaster-risk financing and climate-resilient infrastructure (*The Bahamas, Grenada*). Financial sector resilience also requires attention, including by strengthening deposit insurance frameworks (*Belize*).

For many low-income developing countries, shrinking aid flows have shifted from a latent concern to a binding constraint on fiscal space. Fiscal adjustment risks are forcing cuts to essential services (health, education, and social protection) that are critical for development and poverty reduction. Recent evidence

underscores these costs: A consolidation of 1 percent of GDP is estimated to reduce output by about 0.5 percent cumulatively after two years in *sub-Saharan Africa* (*Abdel-Latif and others 2026*), amplifying the challenge in countries where growth is already fragile. Still, building domestic revenue mobilization capacity remains the most sustainable path forward. Tax gaps in low-income developing countries average about 5 percent of GDP, and evidence shows that well-designed reforms to tax administrations can yield meaningful revenue gains, with estimates ranging from 0.7 percent to 1.8 percent of GDP, depending on the scope and country circumstances (*Figure 1.38*). Concrete steps countries can take include strengthening core administrative functions such as taxpayer registration, filing, and audit processes; leveraging digitalization through e-invoicing and third-party data sharing; and rationalizing tax expenditures, which average nearly 20 percent of tax revenues in low-income developing countries (*Baer and others 2025*). Country experiences demonstrate what is achievable: *Cabo Verde* increased revenues by 2.9 percent of GDP over three years through digitalization and administrative reforms, and *Mongolia* achieved gains of 5.4 percent of GDP over five years through management of compliance risk and technology-enabled reforms. *Box 1.2* presents recent examples of the fiscal impact of reforms supported by capacity development.

Figure 1.38. Estimates of Revenue Yields from Reform of Tax Administration
(Percent of GDP)



Sources: Adan and others 2023; Atsebi, Gueorguiev, and Nose 2025; and Chang and others 2020.

Note: EMEs = emerging market economies; EMDEs = emerging market and developing economies; LIDCs = low-income developing countries.

In the current high-debt environment, fiscal transparency and communication have become central to maintaining credibility. Market confidence rests not only on sound fiscal frameworks but also on credible and accessible communication of fiscal realities. Hidden deficits, vague promises of future adjustments, and opaque contingent liabilities undermine credibility. Research suggests that public perceptions of debt levels often diverge markedly from reality, shaping expectations in ways that can complicate policy implementation (Box 1.3; see also Bianchi, Dabla-Norris, and Khalid 2025). Clear communication of fiscal aggregates, policy trade-offs, and the rationale for adjustment can help build the social consensus necessary for durable reform. Independent fiscal councils have a critical role to play in this effort and should be adequately resourced to provide rigorous, transparent assessments of fiscal plans.

Credible medium-term debt management strategies, aligned with fiscal frameworks and informed by prevailing market conditions and risk assessments, are also essential. Such strategies can help governments manage rollover risks, reduce borrowing costs over time, and signal commitment to prudent fiscal management.

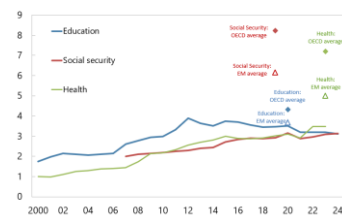
Box 1.1. Fiscal Reforms to Reduce China’s High Household Saving Rate: The Role of Social Safety Nets

China’s household saving rate averages about 20 percent of GDP, roughly double the average among Organisation for Economic Co-operation and Development countries and well above most emerging market peers (Figure 1.1.1, panel 1). Although high saving rates have supported investment, they have also contributed to subdued private consumption and pose challenges for economic rebalancing.

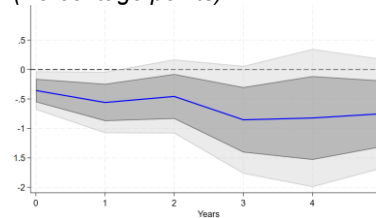
A key driver of the high saving rate in China is the limited scope and uneven distribution of the social safety net. Despite significant increases over the past two decades, government social spending on health, pensions, and education remains below international benchmarks, with out-of-pocket health costs particularly high in rural areas. Regional disparities compound the problem: Social spending per capita is much higher in China’s Tier 1 cities, whereas cities in lower tiers and rural regions operate with weaker safety nets and under more acute fiscal constraints.¹ Pension coverage is now nearly universal (more than 1 billion people are enrolled in public pension schemes), but benefit levels are highly uneven. Urban employees have income replacement rates exceeding 40 percent of GDP per capita, whereas rates for rural pensions average just 2 to 3 percent (Bonthuis, Cao, and Freudenberg 2026).² These gaps drive higher precautionary saving among rural households.

Figure 1.1.1. China: Government Social Spending and Household Saving Rate

1. Government Social Spending (Percent of GDP)



2. Reaction of Rural Saving Rate to Increase in Local Social Spending (Percentage points)



Sources: National Bureau of Statistics and People’s Bank of China, Flow of Funds; EUROPACE AG/Haver Analytics; Organisation for Economic Co-operation and Development; and IMF staff calculations.

Note: Expenditure on health, education, and social security cited in the figure includes only spending that comes from the general government budget; it does not include spending from social security funds. Panel 2 shows the cumulative change in two-stage, least-squares, local-projection impulse responses of rural saving to a shock to per capita social spending amounting to 1 percent. It uses a Bartik instrument (year 2000 old-age share times national growth of social spending), with lagged changes in the saving rate and prefecture and year fixed effects controlled for. Standard errors are two-way clustered; shaded areas show one-standard-deviation and 90 percent confidence bands. EM = emerging market; OECD = Organisation for Economic Co-operation and Development.

Empirical analysis using prefecture-level data (Xu and others 2025) confirms that stronger social protection can meaningfully reduce rural household saving. A 1 percent increase in per capita social spending by prefectures is associated with a cumulative decline in rural saving rates of roughly 0.4 percentage point over two years (Figure 1.1.1, panel 2), consistent with the theory that households with more complete access to health and pension benefits save substantially less than those facing weaker or fragmented coverage.³

¹ The tier system is a widely used classification of Chinese cities based on GDP, political significance, and population size. Tier 1 cities (Beijing, Shanghai, Guangzhou, and Shenzhen) have the highest per capita incomes and fiscal capacity, enabling them to have significantly more comprehensive social safety nets than lower-tier cities and rural areas.

² Replacement rates here use GDP per capita as a benchmark (rather than preretirement wages) to allow for comparison between urban employees with formal wages and rural residents, whose income is often informal or seasonal.

³ Average per capita spending on health, education, and social security across prefectures in the sample is approximately 10 percent of GDP per capita.

Box 1.2. Fiscal Gains from Reforms Supported by Capacity Development

Targeted institutional reforms, supported by IMF capacity development, can generate measurable fiscal gains even within tight budget envelopes. Two recent cases illustrate how improvements in tax administration and treasury management translate into concrete outcomes.

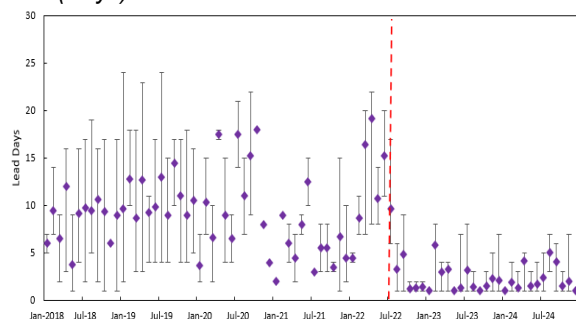
In *Costa Rica*, the Single Social Resources Payment System (SUPRES) reform modernized social assistance payments by introducing a unified digital platform that centralizes and automates transfers directly from the Treasury Single Account to beneficiaries. Payment lead times fell from 9–13 days to 2–3 days (Figure 1.2.1, panel 1), strengthening cash management and reducing reliance on short-term borrowing. During 2018–24, estimated opportunity cost savings exceeded \$4 million. IMF support—through technical assistance, a hackathon focused on public financial management, an ex post impact evaluation, and initiatives to anchor SUPRES as a structural benchmark under the IMF program—was instrumental in the reform’s design and institutionalization.

In *Georgia*, reestablishment of a dedicated Large Taxpayer Office (LTO) in 2021—part of broader tax administration modernization supported by the IMF since 2016—delivered substantial revenue gains without any change in tax policy. Using administrative tax records covering all firms from 2017 to 2024 and a weighted difference-in-differences approach, IMF staff estimate that LTO assignment raised annual tax assessments by 0.4 percent to 0.7 percent of GDP, with gains concentrated in the value-added tax and withholding taxes (Figure 1.2.1, panel 2). The reform exploited two sources of quasi-experimental variation: the LTO launch and an unanticipated tightening of eligibility thresholds in 2024, providing robust validation of its effects over time.

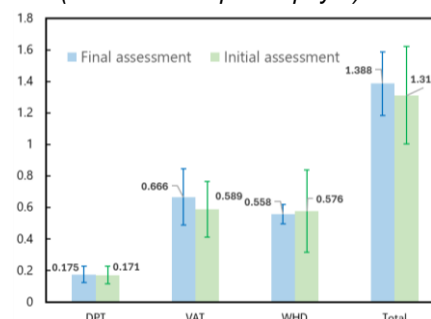
These experiences underscore that well-designed administrative and institutional reforms, backed by sustained capacity development, can yield durable fiscal dividends across diverse country contexts.

Figure 1.2.1. Fiscal Impact of Reforms Supported by Capacity Development

1. Costa Rica: Lead Time for Avancemos Program Payments, before and after SUPRES Reforms (Days)



2. Georgia: Effects of Reestablishment of a Large Taxpayer Office on Tax Assessments (Millions of lari per taxpayer)



Sources: Atsebi and others 2026; Cavalleri and others, forthcoming; Costa Rica Ministry of Finance; Georgia Revenue Service; and IMF staff calculations.

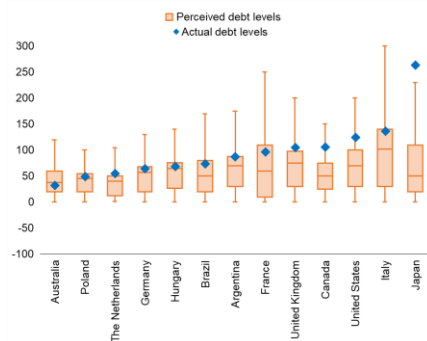
Note: Lead times in panel 1 are calculated as the number of days between the cash outflow from the country’s treasury single account and the receipt of funds by the beneficiary. In panel 2, estimates refer to the assignment of the first cohort of firms to the Large Taxpayer Office. DPT = distributed profit tax assessments; SUPRES = Sistema Único de Pago de Recursos Sociales (Single Social Resources Payment System); VAT = value-added tax assessments; WHD = withholding tax.

Box 1.3. Fiscal Policy Communication When Debt Levels Are High

High global debt levels have increased the need for fiscal consolidation, yet public support for such measures is often limited by widespread misunderstandings of fiscal realities. New cross-country evidence from Bianchi, Dabla-Norris, and Khalid (2025) indicates that the public’s grasp of both actual debt levels and fiscal linkages is systematically weak.

Across 13 surveyed countries, citizens generally view debt as high but significantly underestimate its true magnitude (Figure 1.3.1), particularly in high-debt countries. Even more striking, fewer than half of respondents correctly connect tax and spending choices to deficit outcomes, suggesting that many voters do not fully understand the mechanisms through which fiscal adjustment occurs or why it may be needed.

Figure 1.3.1. Debt Perceptions

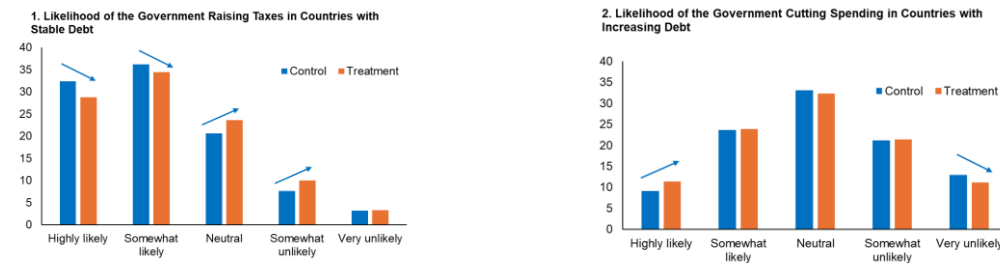


Source: Bianchi, Dabla-Norris, and Khalid 2025.

Randomized information experiments show that accurate data change expectations in meaningful and directionally consistent ways. In countries where debt is stable or falling, providing respondents with the true debt level lowers expectations of future tax increases, especially among those who previously overestimated the situation. Conversely, in countries where debt is rising, providing information makes respondents more likely to anticipate spending restraint, driven largely by individuals who had underestimated the fiscal challenge (Figure 1.3.2). The effects are statistically significant and concentrated among those least informed ex ante.

These findings underscore a central point: Clear and credible communication can realign public expectations in ways that support fiscal adjustment. When people are informed about actual debt levels and fiscal trajectories, their expectations about future policy move in a direction consistent with underlying fundamentals. The results point to two practical implications. First, improving fiscal literacy can help correct persistent misperceptions, especially regarding the link between spending, taxes, and deficits. Second, greater transparency in presenting fiscal data—through accessible reporting and more effective communication of trade-offs—can help anchor expectations and strengthen the credibility of fiscal plans.

Figure 1.3.2. Impact of Information on Expectations of Changes in Fiscal Policy (Percent)



Source: Bianchi, Dabla-Norris, and Khalid 2025.

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