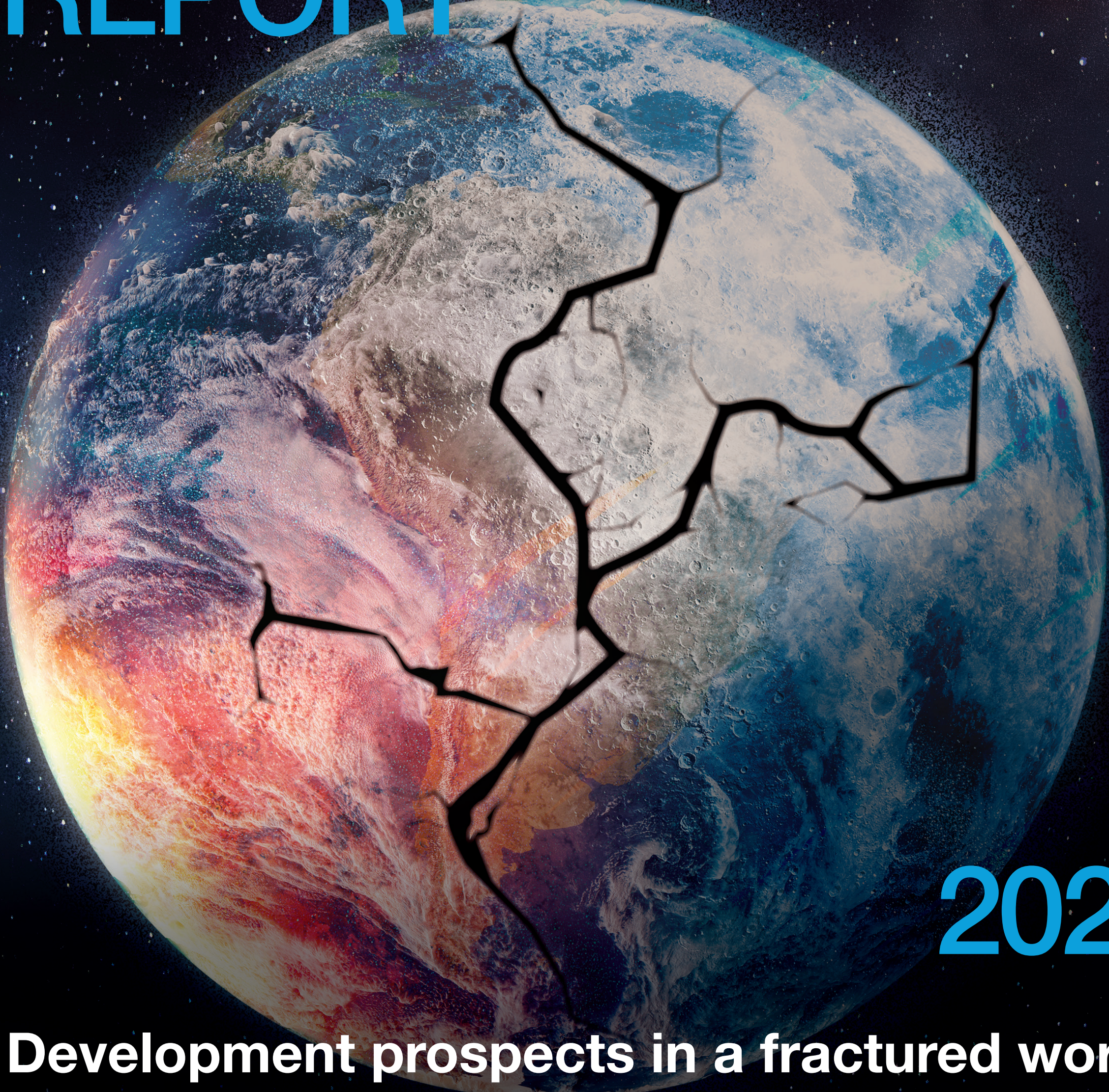
UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

TRADE AND DEVELOPMENT REPORT



2022

Development prospects in a fractured world:
Global disorder and regional responses

ADVANCE COPY
CHAPTERS I, II, III

United Nations

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Chapter I

Global Trends and Prospects

A. TOO CLOSE TO THE EDGE

1. A year of serial crises

After a rapid but uneven recovery in 2021, the world economy is in the midst of cascading and multiplying crises. With incomes still below 2019 levels in many major economies, growth is slowing everywhere. The cost-of-living crisis is hurting the majority of households in advanced and developing countries. Damaged supply chains remain fragile in key sectors. Government budgets are under pressure from fiscal rules and highly volatile bond markets. Debt-distressed countries, including over half of low-income countries and about a third of middle-income countries, are edging ever closer to default. Financial markets are jittery, as questions mount about the reliability of some asset classes. The vaccine roll-out has stalled, leaving vulnerable countries and communities exposed to new outbreaks of the pandemic. Against this troubling backdrop, climate stress is intensifying, with mounting loss and damage in vulnerable countries who lack the fiscal space to deal with disasters, let alone invest in their own long-term development. In some countries, the economic hardship resulting from these compounding crises is already triggering social unrest that can quickly escalate into political instability and conflict.

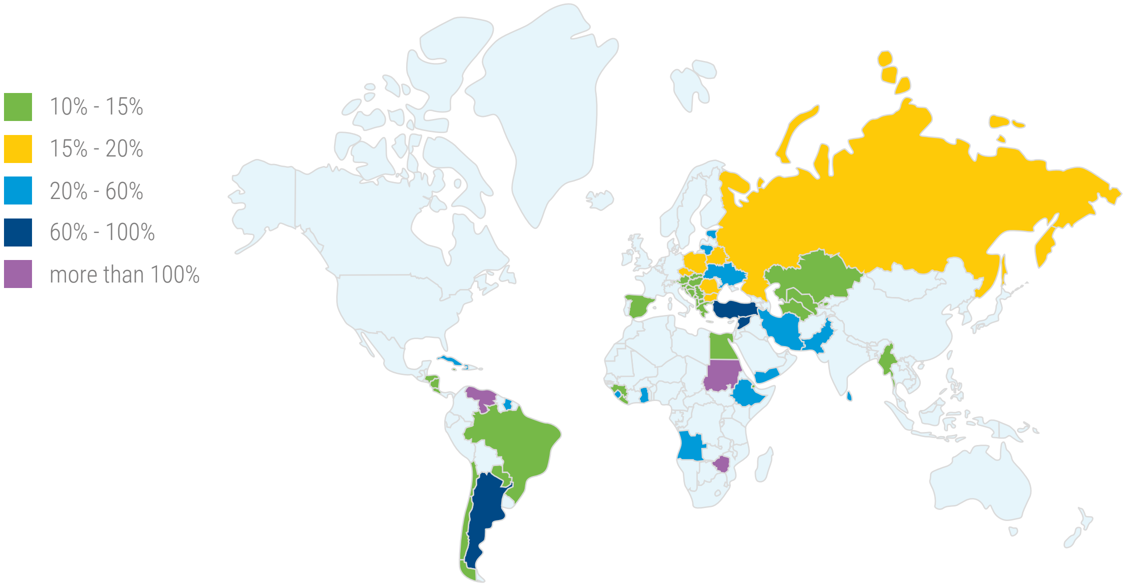
The resulting policy challenges are daunting, especially in an international system marked by rising distrust. At the same time, the institutions of global economic governance, tasked since 1945 with mitigating global shocks, delivering international public goods and providing a global financial safety net, have been hampered by insufficient resources and policy tools and options that are "rigid and old fashioned" (Syed, 2022; Yellen, 2022). Even as growth in advanced economies slows down more sharply than anticipated in last year's Report, the attention of policymakers has become much too focused on dampening inflationary pressures through restrictive monetary policies, with the hope that central banks can pilot the economy to a soft landing, avoiding a full-blown recession. Not only is there a real danger that the policy remedy could prove worse than the economic disease, in terms of declining wages, employment and government revenues, but the road taken would reverse the pandemic pledges to build a more sustainable, resilient and inclusive world (chapter III).

As noted in last year's Report, the pandemic caused greater economic damage in the developing world than the global financial crisis. Moreover, with their fiscal space squeezed and inadequate multilateral financial support, these countries' bounce back in 2021 proved uneven and fragile, dependent in many cases on a further build-up in external debt. The immediate prospects for many developing and emerging economies will depend, to a large extent, on the policy responses adopted in advanced economies. The rising cost of borrowing and a reversal of capital flows, combined with a sharper than expected slowing of China's growth engine and the economic repercussions from the war in Ukraine, are already dampening the pace of recovery in many developing countries, with the number of those in debt distress rising, and some in default. With 46 developing countries already severely exposed to financial pressure from the high cost of food, fuel and borrowing, and more than double that number exposed to at least one of those threats, the possibility of a widespread developing country debt crisis is a very real one, evoking painful memories of the 1980s and ending any hope of meeting the sustainable development goals (SDGs) by the end of the decade.

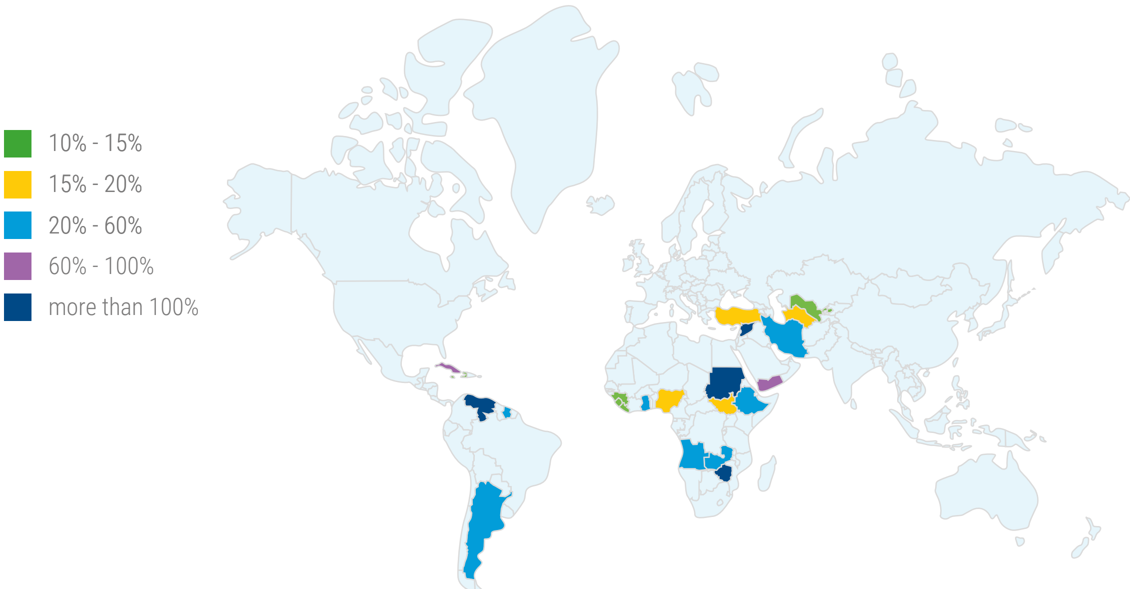
The acceleration of inflation beginning in the second half of 2021 (figure 1.1) and continuing even as economic growth began to slow down in the final quarter of the year has led many to draw parallels with the stagflationary conditions of the 1970s. Despite the absence of the wage-price spirals that characterized that decade, policymakers appear to be hoping that a short sharp monetary shock – along the lines, if not of the same magnitude, as that pursued by the United States Federal Reserve (the Fed) under Paul Volker – will be sufficient to anchor inflationary expectations without triggering recession. Sifting through the economic entrails of a bygone era is unlikely, however, to provide the forward guidance needed for a softer landing given the deep structural and behavioural changes that have taken place in many economies, particularly those related to financialization, market concentration and labour's bargaining power.

Figure 1.1 Countries with double-digit inflation rates, June 2022 vs June 2021

69 Economies with confirmed double-digit inflation, representing more than 2.1 billion of world population, June 2022 *(Consumer Price Index, change over respective period of previous year)*



23 Economies with confirmed double-digit inflation, representing less than 0.9 billion of world population, June 2021 *(Consumer Price Index, change over respective period of previous year)*



Source: UNCTAD secretariat calculations, based on Internati al Monetary Fund (IMF) data, Refinitiv, and various national sources.[1]
Note: For 2022 (top figure), the latest monthly data are available for 164 of 182 economies; for 9 of them, figures are for one of the last months in 2021; another 10 are estimations for 2022 from various sources. Out of 69 economies with double-digit inflation, 18 show double-digit inflation rate (at least) since the end of 2019. For 2021 (bottom figure), out of 23 economies with double-digit inflation, 16 show double-digit inflation rate (at least) since the end of 2019.

[1] The designations employed and the presentation of material on any map in this work do not imply the expression of any opinion whatsoever on the part of the United Nations concerning the legal status of any country, territory, city or area or of its authorities, or concerning the delimitation of its frontiers or boundaries.

The origins of this latest wave of inflation are, in fact, unique. The successful roll-out of the vaccine in advanced and some developing countries and the easing of Covid restrictions, combined with continued government support for households and firms, saw demand pressures running ahead of supply responses during the first half of 2021, creating bottlenecks, including in some key markets, such as automobiles. The surge in inflation from the end of last year belied hopes that this would be a short-lived inconvenience. However, the evidence does not suggest this surge has come from a further loosening of fiscal policy or wage pressure, but instead derives largely from cost increases, particularly for energy, and sluggish supply response due to a prolonged history of weak investment growth (chapter III). These have been amplified by price-setting firms in highly concentrated markets raising their mark-ups to profit from two rare opportunities – in 2021, the surge in demand due to the global recovery, and in 2022, the surge in speculative trades related to a wave of global concern over the availability of particular sources of energy, with no substantial changes in overall demand or supply.

Under these circumstances, continued monetary tightening – through rising central bank rates and the normalization of their balance sheets – will have little direct impact on the supply sources of inflation and will instead work indirectly to re-anchor inflationary expectations by further reducing investment demand and pre-empting any incipient labour market pressures. A more immediate impact could be a sharp correction in asset and commodity prices, from crypto currencies to housing and metals.

With financial entanglements since the global financial crisis (GFC) becoming increasingly global, complex unanticipated shocks, including outbreaks of financial panic or extreme price volatility, or a combination of external triggers, are a present danger. Monetary tightening poses additional risk to the real economy and the financial sector: given the high leverage of non-financial businesses, rising borrowing costs could cause a steep increase in non-performing loans (NPLs) and trigger a cascade of bankruptcies. With direct price and markup controls ruled out as politically unacceptable, and if monetary authorities are unable to stabilize inflation quickly, governments might resort to additional fiscal tightening. This would only help precipitate a sharper global recession.

Finally, what does seem likely is that the impact of Fed tightening will be more severe for vulnerable emerging economies with high public and private debt, substantial foreign exchange exposure, a high dependence on food and fuel imports and higher current-account deficits (chapter II).

According to one recent estimate, an increase in United States interest rates of 1 percentage point reduces real gross domestic product (GDP) by 0.5 per cent in advanced economies and by 0.8 per cent in emerging economies, after three years (Iacoviello and Navarro, 2019).[2] These effects are comparable to the domestic effects of a one-percentage-point increase in the United States interest rate, which lowers the United States GDP by almost 1 per cent after 11 quarters (Fair, 2021). More drastic increases by 2 to 3 percentage points would therefore depress the already stalling economic recovery in the emerging economies by another 1.6 to 2.4 percentage points.

2. Global stagflation: spinning back down the years