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TRADE^{AND} DEVELOPMENT REPORT

EMBARGO

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2022

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

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CHAPTERS I and II



**United
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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.

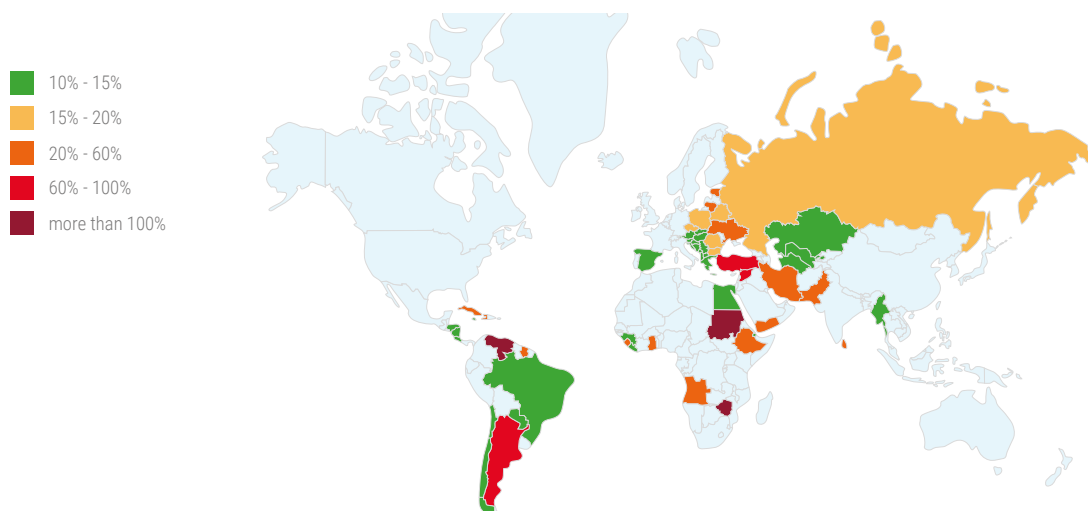
The resulting policy challenges are daunting, especially in an international system marked by rising distrust. At the same time, the institutions of global economic governance, tasked since 1945 with mitigating global shocks, delivering international public goods and providing a global financial safety 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.

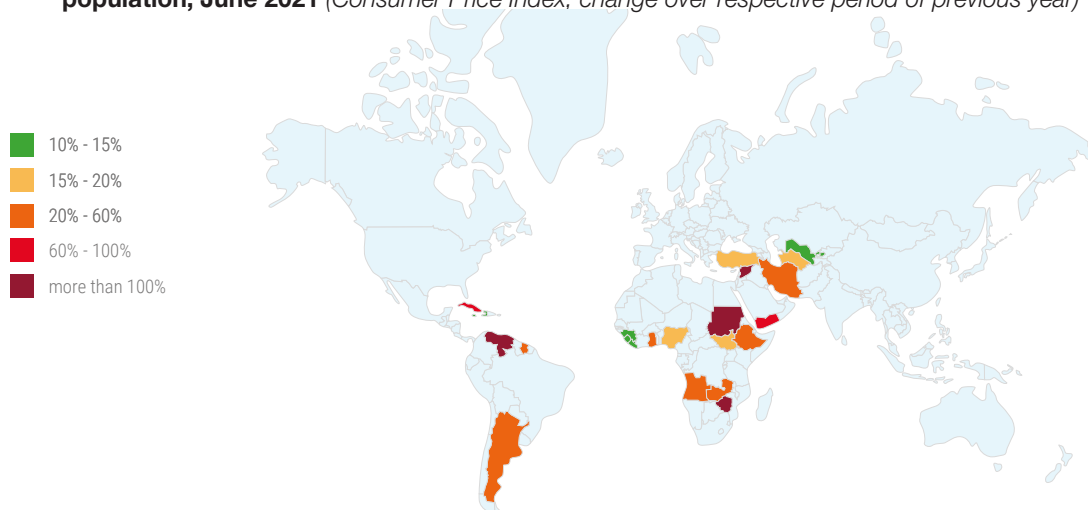
The acceleration of inflation beginning in the second half of 2021 (figure 1.1) and continuing even as economic growth began to slow down in the final quarter of the year has led many to draw parallels with the stagflationary conditions of the 1970s. Despite the absence of the wage-price spirals that 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 International 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

Disruptions to global supply chains, armed conflicts in key commodity-producing regions, slowing economic growth, turbulence in stock markets and accelerating inflation suggest a resemblance to the stagflation of the 1970s (BIS, 2022; World Bank, 2022; Wolf, 2022). Accordingly, the recommended policy action is aggressive monetary tightening, which is supposed to pre-emptively anchor inflationary expectations and avoid the steep economic costs associated with a prolonged period of interest rate increases, such as the world painfully experienced between 1979 and 1981 when the Fed introduced a series of rate increases amounting to almost 9 percentage points.

² Using a structural vector autoregression (SVAR) model, Fed economists Akinci and Queralto (2021) obtained broadly similar results: an increase in United States interest rates by 1 percentage point is found to lower the United States real GDP by 0.5 percentage points and the real GDP of emerging economies by 0.45 percentage points. The new inflationary environment has changed the balance of risks. Gradually raising policy rates at a pace that falls short of inflation increases means falling real interest rates. This is hard to reconcile with the need to keep inflation risks in check. Given the extent of the inflationary pressure unleashed over the past year, real policy rates will need to increase significantly in order to moderate demand. Delaying the necessary adjustment heightens the likelihood that even larger and more costly future policy rate increases will be required, particularly if inflation becomes entrenched in household and firm behaviour and inflation expectations.

From this perspective, the Bank for International Settlements (BIS, 2022: 26) has clearly defined the task facing central bankers:

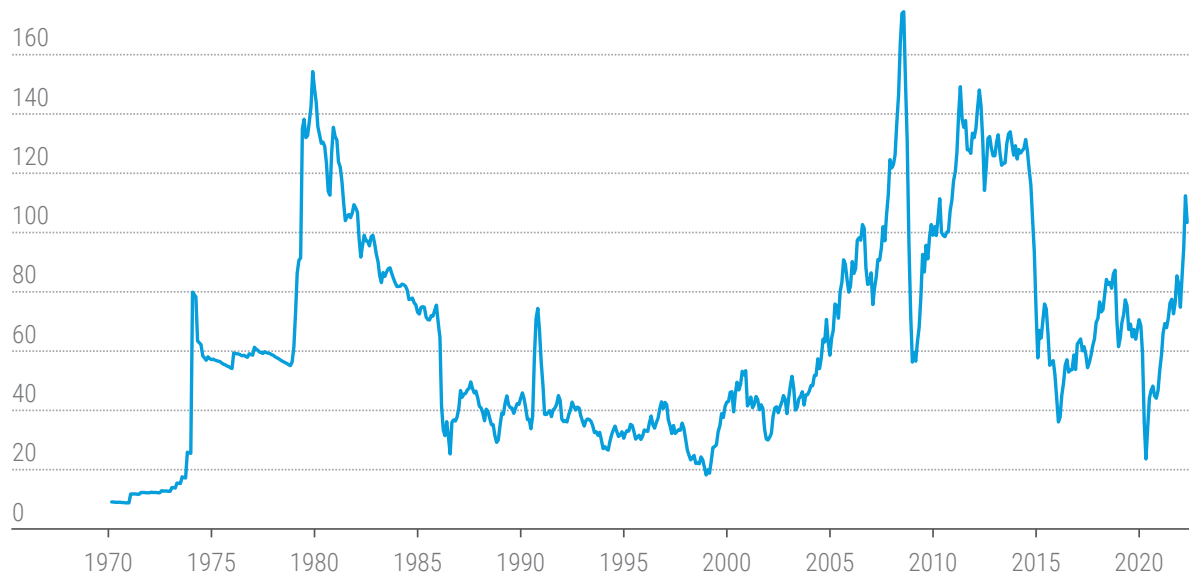
“The new inflationary environment has changed the balance of risks. Gradually raising policy rates at a pace that falls short of inflation increases means falling real interest rates. This is hard to reconcile with the need to keep inflation risks in check. Given the extent of the inflationary pressure unleashed over the past year, real policy rates will need to increase significantly in order to moderate demand. Delaying the necessary adjustment heightens the likelihood that even larger and more costly future policy rate increases will be required, particularly if inflation becomes entrenched in household and firm behaviour and inflation expectations.”

These policy recommendations, along with calls for fiscal policy to address investor concerns by cleaning up public finances (World Bank, 2022: 69), closely resemble the dominant policy recommendations of the early 1980s, and these proved disastrous, particularly for developing countries, in terms of economic growth, inequality and poverty (TDR, 2021).

The primary cognitive blinder hindering adequate understanding of the key lessons from past crises is still the widely shared belief and confidence in monetary policy’s singular ability to reduce output volatility and ensure stable and lasting growth in market economies in a neutral manner, without affecting potential output growth of the economy under consideration (Goodfriend, 2007; Blanchard, 2018). In fact, the aggressive monetary tightening of the early 1980s provoked deep distributional shifts within and across countries, and repeating that approach today could be equally damaging.

Moreover, while echoes of the 1970s are audible in current conditions, there are important differences between then and now – and these should caution us to avoid drawing direct policy lessons. First, the recent commodity price increases, when measured in real terms, have so far been smaller than in the 1970s. Figure 1.2 shows this for the real increase in global oil prices. Second, the energy intensity of GDP has declined considerably since the 1970s (figure 1.3), reducing the inflationary impact of higher energy prices.

Figure 1.2 Real oil price, January 1970 – April 2022 (adjusted dollars per barrel)



Source: World Bank (2022).

Note: Real oil prices are averages of Dubai, Brent, and WTI prices, deflated by the CPI index of the United States (using March 2022=100).

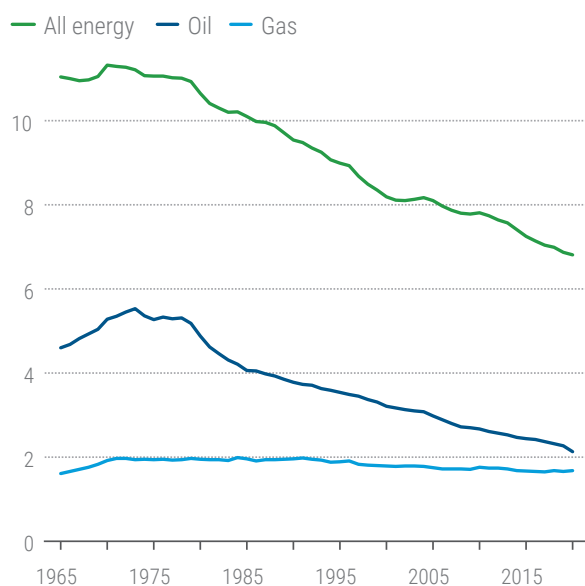
A second notable difference is that core global inflation in 2022 is driven by fewer sectors than it was in the 1970s.³ In 1979-1980, global headline inflation (a broader measure) and global core inflation (which excludes volatile items such as food and energy) were similar: 15.2 per cent and 15.3 per cent, respectively. But in 2022, the global core inflation rate is 2.8 per cent, whereas the global headline inflation rate is much higher, at 7.5 per cent.⁴

Third, and insufficiently emphasized in many of the theorized parallels between the two periods, nominal wage growth is not keeping up with consumer price index (CPI) inflation; hence, real wages in developed and developing countries alike are stagnating or declining, ruling out a wage-price spiral as the inflationary lubricant. This is not surprising given the declining influence of organized labour and workers' bargaining power in recent decades (ILO, 2022) – something also showing up in the secular decline in the labour income share (figure 1.4).

Fourth, a final structural difference between the 1970s and the current conjuncture concerns the significantly higher levels of indebtedness today in both developed and developing countries and for both private and public sectors, with much of the developing country debt denominated in foreign currency and short-term (chapter II).

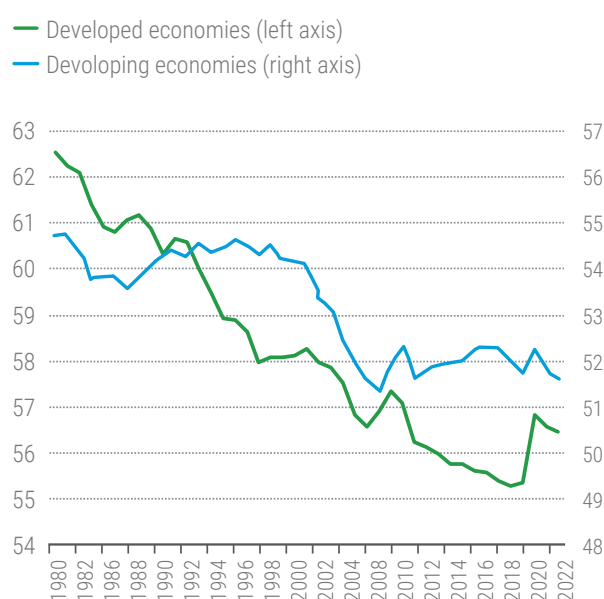
In 1980, total debt of the emerging market and developing economies (EMDEs) stood at 65 per cent of their GDP; half of this debt was sovereign debt and the other half was private-sector debt (figure 1.5). When the Fed tightened monetary policy in the late 1970s and early 1980s in response to rising inflationary pressures in the United States, it triggered the “Third World” debt crisis. Today many emerging economies are facing even tighter financial conditions against a backdrop of high debt (chapter II). Fifteen EMDEs already experienced a downgrading of their sovereign debts in the first five months of 2022. Monetary tightening by the Fed thus has a considerable risk of triggering a new chain of financial crises in EMDEs (chapter II).

Figure 1.3 Energy intensity, 1965-2020
(percentage, megajoule to GDP)



Source: Bank for International Settlements (2022).

Figure 1.4 Labour share, 1980-2022
(percentage of GDP)



Source: United Nations Global Policy Model database.

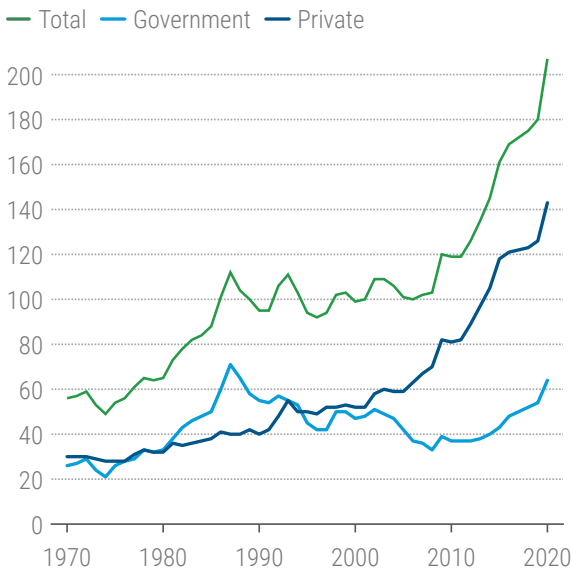
Note: Labour share is calculated as the ratio of the sum of compensation of employees and mixed income to GDP.

³ According to BIS (2022), inflation in the emerging economies is rapidly becoming more broad-based.

⁴ The global inflation rates are averaged for 66 countries, using CPI data for January to April 2022.

Finally, far more central banks are independent today than in the early 1980s, with clear mandates to prioritize inflation targeting (figure 1.6) and follow “transparent” monetary policy rules. Some assessments (e.g. World Bank, 2022) say this “revolution” in monetary policy is better placed to anchor inflation expectations, with core inflation becoming less sensitive and more resilient to (unexpected) inflation shocks. What is missing in this narrative is that commercial banks have become progressively less important financial actors in the intervening years, and a variety of non-bank financial institutions have emerged as credit providers in a loosely regulated market environment (box 1.1). This evolving “shadow banking” system, largely ignored (or worse yet, encouraged) by the authorities in the run-up to the GFC, greatly complicates the transmission of monetary policy (chapter III). More than a decade later, shadow banking poses renewed risks to financial stability, in advanced and developing countries alike.

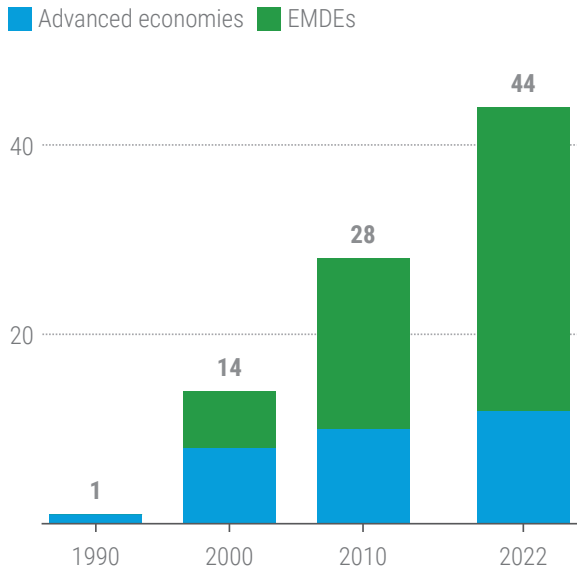
Figure 1.5 Debt, emerging market and developing economies, 1970-2020
(percentage, of GDP)



Source: World Bank (2022).

Note: GDP-weighted averages based on a sample of up to 153 EMDEs.

Figure 1.6 Number of countries with inflation-targeting central banks, 1990-2022



Source: World Bank (2022).

Box 1.1 Exile on Wall Street: shadow banking and financial fragility

Non-bank financial intermediaries carry out many of the same fundamental functions as regulated banks,⁵ yet they remain unregulated. The universe of non-bank financial institutions and credit providers, known as a shadow banking system, came under the spotlight during the GFC. It comprised the markets for asset-backed commercial paper, repurchase (repo) deals, securitization products, money market funds, private currency swaps and other over-the-counter (OTC) transactions and off-balance sheet activities, often sponsored or owned by official banks. Largely unnoticed until then, the vast network of unregulated credit intermediaries, their opaque connectivity to the

⁵ Including lending, deposit taking and similar operations that create credit.

official banks and the hidden risks of such connections were at the epicentre of the global financial implosion. Having started in the relatively isolated segment of the United States mortgage market, the financial crisis spread through shadow banking channels, was magnified by the speculation by hedge funds and other operations involving complex, unregulated financial products and threatened the viability of the official banking sector.

The system of shadow banking not only endangered commercial banks, but also placed additional demands for public bailouts provided by governments trying to prevent bank failures over the period 2007 to 2008. Despite some efforts to contain and regulate parts of non-bank finance, over the past decade, the global shadow banking has expanded in size, geography and diversity. The share of global financial assets held at shadow banking institutions increased globally from 42 per cent in 2008 to close to 50 per cent at the end of 2019. In 2020, shadow banking institutions originated more than two-thirds of all United States mortgages; the share of loans to businesses they hold is nearly equal to the share held by banks (Kelleher and Basil, 2022). And while during the pandemic, the shadow banking sector's relative share of total global financial assets decreased from 49.7 per cent to 48.3 per cent in 2020, in 2021, shadow banks controlled \$226.6 trillion of assets out of the total of \$468.7 trillion (FSB, 2021).

In advanced economies, shadow banking accounts for, on average, 56 per cent of total financial assets (compared to 27 per cent in emerging markets). At the same time, the rate of growth of shadow banking sectors has been faster in the emerging markets than in the advanced economies, especially in the loan provision by non-bank entities dependent on short-term funding. According to the Financial Stability Board (FSB), in 2021, shadow banks controlled \$226.6 trillion of assets (out of a total of just over \$468.7 trillion). More than \$57 trillion of the assets controlled by shadow banking entities are the result of their credit creation functions, such as short-term market funding, credit intermediation and securitization base funding (FSB, 2021).

This continuous expansion poses systemic and financial stability risks in advanced and developing countries alike. In the United States, during the 2008 crisis and again in the 2020 pandemic, when funding markets all but shut down, the Fed stepped in with trillions of dollars in support as a backstop for virtually every asset class. This made the Fed the “market-maker of first resort” and a buyer in the asset backed securities (ABS) market (Kelleher and Basil 2022). Today, similar pressures are mounting in the financial system in China, where earlier attempts to reduce the shadow banking sector did not reduce financial fragility. The debts accumulated by local banks through shadow banking facilities domestically, as well as the debt exposures internationally, are threatening the China's growth prospects in 2022-2023.

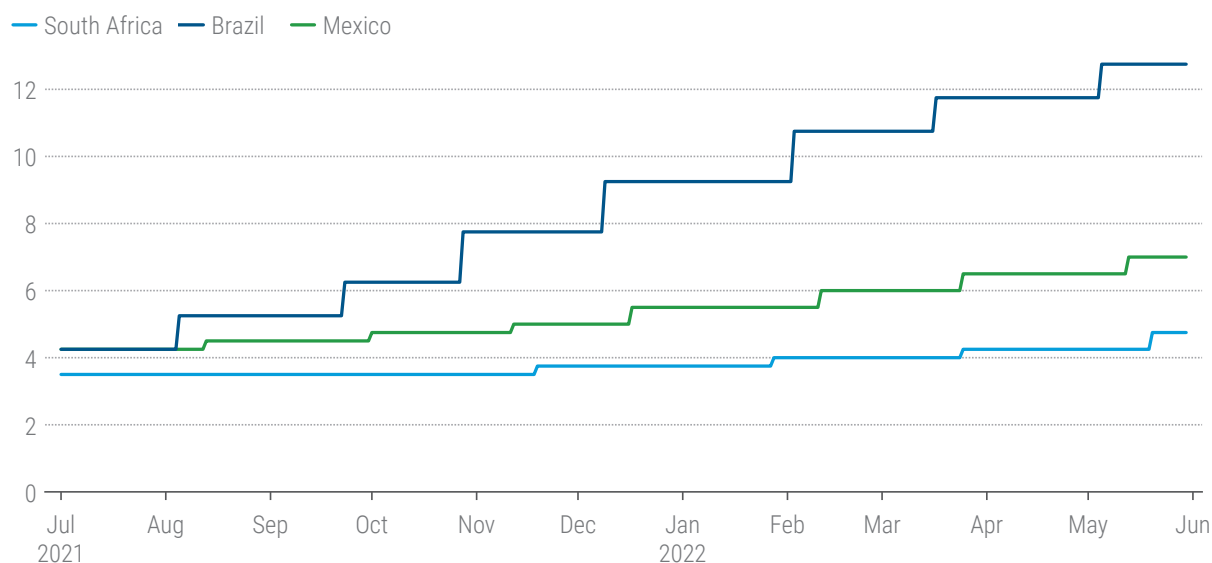
In other words, not only were the risks of the unregulated system of shadow banking not addressed in the wake of the GFC, but they were magnified in the decade that followed. Today, shadow banking poses new challenges to financial stability and is likely to require new intervention by the central banks in 2022-2023. In the context of the uncertainty of global growth prospects and high inflation expectations, such interventions may not be as forthcoming as they were during the two previous financial crises. The situation is much starker in the developing countries.

The large role of the shadow banking sector means central banks have limited capacity to control credit expansion in large segments of the financial system. That is even more true for central banks in many developing economies, as they have more fragile financial systems, higher debt denominated in foreign currency and greater exposure to commodity price shocks. In fact, many of them began to raise interest rates already in late 2021 (figure 1.7), but the inflationary pressures have not abated, and the financial vulnerabilities have continued to build.

A recent analysis of 129 monetary policy tightening episodes over the period 1985 to 2018 has shown that hard landings are more likely when monetary tightening is preceded by a build-up of (household)

indebtedness – as is the case now (BIS, 2022). Hard landings are also historically associated with low real interest rates before the start of the tightening cycle. To be precise, the average real interest rate at the start of tightening cycles that end in hard landings is 0.4 per cent, compared to 1.4 per cent at the start of those that end in soft landings. Given that real interest rates were relatively low at the start of the current monetary tightening cycle, the initial conditions do not augur well for a soft landing.

Figure 1.7 Nominal interest rates, selected emerging economies, July 2021–May 2022 (percentage)



Source: Bank for International Settlements (2022).

Today, inflation is caused by a mixture of disruptions in global supply chains, high (container) shipping costs, the impact of war on key sectors, higher mark-ups, commodity-market speculators and the ongoing uncertainty of an evolving pandemic. In this situation, central banks cannot bring inflation down at a socially acceptable cost. Instead, supply-chain disruptions and labour shortages require appropriate industrial policies to increase the supply of key items in the medium term; this must be accompanied by sustained global policy coordination and (liquidity) support to help countries fund and manage these changes (TDR, 2022; Gallagher and Kozul-Wright, 2022).

In the meantime, policymakers should seriously consider alternative paths of action to lower inflation in socially desirable ways, including strategic price controls, better regulation to reduce speculative trades in key markets, targeted income support for vulnerable groups and debt relief.

If monetary tightening in the advanced economies continues over the coming year, however, a global recession is more likely, and, even if it is looser than the 1980s, it will almost unavoidably harm potential growth rate in the developing economies. The permanent damage to economic development in these countries will not only be substantial but will also leave the ambition to achieve a better world by 2030 dangling by the most precarious of threads.

3. Global stagflation redux: bad news on the doorstep

The decade following the GFC brought the global economy to its current precarious state. The period was characterized by low levels of capital formation, weak (and in many cases falling) productivity growth, stagnant wages and flagging aggregate demand. Since 2010, government budgets have been kept on a tight leash (TDR, 2021). Yet financial markets remained buoyant, as central banks maintained a loose monetary policy, with efforts to normalize their balance sheet proving ephemeral

and in some cases (as in the 2013 taper tantrum) counterproductive. Profits also remained high, with a large-firm bias, benefitting from weak regulatory oversight and a policy environment geared to lowering production costs, with wages in particular showing little sign of picking up even as unemployment dropped (chapter III).

In this high-profit-low-investment environment, financial engineering became an instrument of rent-seeking behaviour, particularly among larger international corporations. Thanks to their market power, they have often generated income from the manufacture of scarcity rather than the production of goods or delivery of services (TDR, 2017; 2018). The spread of such behaviour through knowledge monopolies, mergers and acquisitions, government procurement contracts etc. has been accompanied by systematic tax avoidance, including the channelling of profits through offshore tax havens, the accompanying growth of illicit financial flows and the widespread use of leveraged buyouts and share buybacks. In many cases, this has led to a growing divergence between large cash-rich corporations and small cash-strapped firms and an accompanying trend towards more highly concentrated markets (Akcigit et al., 2021). These trends have locked in and in some cases exaggerated the high levels of inequality that had emerged prior to the GFC (TDR, 2017; 2018; 2021).

The scarring effects of these trends reflect what some observers have dubbed “super-hysteresis” whereby external shocks lead not only to a permanent loss of output due to recession but also to a permanent reduction in the potential growth rate because the decline in capital formation (and in aggregate demand) lowers labour productivity growth. In many developing countries, this threat has been amplified by a process of stalled industrialization (and in some cases, premature deindustrialization) rooted in the rapid liberalization of both the capital and current accounts under structural adjustment programs in the 1980s and 1990s, which has led, in turn, to an even greater dependence on commodity exports as a source of foreign exchange.

As noted in previous Reports, the slowdown in growth in the second half of the decade did little to dampen the irrational exuberance in financial markets, further stretching the balance sheets of both firms and households and creating new sources of fragility. This decoupling of finance and the real economy was particularly evident in developing and emerging economies, as capital inflows from advanced countries intensified after a sudden stop in 2013, driven by a search for higher yields. By the end of the decade, on a wide variety of measures of debt sustainability, there were clear signs of growing trouble ahead, unless growth picked up sharply or significant debt relief could be agreed upon (TDR, 2019). Neither happened with the onset of Covid. At the end of 2015, the IMF classified 29 low-income (Poverty Reduction and Growth Trust (PRGT) eligible) countries as in high risk of, or already in, default; by 2019, there were 52, and in 2022, that figure had risen again to 59 (UNDESA, 2022).

The Covid shock in March 2020 was quickly and predictably registered by sharp turmoil in financial markets, forcing the leading central banks to inject an unprecedented \$9 trillion into them by the end of the year, approximately nine times the amount injected between late 2008 and 2009. This included liquidity support to financial institutions, direct credit lines to corporations and in the case of the Fed, extended swap lines to select central banks in other countries, thus earning it, somewhat hyperbolically, the title of the global lender of last resort (chapter III). However, the Fed’s move steadied financial markets.

With Covid, governments were obliged to reassess their spending priorities, as the health and safety of their citizens took precedence over narrower economic goals. With a mixture of voluntary social distancing and mandated lockdowns – particularly in the developed world – in place, governments had little option but to put a floor under household spending through stimulus checks, enhanced unemployment benefits and housing support, and extend financial support to businesses through tax relief, loan guarantees and job retention schemes. As a result, government spending surged, largely through increased transfers to households and businesses, albeit with considerable variation across countries, particularly between developed and developing countries, reflecting their differing fiscal space and sovereign debt issuing capacities.

Despite their scale and the support extended to people in the most precarious economic situations, these programs had little redistributive impact, reflecting pre-existing inequalities and interests (Tooze, 2021). Even with historically low (and in many cases negative) interest rates and the willingness of central banks to assume private sector risks, investment, both public and private, remained subdued, further locking in the supply-side weaknesses that had emerged during the previous decade. Moreover, as central bank support triggered a surge in stock markets, the boom was skewed towards larger firms in select sectors, notably high-tech and pharmaceuticals, whereas many in the old economy remained in difficulty, further propelling the polarization of the previous decade (TDR, 2022).

In this sense, today's combination of slowing growth and rising prices is rooted in the constraints and contradictions of the financialized capitalism of our times, which are quite unlike those of 1970s managed capitalism. The policy agenda needs to respond accordingly, beginning with a much more pragmatic approach to bringing down inflationary pressures.

B. GROWTH PROSPECTS THROUGH THE FOG OF WAR AND INFLATION

Two and a half years after the Covid shock, with many parts of the world economy still fighting the pandemic, a new round of shocks has complicated the policy landscape. The V-shaped Covid shock and recovery left many global supply chains disrupted, triggering wide inventory fluctuations and multiple production bottlenecks. In the first phase of the pandemic, the demand for goods soared, and the demand for services collapsed. Then, as countries eased their health-related restrictions on the economy, the demand for services recovered even as the demand for goods remained high. The two processes put upward pressure on both producer and consumer prices, even before the war in Ukraine, pushing inflation in advanced economies above established monetary targets and in many emerging and developing economies to a level not seen since the first Gulf War in the early 1990s.

Even though the risk of another mutation of the virus cannot be discarded, combatting inflation has pushed public health down the economic policy priority list, particularly in advanced economies. The increase in inflation sparked a debate about whether the Covid stimulus policies were too expansionary in some countries, especially in the United States, or whether the problem was the inevitable consequence of an ongoing adaptation to a new post-pandemic production and consumption structure. In the end, the response has been driven more by policy routine and political expediency than measured assessment.

Starting in mid-2021, the inflationary pressure led some countries to begin tightening monetary policy to fight the secondary effects of the unbalanced recovery (box 2.2). Monetary tightening gained momentum in the beginning of 2022, when the start of the war in Ukraine triggered another adverse global supply shock. Fuel and food prices, which were already rising, shot up further. For oil, this was clearly the consequence of speculative trades, as the price increases far outpaced any changes in supply and consumption. Supplies of some key grains and fertilizers were disrupted, and consumer prices accelerated everywhere (chapter II). As of mid-2022, even previously low-inflation economies were facing inflationary pressures, dangerously close to double digits, which, in the absence of other policy measures, forced their central banks to raise short-term interest rates, at a pace not experienced in decades.

In the second half of 2022, higher short-term interest rates and the end of any remaining Covid-related fiscal and financial stimuli are expected to further constrain income growth across much of the global economy, leading to a “growth recession” – conventionally defined as annual global output growth below 3 per cent at both market and purchasing-power-parity prices. This echoes what happened

after the GFC, when many countries were quick to adopt austerity budgets, dampening the budding economic recovery. But unlike then, today's situation is led by monetary tightening, with the threat, against a backdrop of higher debt levels and inequality, of greater macroeconomic volatility and more country heterogeneity (making the consequences of the Fed's rate increases vastly different from country to country). Compared to early 2021, when the economic policy debate revolved around a shared ambitious policy agenda of inclusive recovery and the building of resilience to future shocks, the prospect of coordinated policy programs that would make the global economy fairer and more sustainable has dimmed. With the partial exception of the United States, plans for the energy transition have been largely put on hold, while countries scramble to increase supplies of coal, oil and gas in order to contain fuel and electricity prices, especially in Europe. High food price inflation and exchange-rate volatility have undermined the livelihoods of millions of people, especially in low- and middle-income countries, upending any plans to tackle high levels of inequality. Many liquidity-constrained economies are now allocating their limited fiscal space to emergency price subsidies, sacrificing public investment in infrastructure and welfare programs, while advanced economies are once more warning of a fiscal cliff and raising the spurious claim of the expansionary effects of austerity (chapter III). Finally, the war in Ukraine and the growing United States-China rivalry are pushing the world towards a conflictual multipolar configuration, diminishing the hope, at least for the moment, of a more cooperative global order.

These policy trends notwithstanding, a path to overcome the current economic setbacks and achieve the SDGs is still available. It requires simultaneously dealing with the urgency of the cost-of-living crisis and the necessity of advancing structural transformation towards a greener economy, while addressing a deteriorating growth outlook by boosting productive investment and expanding redistributive measures to bolster local markets and boost the confidence of firms and households. Elements for such a program are considered further in Section C below and in chapter III.

1. Global growth and inflation outlook

Based on the United Nations Global Policy Model, the world economy is expected to grow 2.5 per cent in 2022 (table 1.1). This is 1.0 percentage points below the rate projected for this year in the Trade and Development Report 2021 but broadly in line with our March update (TD R, 2022). The downward revision from last year derives from three factors:

I - The policy stimulus enacted in 2020 and 2021 proved less effective than expected. In particular, in the bounce-back from the recession, the fiscal and financial stimuli turned out to be smaller than expected (TDR, 2021: box 1.1), with a weaker impact on growth. This made the subsequent policy tightening (both fiscal and monetary) more recessionary than it would have been had the recovery been stronger.

II - The supply response of key goods and commodities was insufficient to match the post-lockdown demand surge. This outcome is unsurprising; many governments were reluctant to boost public investment and employ an active industrial policy, thus leading to a situation where the “policy tapering” underway (to liquidate excess central bank assets) was compounded by the interest rate hikes meant to counter inflationary pressures.

III - Unexpected headwinds coming from the war in Ukraine brought down growth in the Russian Federation and Ukraine and also triggered a swing in commodity prices (mostly abated by now) and are now acting as an adverse supply shock in both advanced and developing economies.

The ongoing war in Ukraine and geopolitical tensions are adding to economic anxieties. The TDR update in March 2022 already factored in the possible consequences: energy and commodity shocks, trade disruptions, financial and exchange rate instability, inflationary pressures, forced migration and unstable remittance flows. Since most of these consequences have so far played out as anticipated, our projection is largely unchanged from 6 months ago. But this also serves as a reminder that the most critical problems faced by the global economy today predate the war in Ukraine.

Table 1.1. World output growth, 1991-2023 (annual percentage change)

Country groups	1991-1999 ^a	2000-2009 ^a	2009-2019 ^a	2015-2019 ^a	2019	2020	2021	2022 ^b	2023 ^b	Revisions for 2022 against TDR March	
										Reported March 2022	Revision for 2022
World	2.9	3.3	3.0	3.0	2.6	-3.4	5.8	2.5	2.2	2.6	-0.1
Africa	2.4	5.5	3.0	2.9	2.8	-2.6	5.1	2.7	2.4	1.8	+0.9
North Africa (incl. South Sudan)	3.0	5.2	1.6	3.8	3.1	-3.7	7.4	3.0	2.4	2.2	+0.8
South Africa	2.0	4.0	1.7	1.0	0.1	-6.3	4.9	1.4	1.3	1.1	+0.3
Sub-Saharan Africa (excl. South Africa and South Sudan)	1.9	6.3	4.3	2.8	3.3	-1.0	3.7	2.8	2.6	1.8	+1.0
America	3.4	2.5	2.1	1.9	1.8	-4.3	5.8	2.1	1.0	2.4	-0.3
Latin America and the Caribbean	3.3	3.4	1.6	0.4	0.0	-7.2	6.6	2.6	1.1	2.3	+0.3
Central America (excl. Mexico) and Caribbean	2.9	4.4	3.4	3.1	2.3	-8.6	7.8	3.7	2.5	3.5	+0.2
Mexico	3.0	1.9	2.7	2.1	-0.2	-8.3	4.8	1.8	1.4	1.3	+0.6
South America	3.5	3.9	1.0	-0.5	-0.3	-6.6	7.0	2.7	0.7	2.4	+0.3
Argentina	4.6	3.8	0.9	-0.3	-2.0	-9.9	10.2	4.1	-0.8	4.6	-0.4
Brazil	2.9	3.6	0.7	-0.4	1.2	-3.9	4.6	1.8	0.6	1.3	+0.5
North America	3.4	2.3	2.2	2.3	2.3	-3.5	5.6	2.0	1.0	2.4	-0.4
Canada	2.8	2.3	2.1	2.0	1.9	-5.2	4.6	3.2	2.2	3.0	+0.2
United States	3.5	2.3	2.2	2.3	2.3	-3.4	5.7	1.9	0.9	2.4	-0.4
Asia (excl. Cyprus)	4.4	5.6	5.1	4.7	3.7	-1.1	6.2	3.5	4.1	3.8	-0.2
Central Asia	-4.4	8.2	5.1	3.9	3.5	-1.5	5.2	3.6	3.5	0.2	+3.5
East Asia	4.4	5.6	5.2	4.8	4.1	0.4	6.5	3.2	4.3	3.9	-0.7
China	11.0	10.6	7.5	6.7	6.0	2.3	8.1	3.9	5.3	4.8	-0.9
Japan	1.2	0.9	1.2	0.9	-0.2	-4.5	1.7	1.0	1.8	2.0	-1.0
Republic of Korea	6.8	4.9	3.1	2.9	2.2	-0.7	4.1	2.2	2.0	1.7	+0.5
South Asia	4.8	6.4	5.8	5.9	3.1	-4.5	6.8	4.9	4.1	4.0	+0.9
India	5.9	7.2	6.9	7.0	4.5	-6.6	8.2	5.7	4.7	4.6	+1.1
South-East Asia	5.3	5.4	5.1	4.9	4.3	-4.2	3.8	4.1	3.8	3.4	+0.7
Indonesia	4.8	5.2	5.3	5.0	5.0	-2.1	3.7	4.3	4.4	4.4	-0.1
Western Asia (excl. Cyprus)	4.0	5.0	4.0	2.7	1.5	-3.5	6.2	4.1	2.9	3.4	+0.8
Saudi Arabia	1.7	4.0	3.4	1.4	0.3	-4.1	3.2	6.6	3.9	4.8	+1.8
Türkiye	3.9	5.0	5.9	4.3	0.9	1.8	11.0	2.4	2.4	2.5	0.0
Europe (incl. Cyprus)	1.4	2.2	1.6	2.1	1.8	-5.9	5.5	1.2	0.5	0.9	+0.2
European Union (EU 27)	1.9	1.8	1.5	2.2	1.8	-5.9	5.4	2.0	0.6	1.6	+0.4
Euro area	1.9	1.6	1.3	2.0	1.6	-6.4	5.4	2.0	0.6	1.7	+0.3
France	1.8	1.6	1.3	1.7	1.8	-7.8	6.8	2.0	1.0	2.4	-0.4
Germany	1.6	1.0	1.8	1.8	1.1	-4.6	2.9	1.1	0.0	1.4	-0.3
Italy	1.5	0.7	0.1	1.1	0.5	-9.0	6.6	2.5	0.5	1.6	+0.9
Russian Federation	-5.9	6.2	1.6	1.2	2.2	-2.7	4.7	-7.4	1.3	-7.3	-0.1
United Kingdom	2.6	2.0	2.1	2.1	1.7	-9.3	7.4	2.6	-0.9	1.3	+1.3
Oceania	3.6	3.2	2.7	2.6	2.1	-2.2	4.8	3.6	2.1	3.0	+0.6
Australia	3.7	3.3	2.6	2.5	2.0	-2.1	4.8	3.9	2.3	3.3	+0.6
Memo items:											
Developed (M49, incl. Republic of Korea)	2.3	2.2	1.9	2.1	1.8	-4.5	5.2	1.7	1.0	1.8	-0.1
Developing (M49)	4.9	6.4	5.0	4.4	3.7	-1.7	6.8	3.7	3.9	3.7	0.0

Source: UNCTAD secretariat calculations, based on United Nations Global Policy Model; United Nations, Department of Economic and Social Affairs (UNDESA), National Accounts Main Aggregates database, and World Economic Situation and Prospects (WESP): Update as of mid-2022; ECLAC, 2022; Organisation for Economic Co-operation and Development (OECD), 2022; International Monetary Fund (IMF), World Economic Outlook, June 2022; Economist Intelligence Unit, EIU CountryData database; JP Morgan, Global Data Watch; and national sources.

Note: Calculations for country aggregate are based on GDP at constant 2015 dollars.

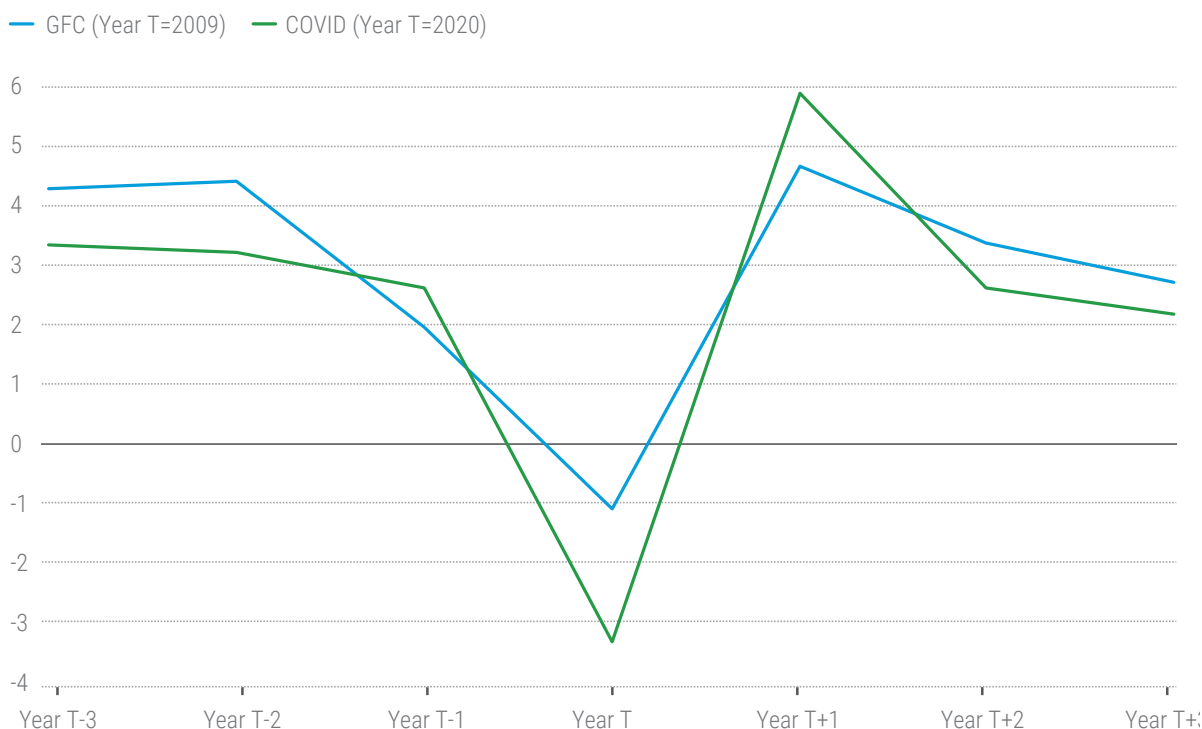
^a Average.

^b Forecasts.

Today's growth performance points to a troubling pattern observed in the post-GFC decade, in which the timing and size of policy responses were such that the recovery lost steam over time. UNCTAD assessment is that the trend is worsening, with growth expected to decelerate further in 2023, to 2.2 per cent.

The estimated 2.5 per cent growth in 2022 is less than half the growth rate of 5.6 in 2021, when economic activity resumed after the sharpest recession in living memory. Part of the growth deceleration this year was to be expected, as countries used up their idle capacity once vaccine programs were rolled out and lockdowns eased. A similar fluctuation happened after the GFC, with a strong recovery in the year immediately after the shock followed by a subsequent slowdown. The distinctive feature of the current episode is its exaggerated form. So far, the downswing and upswing have been wider in 2020 and 2021, respectively, than in 2009 and 2010, and the post-bounce-back deceleration is expected to be more abrupt in 2022-2023 than in 2011-2012 (figure 1.8).

Figure 1.8 Global growth cycles before and after the GFC and the Covid shock, global economy (percentage change)



Source: UNCTAD secretariat calculations based on the United Nations Global Policy Model

Further increases in global real interest rates are expected to reduce world output growth in 2023, compounded by political divisions that continue to block compensatory fiscal action in advanced Western economies and by foreign exchange constraints that do the same in many developing economies. UNCTAD expects the world economy to grow just 2.2 per cent in 2023, but with risks of a further drop if financial conditions deteriorate in leading economies and contagion hits emerging economies. If such a low-growth scenario persists for two or more years, world output will be on course for a slower expansion than after the GFC, itself substandard for many economies (table 1.1).

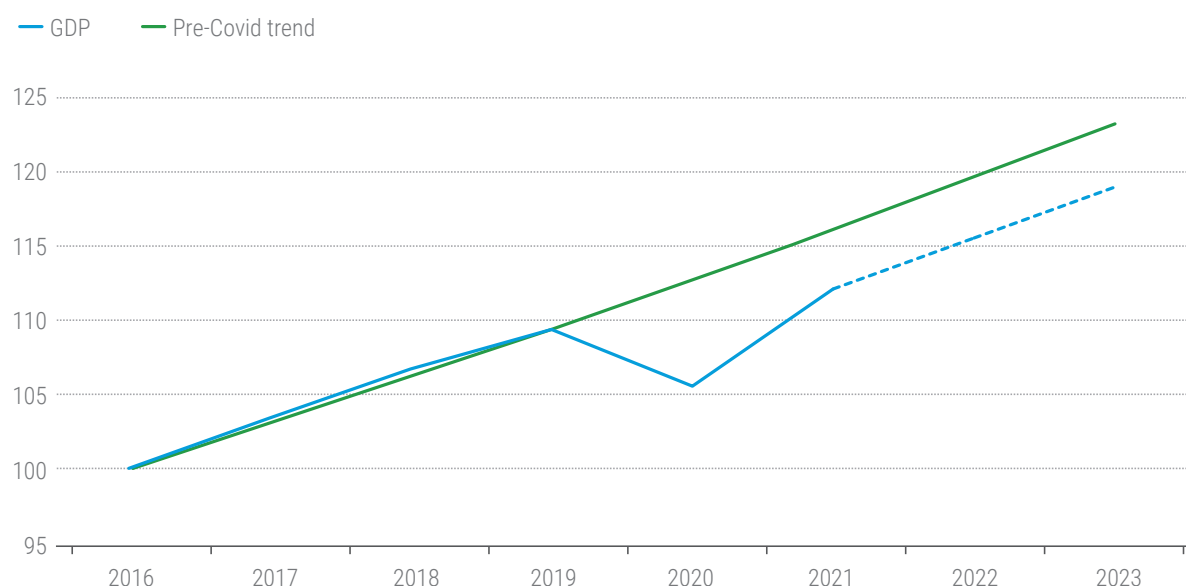
Our projections point to a worrisome trend whereby the slowdown in activity is unable to provide decent jobs, is inadequate to generate incomes to overcome inherited (and excessively large) debt

burdens, is too unstable to offer long-term prospects for economic development and is deepening the inequalities of income and wealth that had become entrenched even before the pandemic hit.

For developing economies, the deceleration is particular cause for alarm. Excluding China, the group is projected to grow 3.0 per cent this year, below the pre-Covid average of 3.5 per cent, and diminishing the room for rising per capita incomes. To put this into context, in the early 2000s, the last period of sustained progress for industrialization and development, the group grew at 5 per cent per year on average. China will slow down too, an estimated 4.2 percentage points less than 2021, although it is projected to continue growing faster than other countries, at almost 4 per cent in 2022, and to accelerate in 2023, one of the few countries expected to do so.

The current macroeconomic and financial conditions place developing economies in a vulnerable position, as they are exposed to ever more frequent shocks from commodity markets, capital flows, inflationary bursts, exchange rate instability and debt distress. Meanwhile, South-South trade has weakened, and friend-shoring, increased market concentration, reduced policy space and a North-centred climate policy weaken developing countries' position in global value chains.

Figure 1.9 Covid recovery compared to pre-Covid trend , 2016-2023 (index numbers, 2016=100)



Source: UNCTAD secretariat calculations based on the United Nations Global Policy Model.

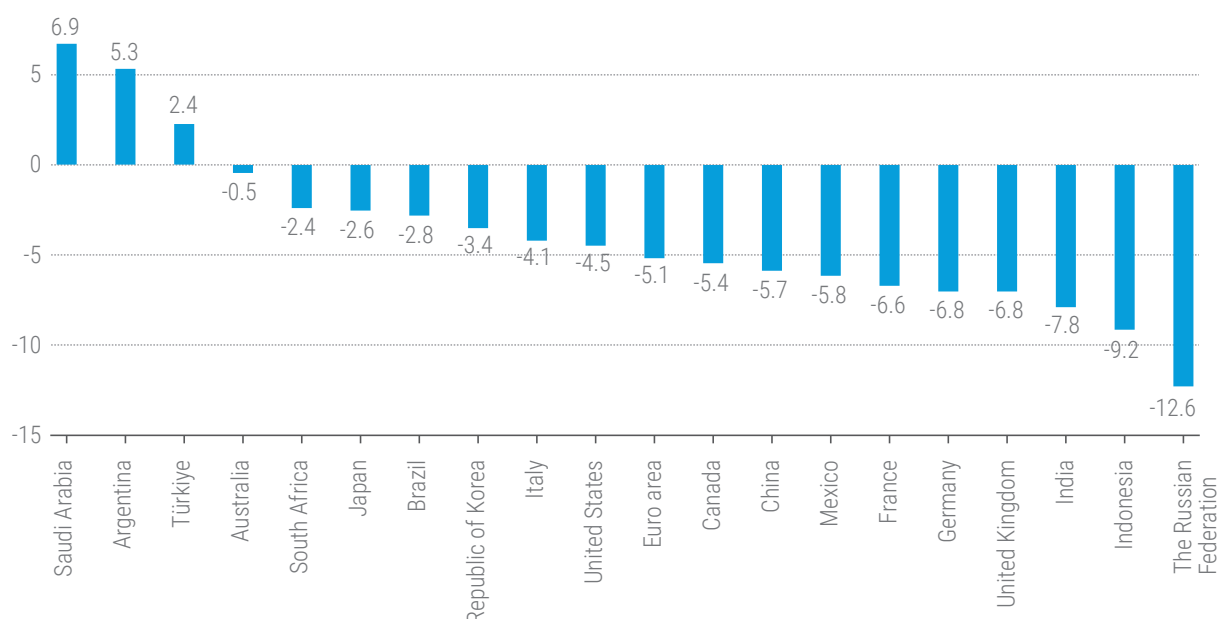
Developed economies are projected to grow 1.7 per cent in 2022 and 1.0 per cent in 2023. On average, this is 0.5 percentage points below the mean of the pre-Covid period and 0.9 per cent below the pre-GFC mean. The slowdown is particularly marked in the United Kingdom and the European Union, especially in France, Germany and Italy. As discussed in previous Reports and the section above, this is a reflection of policymakers relying excessively on monetary policy to manage the direction of the economy.

While the global increase in inflation has sparked concerns about economic overheating in some economies, in most G20 economies, real GDP is expected to be below its pre-Covid trend by the end of 2023. Projecting average 2016-2017 growth into the future, we argue the world economy will still be over 3 percentage points below its pre-Covid trend in 2023 (figure 1.9), with no sign of the gap closing any time soon.

Among the G20 economies, only Türkiye, Saudi Arabia and Argentina are expected to be above trend next year, for idiosyncratic reasons that are not clearly sustainable. In Türkiye, persistent inflation makes the current above-trend growth fragile. Some restrictive macroeconomic adjustment is expected in the short term. In Saudi Arabia, the quick recovery is linked to the fluctuation in the world oil market, which, in turn, reflects the increase in prices and Saudi output after the breakout of the war in Ukraine. And in Argentina, above-trend GDP is actually a reversion to the mean because the economy contracted 0.6 per cent per year in the three years before the pandemic. The rest of the G20 countries will continue their partial recovery in 2023, with the largest gap in the Russian Federation because of the lasting negative effects of the war on the Russian economy (figure 1.10).

UNCTAD slow growth projections for 2022-2023 are subject to caveats. Domestic political decisions and international coordination (or lack thereof) can make a difference for the better (or for the worse). Progressive and coordinated policy actions in the direction of the SDGs could still propel the world economy onto a sustainable and inclusive development path (chapter III).

Figure 1.10 Expected output gap in 2023 in G20 countries (percentage)



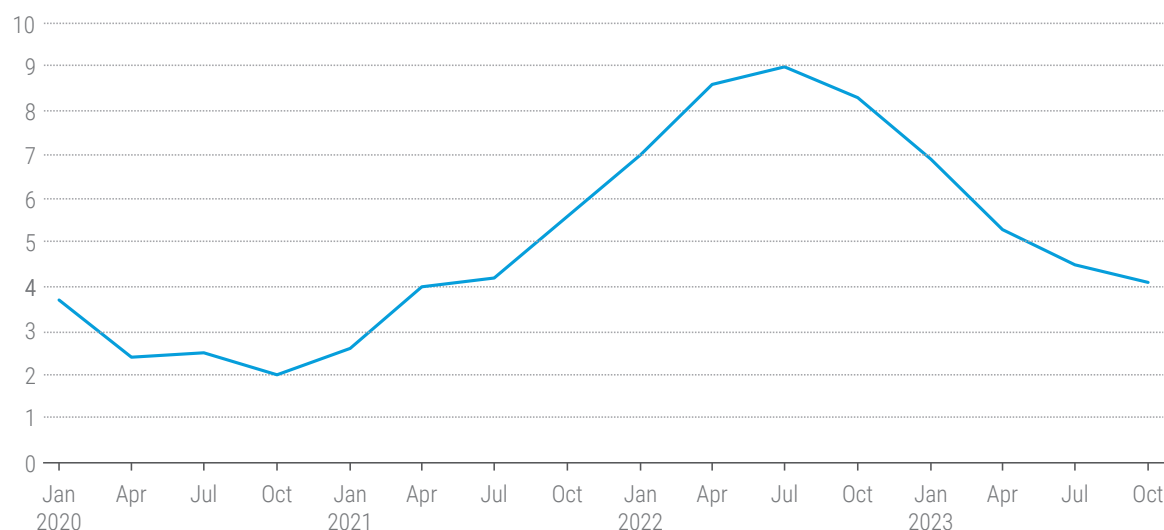
Source: UNCTAD secretariat calculations based on the United Nations Global Policy Model.

On the downside, a lasting war in Ukraine, persistently high inflation, a Volcker-like shock to real interest rates and heightened financial turbulence could push the world economy into a deeper recession, followed by a long stagnation, with macro-financial complications in many developing countries and some developed ones, especially in Europe, where the energy crisis is likely to bite hardest (Thompson, 2022) and the combination of currency union and fiscal disunion magnifies the risk premium paid by some governments in times of crisis.

UNCTAD slow growth prognosis for 2022-2023 is midway between optimistic soft-landing scenarios and pessimistic alternatives centred on deepening geo-political tensions and military escalation. As of mid-2022, assuming the war in Ukraine turns into a political and military stalemate, with a growing human toll but without further negative economic impact on the rest of the world, we expect inflation to fall in the second half of 2022 and the beginning of 2023. A recession in Europe and a sharper growth slowdown in the United States and China would pull commodity prices down faster and further reduce

inflationary pressures. At the same time, the appreciation of the dollar, driven by the interest rate hikes, may generate recessionary shocks in developing economies, further slowing down world output and prices in 2023. There is considerable contingency surrounding these trends. Still, according to the IMF, global annual consumer inflation will peak at 9 per cent, in the third quarter of 2022, and then fall rapidly to 4 per cent, by the end of 2023 (figure 1.11).

Figure 1.11 IMF global consumer inflation estimate and forecast, Jan 2020-Oct 2023 (percentage)



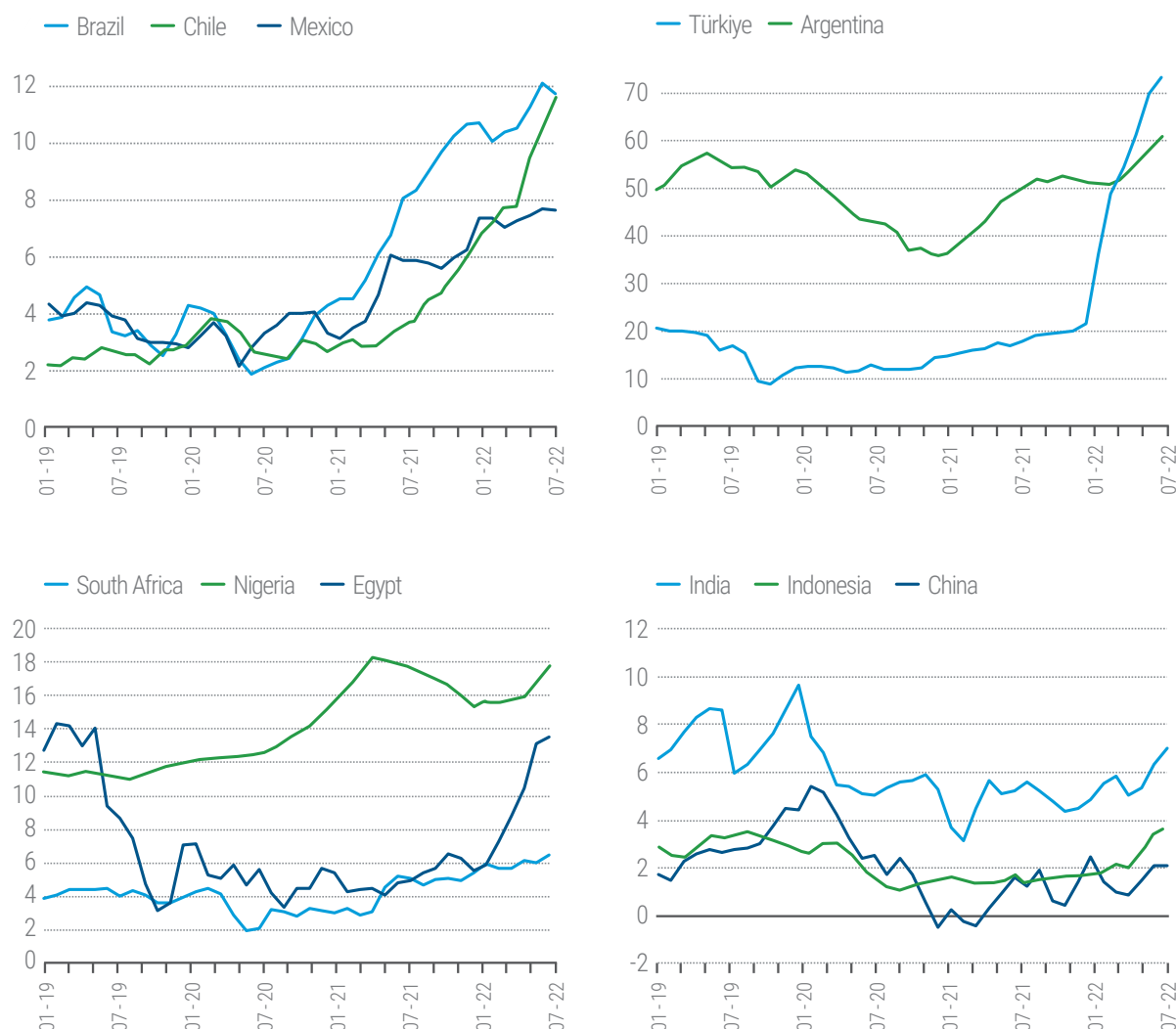
Source: IMF (2022) World Economic Outlook (July update).

Compared to the GFC, the Covid recovery has been relatively more inflationary for advanced economies than for developing countries, where inflation rates are structurally higher. In developed countries, inflation has been highly correlated (Schnabel, 2022). The rate of CPI inflation in the United States increased from 1.5 per cent in January 2019 to 8.5 per cent in May 2022; CPI inflation in the European Union rose from 1.4 per cent in January 2019 to 8.8 per cent in May 2022. In May 2022, the CPI inflation rates for Germany, France and the United Kingdom were 8.7 per cent, 5.8 per cent and 9 per cent, respectively, while Canada's inflation rate in May 2022 was 7.7 per cent.⁶ In all these cases, the main drivers of resurgent inflation turned out to be commodity prices and Covid-related bottlenecks in global supply chains (Schnabel, 2022). Accordingly, in these countries, inflation measures that exclude energy prices are considerably lower than the (headline) CPI inflation rate. However, while imported inflation is already subsiding, commodity prices remain high as does the index of supply chain pressure (chapter II), suggesting that there might still be room for consumer prices and nominal wages to keep climbing. In the European Union, where a large share of wages is set in multi-year contracts, nominal wage adjustments take longer to materialize than in the United States, where labour contracts have shorter duration.

Figure 1.12 shows the monthly CPI inflation rates (from January 2019 to May 2022) for selected developing countries. These were generally higher than in advanced countries, and with some notable exceptions, they increased earlier. The economies in the figure are all relatively large commodity importers: on average, commodities make up slightly less than one-third of their imports (in dollar terms) from 2018 to 2020.

⁶ There is, however, a wide variation among developed economies with inflation in Japan in July 2022 annualized at 2.6 per cent but close to 23 per cent in Estonia.

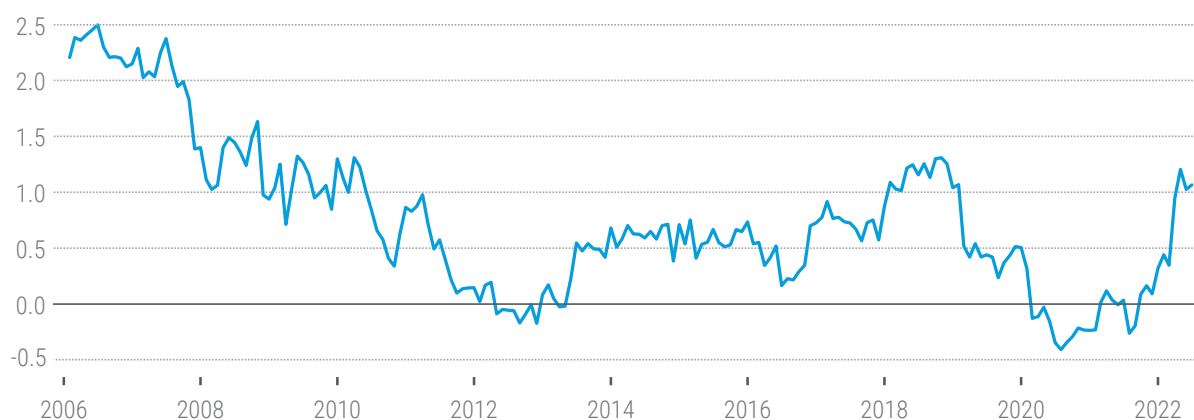
Figure 1.12 Consumer price inflation, major emerging economies, Jan. 2019 - May 2022 (percentage)



Sources: For Brazil, China, Chile, India, Indonesia, Mexico, South Africa and Türkiye: Federal Reserve Economic Data (FRED); for Argentina: World Bank (World Development Indicators database); for Nigeria: National Bureau of Statistics (Composite Consumer Price Index); for Egypt: Central Bank of Egypt (Inflation Data).

The share of commodities in China's and Egypt's imports is 38 per cent, and more than 50 per cent of India's imports are (primary) commodities including food and fuel. As a result, higher commodity prices have a strong impact on domestic prices via imports. Recent estimates covering the past five decades suggest a 50 per cent increase in oil prices (approximately the increase in 2021) is associated with an increase in inflation of between 3.5 and 4.4 percentage points, with a lag of about two years (Choi et al., 2018; Ha et al., 2019). These findings suggest that in emerging economies, as in advanced economies, a considerable part of the inflation experienced in 2021-2022 has been caused by higher commodity (oil) prices.

There is a possible silver lining to the past year of high inflation: it has pushed real interest rates, at least for advanced economies, deep into negative territory (figure 1.13). As a result, if nominal interest rates do not climb too much, the net cost of public debt (the real interest rate minus the GDP growth rate) may continue to be negative or zero after the disinflation process, assuaging concerns about sovereign debt and providing more room for expenditure plans, including for the energy transition.

Figure 1.13 10-year real interest rate in the United States, 2006-2022 (percentage)

Source: Federal Reserve Bank of St. Louis

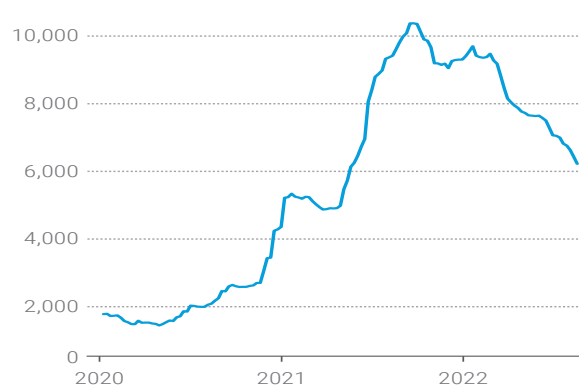
2. Multiple adverse supply shocks

As pointed out in TDR 2021, the Covid pandemic led to a sudden stop and a gradual reopening of the world economy, causing serious disruption to global supply chains, trade logistics and key international prices. The first part of the shock was clearly deflationary, especially for urban services, with a combined fall in demand and supply. Then, as the economy started to adapt to health-mandated lockdowns, the demand for goods recovered, creating supply and logistical bottlenecks around the world which registered as price swings. Two key price indices, one for semiconductors (figure 1.14) and the other for freight (figure 1.15), illustrate the point.

The increase in world inflation has also been driven by a deep V-shaped fluctuation in commodity prices, as discussed in chapter II. For the moment, it suffices to say that the first impact of Covid was deflationary for food, fuel and mineral commodities, but this phase did not last long. After a 30 per cent fall between December 2019 and April 2020, the IMF world commodity index climbed almost uninterruptedly until the beginning of 2022, with a cumulative increase of 187 per cent (figure 1.16), driven by three main forces. First, the post-Covid boom for consumer goods and construction materials was commodity intensive.

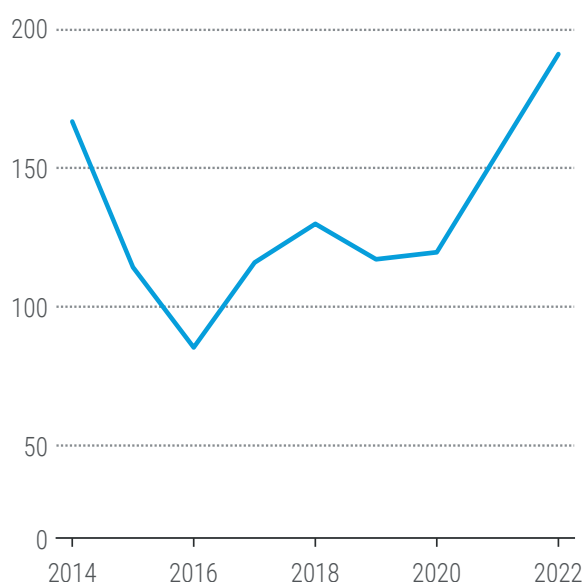
Figure 1.14 United States producers' price index for semiconductors and other electronic components (index numbers, 1984=100)

Source: Federal Reserve Bank of St. Louis.

Figure 1.15 Drewry world container index (DWCI) freight cost (dollars per 40 feet)

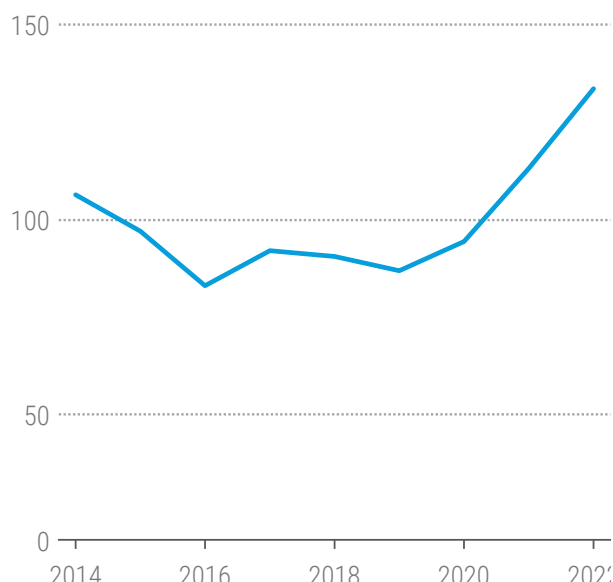
Source: Drewry Supply Chain Advisors

Figure 1.16 Commodity price index, 2014 to 2022 (April) (index numbers, 2016=100)



Source: IMF Primary Commodity Prices dataset.

Figure 1.17 Commodity food price index, 2014 to 2022 (index numbers, 2016=100)



Source: IMF Primary Commodity Prices dataset.

Second, the initial reduction in global nominal interest rates to fight the Covid recession created an incentive to speculate with any financial assets, including commodities. The quantitative easing of 2020 and 2021 led to more speculation and inflation in asset markets, from crypto currencies to oil, food and minerals. Third, the war in Ukraine pushed fuel and food prices further up in early 2022, initially in a context of low global interest rates.

As of mid-2022, the monetary tightening in the United States and the deceleration in world output seem to have stopped the global inflationary trend in commodities. There is still much uncertainty surrounding the consequences of the war in Ukraine for food and fuel prices, but with high interest rates and slower demand growth, the most probable scenario for 2023 is a further, if more gradual, fall in commodity prices. However, because the starting point of the disinflationary trend is very high, the relative prices of commodities in terms of world per-capita income will continue to be high in the short term. In fact, despite its recent fall, in June 2022, the commodity food price index was still 64 per cent above its pre-Covid value (figure 1.17).

Food price inflation poses significant challenges for households in developing economies, as they spend a larger share of their income on food. Higher food prices imply sharp decreases in real incomes for the majority of low-income workers, whose wages do not increase with inflation, and may push millions into poverty. Higher food prices alone are estimated to be pushing an additional 75 million to 95 million people into extreme poverty in 2022, compared to pre-pandemic trends (Gerszon Mahler et al., 2022). Energy inflation may be even more detrimental with Oxfam (2022) warning that higher food and energy prices and persistent crisis conditions may raise the number of people living in extreme poverty by 263 million in 2022.

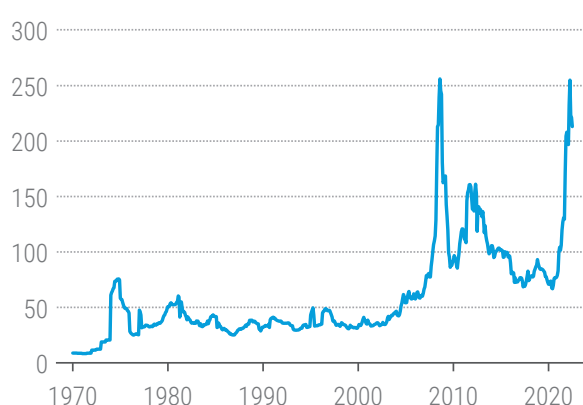
Higher food prices also force households in the emerging economies to lower their spending on non-food items; hence, demand for manufactured goods and services will go down. The result will be a slowdown of growth in non-primary sectors, if not a recession, and the stagflation may well trigger

social unrest and food riots, especially in foreign-exchange-constrained countries that are net food importers.

In theory, high relative prices stimulate investment today and more output tomorrow, so the current increase in food prices should be attenuated in 2023. In practice, because of the long-term effects of global warming and the short-term implication of high fertilizer prices for the next harvest cycle (figure 1.18), the normalization of the world food market is far from taken-for-granted, with the situation in sub-Saharan Africa of particular concern. On top of the uncertain post-Covid adaptation of world food supply to demand, the war in Ukraine has created an adverse supply shock for wheat and fertilizers, pushing some countries to restrict their exports of the two products. In the absence of global coordination, the localized war in Eastern Europe can lead to trade wars in the global food market.

The war in Ukraine and the economic sanctions against the Russian Federation have also caused a major shock in Europe, with a record increase in electricity and fuel prices in 2022 and the risk of rationing later in the year (figure 1.19).

Figure 1.18 Fertilizer price index, January 1970-June 2022 (index numbers, 2010=100)



Source: World Bank Commodity Price data (The Pink Sheet).

Figure 1.19 Energy prices in the euro area, 2014-2022 (index numbers, 2015=100)



Source: FRED database.

Note: Data refer to the monthly Harmonized Index of Consumer Prices: Energy for the euro area (19 countries), which is not seasonally adjusted.

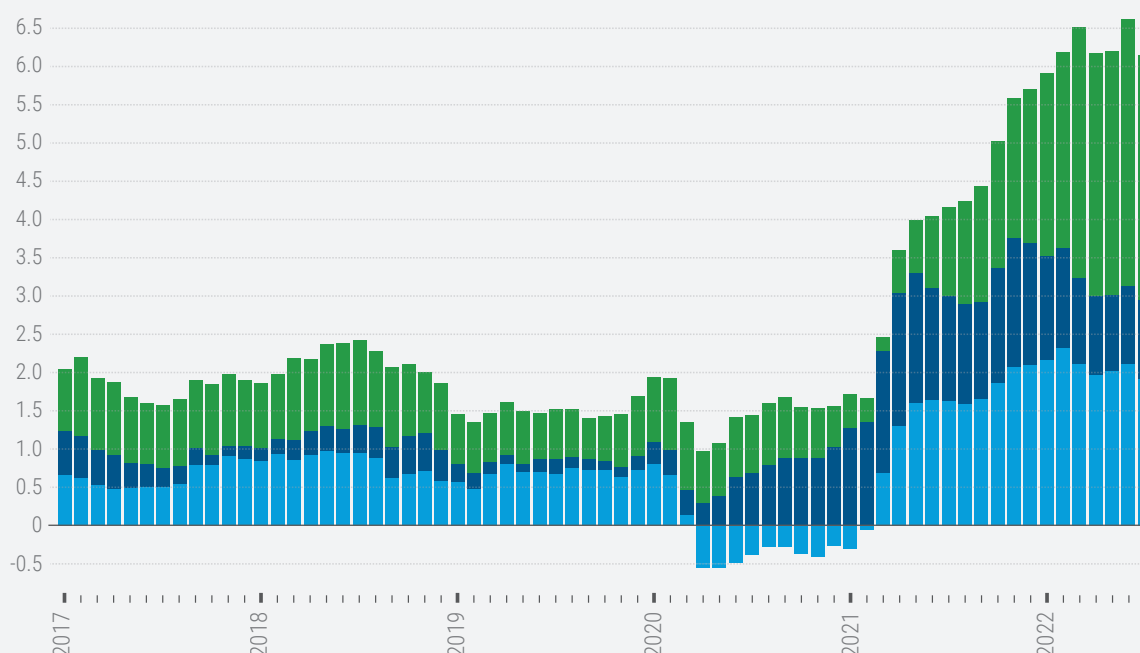
Box 1.2 Demand-driven and supply-driven inflation in the United States

In a recent analysis, the United States Federal Reserve Bank of San Francisco (Shapiro, 2022) decomposed consumer price inflation into demand-driven, supply-driven and ambiguous components. Demand-driven products are those for which unexpected changes in price and quantity happen in the same direction. By analogy, supply-driven products are those for which unexpected changes in price and quantity go in opposite directions. Whatever does not fall in one of the two categories is labelled ambiguous, that is, a result of both supply and demand forces. Figure 1B2.1 shows the results for the United States personal consumption expenditure (PCE) and can be summarized as follows:

- The first impact of Covid was a negative (disinflationary) demand shock. The supply component also fell in early 2020, but it remained positive (inflationary).

- The demand-driven component of the United States PCE inflation turned positive in early 2021; as of mid-2022, it was at running 2 per cent per year, the country's long-term inflation target and twice its value before Covid.
- Despite the recent surge in United States demand-driven inflation, supply shocks continue to be the main determinant of United States consumer prices, accounting for more than 50 per cent of the 6.1 per cent PCE annual inflation rate registered in June 2022. This raises concerns about an inflation response based on interest rate increases, which are mainly effective on demand factors while having serious consequences for developing countries.

Figure 1B2.1 Decomposition of United States consumer inflation, measured by personal consumer expenditures (PCE), January 2017-July 2022 (percentage)



Source: Federal Reserve of San Francisco.

Note: Data refer to year-over-year changes in headline PCE inflation

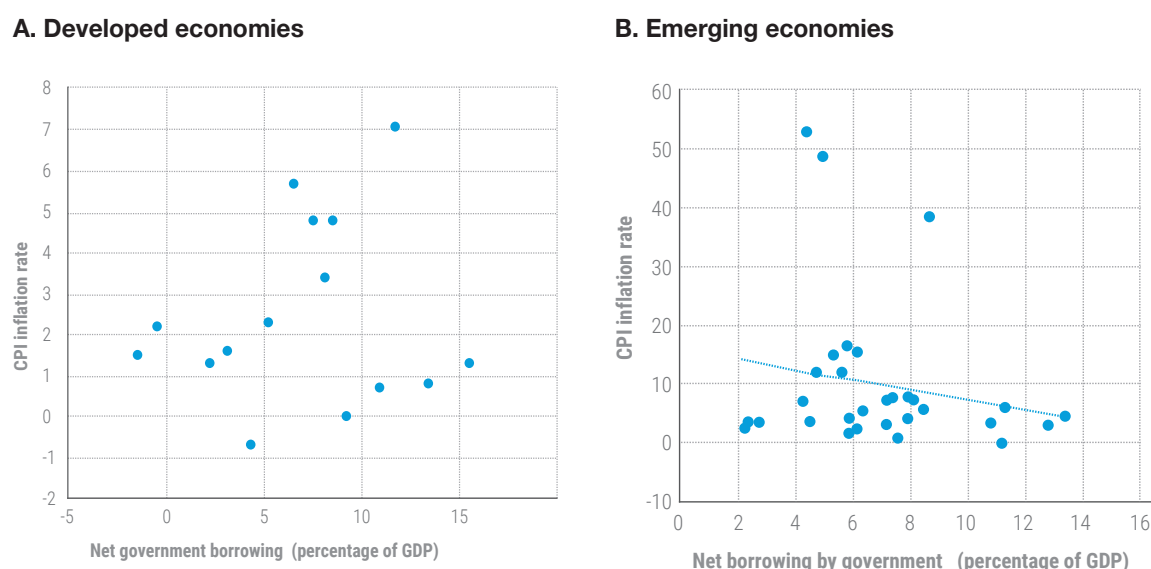
3. Localized demand pressures

Differences in the magnitude of fiscal responses to the Covid crisis do not show up in differences in CPI inflation rates. Figure 1.20.A plots net borrowing by the government (as a percentage of GDP) against the CPI inflation rate during the years 2019-2021 for leading developed economies. The correlation coefficient between net government lending and the CPI inflation rate is 0.14 and is not statistically significant.

Most concerns about overheating after Covid have been concentrated on the United States for three reasons. First, because of the initial deflationary impact of Covid and the increase in the average real earnings (due to massive job loss among low-wage workers), real wages in the United States spiked 6 per cent above trend in early 2020 and remained high throughout the year. Then, in 2021, as the economy recovered, and prices started to accelerate, real wages began to fall. The process is still under way but, as of mid-2022, the purchasing power of United States workers has already fallen 3 per cent below its pre-Covid trend (figure 1.21).

Second, the United States economy seems to have returned to full employment. The unemployment rate of the whole labour force was just 3.6 per cent in July 2022, basically the same as in February 2020 when many economists thought the United States labour market was overheating. Since the previous peak of unemployment happened at 4.5 per cent in early 2007, before the subprime crisis started to unravel, any number below 4 per cent is thought to harbour dangerous inflationary pressures. However, the employment-population ratio of prime-age workers (25 to 59 years) paints a different picture. As of mid-2022, the United States was still one percentage point below the ratio of early 2007 and was apparently turning downwards (figure 1.22), with the situation worse for those lacking a college degree.

Figure 1.20 Government borrowing and the consumer price index, selected developed and emerging economies, 2019–2021



Sources: UNCTAD secretariat calculations, based on Federal Reserve Economic Data (FRED) database; European Commission, Macro-economic database AMECO and Eurostat database; International Monetary Fund (IMF), World Economic Outlook, October 2021; World Bank, World Development Indicators DataBank; and national sources.

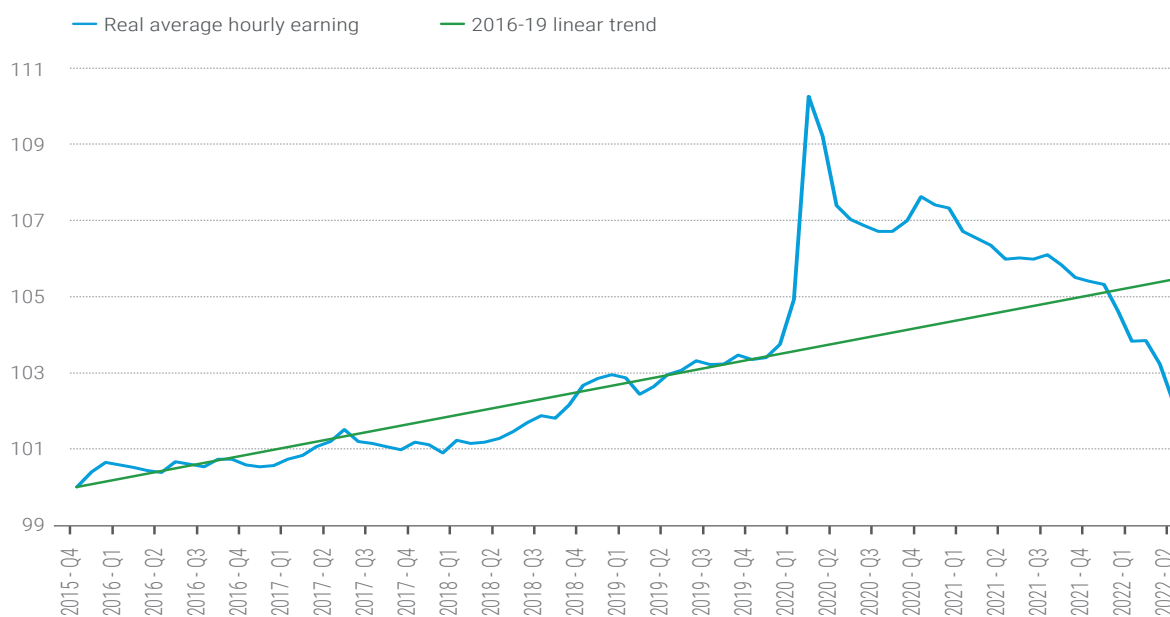
Note: Dots represent observations for each country-year. Selected developed economies are Canada, France, Germany, United Kingdom, United States. Selected emerging economies are Argentina, Brazil, Chile, China, Egypt, India, Indonesia, Mexico, Nigeria, South Africa and Türkiye.

Third, United States consumer demand for durable and non-durable goods, as well as residential investment, boomed after the Covid shock, but demand for services has yet to return to its pre-pandemic trend (figure 1.23). In other words, there seems to have been a change in the composition of household spending; this has caused production bottlenecks and wide inventory fluctuations in the short run and will last until supply finally adjusts to effective demand. As of mid-2022, the sales of consumer goods seem to have stabilized at a high plateau, and residential investment is falling fast. Both changes will reduce further inflationary pressures in the United States, and, for 2023, the monetary tightening by the Fed, the looming increase in unemployment and the reduction in consumers' confidence levels are expected to eliminate any remaining demand pressure created by the Covid shock.

In the wake of the Covid-19 crisis, higher spending on social protection and lower revenues from taxation led to higher public budget deficits in some emerging economies. Government deficits in 2020 (2021) ranged from 4.5 per cent (4.2 per cent) of GDP in Mexico to 12.8 per cent (11.3 per cent) of GDP in India. The largest category of direct fiscal relief was cash transfers of various kinds; on average,

such transfers amount to 30 per cent of monthly GDP per capita, for an average of three months. Much like advanced economies, the differences in the magnitude of fiscal responses to the Covid crisis in emerging economies do not show up in differences in their CPI inflation rates (figure 1.20.B); The correlation coefficient between net government lending and the CPI inflation rate is -0.18 and not statistically significant.

Figure 1.21 Real wages, United States, 2015–2022 (index numbers, December 2015=100)



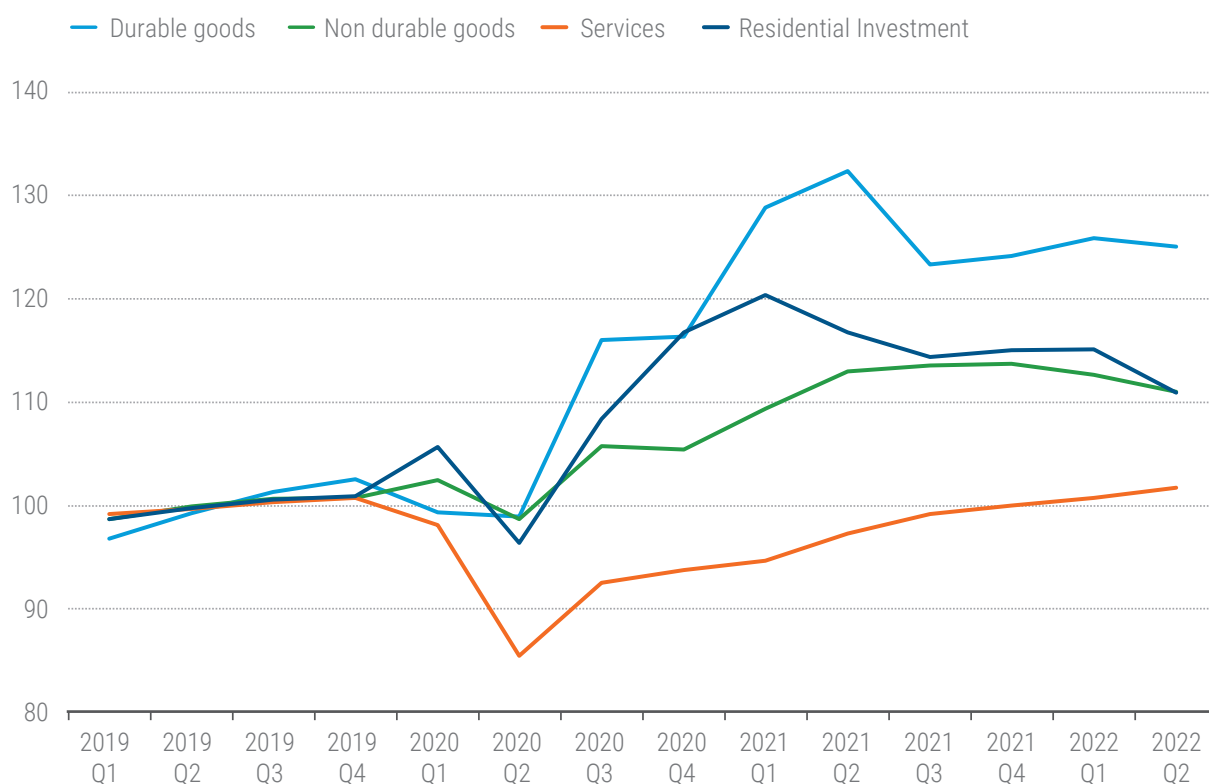
Source: United States Bureau of Labor Statistics

Figure 1.22 Employment/population ratio, United States, 2007–2022 (percentage)



Source: Bureau of Labor Statistics

Note: Age range is 25-54

Figure 1.23 United States private consumption and residential investment (index numbers, 2019=100)

Source: United States Bureau of Economic Analysis

4. Wages and markups

Even when the source of high inflation is on the supply side, mainstream economic theory recommends monetary tightening to stop the supply shocks from affecting workers' expectations and reinforcing higher wage claims, as these may create a destabilizing price-wage spiral. On a more practical level, policymakers hope that through speculation and financial carry costs, a high dollar interest rate puts negative pressure on international commodity prices and helps disinflation in the United States and elsewhere, but usually at a large social cost in terms of unemployment and foregone output, depending on the size of the tightening and the state of the economy.

To analyse the implications of the current monetary restriction we have therefore to check the state of economic activity, especially the labour market, which is usually done by comparing nominal wage growth to labour productivity. In fact, if unit labour costs (ULC) – measured by the ratio of the average wage to productivity – are rising significantly, the monetary tightening needs to be larger, to produce any effect on inflation, with significant damage caused to output growth and employment. Moreover, in normal times, with balanced growth, stable relative prices, and fixed markups, the difference between nominal wage growth and labour productivity growth should equal inflation. However, during crises and adjustment periods, changing relative prices and moving markups add other short-term determinants to inflation. When firms setting higher profit margins are, a source of higher prices, monetary restrictions are a particularly inefficient and unfair response.

Data from OECD on ULC show a common pattern during the Covid shock in 2020, but a divergent behaviour thereafter. More specifically, the first economic impact of the Covid crisis on most firms was to reduce their productivity, which in the face of a constant nominal wage, raised the ULC. Then, as

economies recovered, labour productivity moved up and the ULC moved down. This cyclical pattern emerged in the main OECD economies between early 2020 and early 2021, but then economies diverged (figure 1.24). In the United States, nominal wage growth outpaced labour productivity, pushing the ULC substantially up in late 2021 and early 2022 even as real wages declined. In the first quarter of 2022, the ULC was up 7.1 per cent. In contrast, in the European Union, at the beginning of 2022, annual growth rate of ULC was 2 per cent, in line with the region's long-term inflation target. In Japan, the ULC was practically stable in the beginning of 2020 (zero growth rate), also ruling out excessive demand pressures in the labour market. The most remarkable case is the United Kingdom, where the ULC growth rate shot up to double digits during the lockdown of 2020 and then collapsed to negative double digits during reopening. The United Kingdom ULC continued to fall in first half of 2022, with nominal wage growth almost 3 points below labour-productivity growth on an annual basis.

Figure 1.24 Unit labour cost per employed person (percentage change over respective quarter of previous year)

United States



Euro area (19 countries)



Japan



United Kingdom

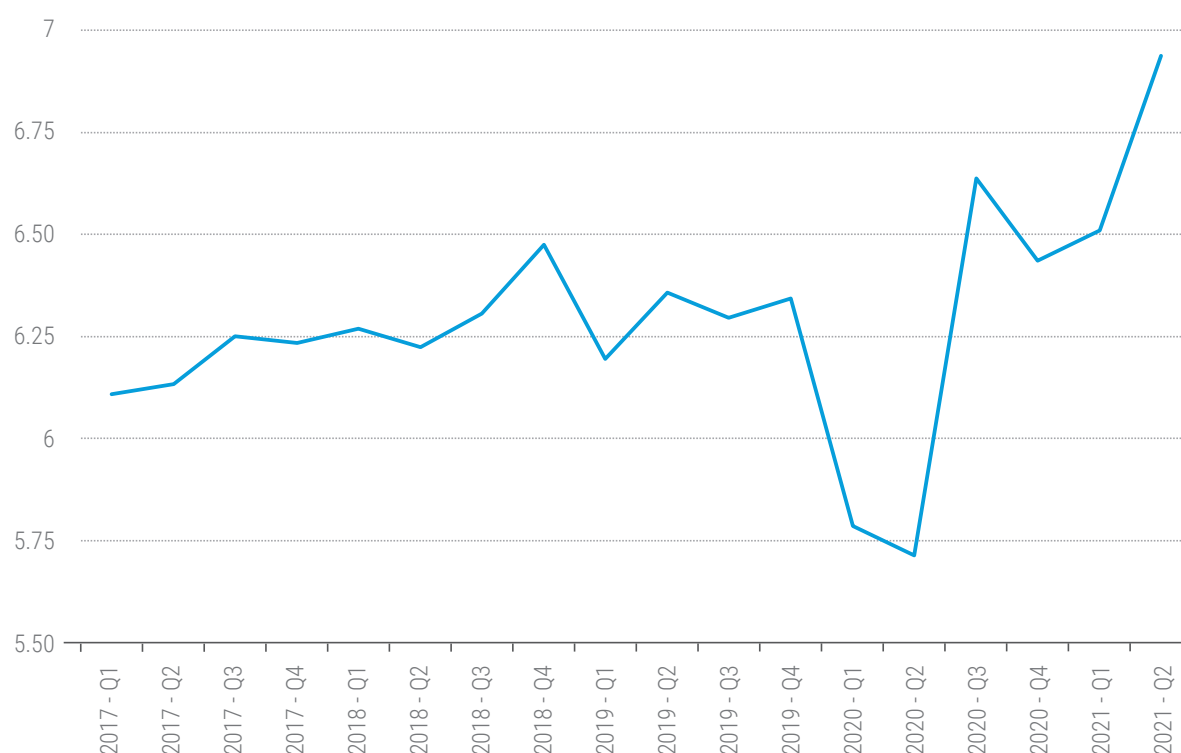


Source: Organisation for Economic Co-operation and Development.

Changes in ULC, however, do not automatically translate into price level variations. Their transmission depends on the firms' decision to set a markup over production costs. In theory, prices can still go up when the ULC goes down, provided firms are hiking their gross profit margins (EBITDA: earnings before interest, taxes, depreciation and amortization) faster than the ULC is falling. Using the ratio of corporate profits to gross production value (which includes intermediate consumption) as a proxy of the aggregate markup margin, the recent behaviour of the United States economy shows a fall during the first impact of the pandemic in early 2020, followed by a quick recovery in 2021. By mid-2022, the ratio of corporate profits to GDP was 7 per cent, against 6.25 per cent before the pandemic (figure 1.25). And between 2020 and 2022, an estimated 54 per cent of the average price increase in the United States non-financial sector was attributable to higher profit margins, compared to only 11 per cent in the previous 40 years (Bivens, 2022; Konczal and Lusiani, 2022). High wage costs and non-wage costs (for energy and fuel) cannot fully explain the recent price acceleration in the United States. Procyclical markups have been a major factor. In this context, competition policy and price controls have a critical role to play.

For most developing countries, data on non-wage costs and profit margins are patchy, but two factors suggest dynamics similar to those in the United States may be at play. First, labour shares have been falling overall in developing countries, pointing to a reduction of (real) unit labour costs (chapter III). Second, the factors that drove up profit margins in the pre-pandemic period (TDR, 2018) likely reappeared after the first Covid shock of 2020.

Figure 1.25 Aggregate markup, United States, 1st quarter 2017 - 2nd quarter of 2021 (percentage)



Source: UNCTAD secretariat calculations based on OECD data.

Note: Data refer to the ratio of corporate profits to gross production value.

C. OBSCURED BY MONETARY CLOUDS: TOWARDS A MORE SUSTAINABLE AGENDA

In the decade following the GFC, an opportunity was missed to put the world economy on a more stable, sustainable and inclusive growth path. Once the panic had been extinguished, the banking system propped up and growth somewhat restored, advanced country governments immediately began to cut spending, while central banks continued to prime financial markets with continued purchases of assets from private actors (quantitative easing). With this backing, non-bank financial institutions greatly expanded their portfolios (chapter III), while large corporations indulged in share buy backs and acquired rival companies. Yet weak capital formation, wage stagnation and unchecked wealth and income inequality held back a strong and inclusive recovery. Rising levels of indebtedness in developed and developing countries alike and across all sections of the economy kept economies ticking, although financial stress mounted, even before Covid struck.

The recent supply-driven rise in inflation has pushed many governments into a somewhat muddled strategy. The emphasis is on interest-rate hikes, tempered to varying degrees by tax breaks and subsidies and combined with a disjointed mixture of military build-up and cuts to social programs, in the hope that “cooling down” some parts of the economy will restrain wage growth and stop runaway prices. The promise is a soft landing in advanced economies and a return to pre-Covid normalcy (chapter III). In developing countries, fiscal consolidation looks less ambiguous: it will likely be more contractionary in hope of stabilizing financial markets, curbing capital outflows, halting devaluation and boosting investor confidence. All of this, as outlined in this chapter, comes with a good deal of wishful thinking.

While interest rate hikes can fight temporary inflationary pressures and help contain expectations, they also, as noted earlier, add to household and business costs (Deleidi and Levrero, 2020). In this sense, they will cause damage to the productive economy and increase exposure to future supply-side shocks, perpetuating the line of policy action that privileges financial markets over non-financial businesses. This is especially concerning as the current policy mix does not consistently include a strategy to eliminate production bottlenecks, raise investment rates, increase productivity and rebalance budgets in a progressive direction.

In theory, coordinated monetary action by the IMF and leading central banks can help reduce the risk of financial shocks and, if a shock does occur, limit contagion. But if recent history is any guide, the most probable scenario, particularly for developing countries, is one in which policy action is “too little, too late”, taken only after crises have erupted and with a strong bias to creditor interests.

The world is facing a systemic crisis and only systemic action can solve it. Focusing solely on a monetary policy approach – without addressing supply-side issues in trade, energy and food markets – to the cost-of-living crisis may indeed exacerbate it. Under current supply-chain challenges and rising uncertainty, where monetary policy alone cannot safely lower inflation, pragmatism will need to replace ideological conformity in guiding the next policy moves.

The challenge is complicated by the legacy of forty years of predominantly neoliberal economic policies in the main economies of the world that have left state capacity and international coordination in poor condition. Fortunately, institutions can adapt fast; a point confirmed by the initial response to the Covid-19 pandemic. With a focus on linking immediate macroeconomic policy challenges to boosting investment in the SDGs and drawing on suggestions made in past Reports, policy programs, appropriately tailored to local economic circumstances, should be built around the following elements:

I - Containing inflation (not cutting wages): Policymakers should avoid an undue reliance on monetary tightening and forswear a premature return to austerity budgets. The alternative to a damaging rise in interest rates to bring down inflation requires a pragmatic mix. First, while subsidies to ease the cost-of-living are important in the short term, price and markup controls are paramount, as they also allow for overdue increases in real wages. This requires a reinforcement of anti-trust measures and a reconsideration of regulation in specific markets (Box 1.3). As detailed in chapter III, these policies can be bolstered at a regional level, so that single countries are shielded from external constraints, such as exchange rate movements and capital flows.

II - Managing growth (not mismanaging booms and busts): Monetary and fiscal rules need to be better adapted, not just to respond to shocks, but also to support much-needed structural changes in the economy, such as industrialization in developing countries and the energy transition. Maintaining sustained job creation and industrial upgrading will require governments to have sufficient fiscal space for the necessary investments and ongoing support measures. Liquidity creation should always be allowed for development projects that guarantee, in the medium-long term, higher income and tax revenues (TDR, 2021: box 1.3). This will require not only rethinking the independence of central banks from any development and social goals but also considering, where appropriate, new regional arrangements (chapter VI).

III - Investment first (second and third): There needs to be higher public investment in economic and social infrastructure to boost employment, raise productivity, improve energy efficiency and reduce greenhouse-gas emissions, in an internationally coordinated effort around common global objectives. But crowding in private investment will also require taming financial institutions to make sure they serve the broader social good. Industrial policies will also be required to target desired sectors and guide investment, along with better capitalized public banks committed to lengthening the investment horizon of private businesses, including through the productive leveraging of reinvested profits.

IV - Levelling up: While anti-trust measures and incomes policies to boost productivity growth can help achieve more equitable distribution of income, redistributive policies can help mitigate unbalanced outcomes. These include the reinforcement of public service provisions and progressive tax reform, such as wealth and windfall taxes, together with a reduction of regressive tax cuts and loopholes. Clamping down on the use of tax havens by firms and high-wealth individuals will require legislative action at both national and international levels. Interim efforts in this direction could include a global financial register, recording the owners of financial assets throughout the world.

V - A new Bretton Woods: In an interdependent world, calling for greater ambition from domestic policymakers requires rethinking global economic governance from a development perspective. Almost eight decades on from the foundational conference in New Hampshire, the international financial architecture is struggling to address the imbalances and inequities of a hyperglobalized world order. A stable multilateral monetary and financial system will require more timely balance of payments and liquidity support, a swap facility open to all, a public credit rating facility and rules for managing sovereign debt crises. A bolder agenda to scale up public development finance will require an increase in base capital of multilateral financial institutions along with a reassessment of their lending headroom and priorities, combine with stronger price and quantity-based controls and incentives to ensure that complementary private finance flows towards productive transformation.

Box 1.3 Cereal killers: Cracking down on commodity market speculation

There is a good deal of evidence to suggest speculation is contributing to rising food and energy prices (chapter II). The financialization of commodity markets, linked to the creation of tradable commodity indexes by the big banks, was already visible with the commodity price boom and bust in the first decade of the new millennium. The details of these price movements have been examined in previous Reports; the conclusion was that the growing participation of financial investors in commodity trading for purely financial motives was a contributing factor to price rises (TDR, 2011: chap V). Today, there is strong evidence that the disconnect between financial speculation and commercial hedging is one important factor driving up energy, food and commodity prices.

While a balance between speculators and commercial hedgers is necessary for price discovery and sustained liquidity in regulated financial markets (ideally, this ratio is around 3 to 7), the participation of large financial institutions – investment banks, pension funds, sovereign wealth funds etc. – in commodity price bets has come to outstrip the role of commercial hedgers. Before 2002, the average composition of non-commercial speculators in the United States oil futures market was 20 per cent; in 2009, it rose to approximately 50 per cent. More recent estimates put it between 70 per cent and 80 per cent (Greenberger, 2018a). All the major oil companies, leading United States banks and private energy trading houses led by Vitol, Trafigura, Mercuria and Glencore are involved in speculative energy trading (Juhasz, 2022). The effect of the excessive speculation is overwhelming volatility in oil prices, often driving the price of a barrel of crude oil \$25 to \$30 above what market fundamentals dictate (Juhasz, 2022).⁷ Likewise, speculative activity by hedge funds, investment banks and pension funds has driven up wheat prices (box 2.3; Kornher et al., 2022). The resulting super profits enjoyed by these firms stand in sharp contrast to the economic hardship experienced by households in developed and developing countries alike, as the price of these basic necessities has spiked.

Without undermining the positive role financial instruments can play in boosting liquidity and reducing hedging costs in these markets, UNCTAD (TDR, 2011) proposed a series of market-level reforms that could help reduce the distortions and volatility such instruments can introduce.

These included:

- Greater transparency in physical markets through the provision of more timely and accurate information about commodities, such as spare capacity and global stock holdings for oil, and for agricultural commodities, such as areas under plantation, expected harvests, stocks and short-term demand forecast.
- A better flow of, and access to, information in commodity derivatives markets, especially with respect to position-taking by different categories of market participants.
- Tighter regulation of financial market participants, such as setting position limits, to reduce financial investors' impacts on commodity markets; for example, proprietary trading by financial institutions involved in hedging transactions of their clients could be prohibited because of conflicts of interest.
- Market surveillance authorities could be mandated to intervene directly in exchange trading on an occasional basis by buying or selling derivatives contracts with a view to averting price collapses or deflating price bubbles.

Progress on these fronts has been slow or has not advanced at all, leaving gaps and loopholes in the regulatory system (Greenberger, 2018b) and limiting the space for policymakers to reduce the incidence of commodity price volatility (Larsen, 2022). In the meantime, financial innovation and arbitrage strategies, especially those deployed in over-the-counter (OTC) deals with financial swap contracts, have made the conceptual distinction between commercial hedging and financial speculation more challenging (Chadwick, 2017).

⁷ Mention of any firm, product, service or licensed process does not imply endorsement or criticism by the United Nations.

In light of recent developments, revisiting earlier proposals and considering more radical regulatory steps would be timely. Even within the existing legislation, the Commodities Futures Trading Commission (CFTC) can discourage speculators by tightening position limits in energy futures markets to discourage speculative, market momentum-based speculators, for example, limiting the number of shares or derivative contracts that a trader or any affiliated group of traders and investors may own.

On top of introducing position limits, the CFTC should increase margin requirements, forcing a trader to hold larger capital reserves for a given number of positions, making it much more expensive to corner the market and gain from speculation. There also needs to be better oversight and control of clearing platforms, with a possibility of disallowing those types of transaction that point to excessive speculation.

An outright ban on commodity index funds and compulsory premarket government licensing of complex financial instruments (Chadwick, 2017) can be part of a strong regulatory toolset as well. These could shift the burden of proof concerning the social utility and risks posed by a given financial instrument onto those seeking to profit by its trade.

As previous experience shows, to be effective, these proposals need to be implemented systemically, in line with other institutional measures aimed to protect the most vulnerable parts of the world population from the crises driven by financial speculation, corporate arbitrage and market manipulation.

D. REGIONAL TRENDS

1. The Americas

The United States economy is decelerating. Growth will fall from 5.7 per cent in 2021 to 1.9 per cent in 2022, and then continue to slide, reaching 0.9 per cent in 2023. This deceleration is driven by three forces. First, the increase in real interest rates to reduce inflation is already slowing demand down, especially residential investment and consumer demand. Second, the phasing out of the American Rescue Plan's fiscal stimulus adds a negative impulse to United States demand. Third, the adjustment of asset prices to higher interest rates has imposed huge capital losses to United States firms and families, reducing private demand temporarily. Most of the growth deceleration will happen between mid-2022 and mid-2023, with a marginal recovery in late 2023.

Canada is expected to follow the United States fluctuation, but with a lower volatility because interest-rate-induced capital losses have a relatively lower effect on the Canadian economy.

Recessionary dynamics are also at play in Mexico for 2022-2023. Growth in 2022 is expected to reach 1.8 per cent, even though the recovery in 2021 was only half-way back, after the sharp recession of 2021. Part of the slowdown is due to economic policy, as the Mexican government refrained from adopting a large fiscal stimulus after the pandemic. For 2023, because of its close ties to the United States business and monetary cycle, Mexican GDP is expected to decelerate further, to a 1.4 per cent growth rate.

Similarly, after a brief recovery in 2021, the Brazilian economy is now at risk of an abrupt deceleration, reaching 1.8 per cent growth in 2022. Regardless of 2022 election results, there will probably be a negative fiscal impulse in 2023, which together with the lagged effects of monetary tightening, is expected to reduce GDP growth to just 0.6 per cent in 2023.

Argentina is also on the way to a growth recession. Even if the momentum from 2021 contributes to yield a robust 4.1 per cent growth in 2022, a sharp deceleration starting in the second half of the year will bring about an economic contraction of about 0.8 in 2023. In addition to the global headwinds created by higher international real interest rates, Argentina's turn-around reflects the recessionary impact of exchange-rate depreciation. The economy is at risk of entering a trap of high inflation and sharp falls in real income.

Chile and Colombia have comparatively more diversified economic structures. Their respective governments aim to shift economic policy towards social inclusion and employment generation, but the global monetary tightening and the balance of payments constraints on Latin American economies reduce their fiscal space.

Other economies of South America and of Central America and the Caribbean will, with some differences among them, follow the trend of the larger economies, with moderate growth this year and a deceleration in 2023.

2. European Union

France experienced two quarters of relatively strong growth, especially in agriculture and industrial sectors, but it is expected to slow down the second half of 2022, affected by the slowdown in global demand, the increase in interest rates that is already being felt on residential investment and the rising cost of energy. France is one of a few countries in the region whose electricity production relies more than 90 per cent on renewable sources and nuclear power; yet the increases in fuel prices have taken a visible toll on private demand for goods and services. France is projected to grow 2 per cent in 2022 and 1 per cent in 2023.

Germany relies more heavily on fossil fuels for electricity production, with 24 per cent of electricity deriving from coal and 18 from gas, for a total of approximately 44 per cent of electricity from fossil fuels. The energy crisis and possible rationing of gas are expected to take a toll on manufacturing activity, employment creation and, through rising costs, on households' real spending. Meanwhile, Germany's export sector, a long-time driver of growth, is expected to suffer from the slowdown of global demand in an environment of rising interest rates. The main drivers of Germany's growth in 2022 have been external demand and fiscal policy, while the private sector has been dramatically reducing its claims on real output. In 2022, growth is projected to reach 1.1 per cent. In 2023, with the fiscal stimulus thinning down, the economy is projected not to grow.

The Italian economy experienced a growth rebound in the second quarter of 2022 after a flat first quarter, mostly because of an increase in demand for services after the last Covid-related restrictions were lifted in March and the strong activity in construction, buoyed by state subsidies. Industrial production remains a positive factor but is expected to slow due to rising energy and component costs, as well as subdued global demand. The net external position has turned negative because of the price of energy imports. Overall, we expect Italy to grow 2.5 per cent in 2022 and 0.5 per cent in 2023.

Overall, the European Union is expected to slow down because of higher energy costs and subdued global demand, with Germany and Italy particularly exposed. Inflation has been highest in Germany and Spain, where incomes are still below pre-pandemic levels (-0.2 per cent from the last quarter of 2019 in Germany, -2.5 per cent in Spain). Various measures have been taken at the national level by member countries to cushion the impact of the rising cost of living, in some cases funded by windfall taxes on energy companies. While the disbursement of the Recovery and Resilience Facility fund continues, with €100 billion in loans and grants disbursed out of €723.8 billion, no European Union-wide provision to face the energy crisis has been announced.

3. The Russian Federation, Belarus, Ukraine

The strong rebound of the Russian economy in 2021 was short-lived. The full impact of the sanctions imposed on the country following its invasion of Ukraine in February 2022 is yet to become clear. While the effect of financial sanctions has already been registered, the impact of trade restrictions is expected to become more acute in late 2022, after companies exhaust the stocks of their imported inventories. The embargo on Russian oil imposed by the European Union which puts federal budget revenues under pressure is due to come into effect in late 2022.

Reflecting this uncertainty, estimates of the depth and duration of the Russian Federation recession in 2022-2023 vary. But despite continued state support of selected industries, redirection of exports away from Europe and other traditional markets, a decline of GDP in the order of 7 per cent is expected in 2022. More pessimistic readings, based on the absence of growth stimuli in an economy heavily dependent on imports in key sectors and where pre-war growth has been driven by consumer demand, see the recession continuing into 2023. UNCTAD expects that after the sharp contraction of 2022, the Russian economy may post a weak growth rate of 1.3 per cent in 2023.

The GDP of Belarus is expected to drop by about 4 per cent in 2022, as a consequence of the loss of export revenues due to sanctions and a breakdown in logistical chains. While reliance on Russian imports has helped to limit the effect of the crisis to individual sectors, IT and the external sector have weakened in 2022. In 2023, the Belarussian economy is likely to show a growth rate of no more than 1 per cent.

Ukraine, in addition to humanitarian losses, faces an estimated cost of \$10 billion per month for the war, approximately half of which is covered by external finance. Estimates of the ultimate economic costs of the war vary. While it is impossible to offer definitive estimates at a time of ongoing conflict, it is apparent that the resilience of the economy is waning.

4. The United Kingdom

The economy of the United Kingdom grew rapidly in 2021, by 7.4 per cent, but still not compensating for the contraction of 9.3 per cent with the Covid-19 shock. While the growth momentum continued into the first quarter of 2022 (with an annualized growth rate of 3 per cent), a series of headwinds, some resulting from Brexit and others from international conditions, are impacting the outlook. Gross fixed capital formation, virtually stagnant in real terms since 2017, remains subdued. External adversities stemming from sluggish global demand, exchange rate instability and yet unresolved Brexit shortcomings are contributing to current account challenges. The stimuli from government spending in response to the Covid shock started to weaken mid-2021, and all indications suggest fiscal tightening will become the norm. At the same time, consumer demand is weakening due to the cost-of-living crisis. Given these conditions, while the economy will exhibit an annual growth of 2.6 per cent in 2022 (on the heels of the inherited growth momentum), it is likely going to contract by 0.9 per cent in 2023.

5. East Asia

The East Asian region registered a strong recovery in 2021, but UNCTAD estimates a moderation in the growth rate in 2022. Our baseline scenario envisages an expansion of 3.2 per cent this year, compared to 6.5 per cent growth in 2021. A confluence of factors – including a significant increase in the prices of the region's imported commodities, as well as a softening in global demand for the region's exports and a tightening in international monetary conditions – is weighing on growth throughout the countries in East Asia. For 2023, we expect growth to pick up moderately to 4.3 per cent.

UNCTAD expects a significant deceleration in economic activity in China in 2022, from 8.1 per cent in 2021 to 3.9 per cent, mainly because of the protracted lockdowns. Continued uncertainty weighs on consumer spending, despite a loosening of credit conditions by the authorities. The property sector

is locked in an evolving financial crisis. While certain export industries have performed strongly (most notably the semiconductor industry), others are seeing slowing external sales as international demand weakens amidst growing inflationary pressures and monetary tightening.

State support has largely concentrated on the supply side of the Chinese economy. The government has relied on boosting infrastructure investment and providing support to businesses, along with some deregulation in the financial and real estate sectors. Monetary policy stimulus has been limited despite subdued domestic inflation. The authorities have reduced the 5-year loan prime rate for mortgage lending and directed banks to increase lending. While these sets of policy measures will help to buttress growth, they are not of the same scale as the stimulus measures applied in the last two years. We expect growth in 2023 to yield 5.3 per cent, falling slightly short of the authorities' annual target of 5.5 per cent.

In Japan, growth of GDP in 2021 was 1.7 per cent, after a negative 4.5 per cent in 2020. It is estimated that a relatively strong positive rate for the second quarter of 2022 will be followed by positive but faltering growth in the next quarters, leading to an annual growth of 1.0 per cent in 2022. The economy, which continues to rely on the growth of exports, is affected by the deceleration of growth in China and a more generalized slowdown of global trade and high prices for imported commodities. These factors together suggest Japan's GDP growth will reach 1.8 per cent in 2023, allowing the level of economic activity to surpass that of the peak of 2019 only towards the end of 2023.

In the Republic of Korea, growth is expected to slow following the robust bounce-back observed in 2021, at 4.0 per cent, when a dynamic export sector and continued fiscal and monetary support measures helped to propel economic activity. For 2022, we estimate a less dynamic expansion of 2.2 per cent. High household debt and increasing inflation are dampening consumption spending. With inflation mostly imported, the impact of monetary tightening on prices will likely be very limited. We expect growth to decelerate further in 2023 to 2.0 per cent, as weakening external demand impacts the export sector; in addition, more restrictive fiscal and monetary policies are expected to inhibit consumption and investment spending.

6. South-East Asia

South-East Asia registered a relatively anaemic growth of 3.8 per cent in 2021, far below the rate of expansion observed in recent years. For 2022, the economic performance of the region has so far been stronger, albeit uneven. UNCTAD estimates the region will grow by 4.1 per cent in 2022, yet growing inflationary pressures and a subsequent tightening of domestic monetary stances, along with more costly international financing conditions, will dampen activity. For 2023, we expect the region's growth rate to decelerate to 3.8 per cent in the context of sluggish growth of global trade and the expected effects of tightened domestic monetary policy, as the region's vulnerability to financial and exchange rate instability weighs on policymakers' minds.

UNCTAD expects the Indonesian economy to grow 4.3 per cent in 2022, after having registered a relatively weak recovery in 2021. The stronger growth performance in 2022 is largely a result of the lifting of Covid restrictions, favourable conditions for the export sector and the accommodative stance of the Central Bank. Yet the pronounced increase in domestic food and energy prices was met by the introduction of a temporary ban on the export of palm oil and increases in energy subsidies. For 2023, UNCTAD estimates 4.4 per cent growth, as the positive impact of continued high prices for Indonesia's commodity exports will be somewhat tempered by a more restrictive monetary stance, dampening the growth in activity.

In Malaysia, UNCTAD expects economic activity to pick up from 3.1 per cent in 2021 to 5.4 per cent this year. This is partly thanks to the use of increased fiscal revenues – from the country's commodity exports to cushion imported inflation and export bans on certain agricultural products. Tempering this broadly positive outlook is the country's vulnerability to tightening international financial conditions,

due to its relatively high levels of external debt. As a result, we expect growth to slow to 3.5 per cent in 2023, as more costly international financing conditions will only be partially offset by the continued favourable terms of trade for the country's commodity exports.

In Thailand, despite the expected expansion of 3.0 per cent in 2022, the recovery has been subdued. The over-reliance of the economy on the tourism sector continues to weigh on activity: the shortfall in tourism-related services exports, together with the increased cost of energy imports, has led to a deterioration in the current account balance precisely as external financing conditions become more costly. On the domestic front, increased inflationary pressures have proven detrimental to households' purchasing power and have only been partially countered by government subsidies. For 2023, we expect growth of 4.0 per cent largely thanks to tourism flows beginning to recover to their pre-pandemic levels.

UNCTAD expects a strong 6 per cent GDP growth in Viet Nam in 2022. The dynamism of manufacturing exports and services will drive the expansion, as international companies continue to start productive operations in the country. Although weakness in private consumption will temper growth, and energy and food prices will be high, we expect growth to remain robust in 2023, at about 6.5 per cent.

7. Western Asia

The Western Asian region will register a relatively strong growth rate of 4.1 per cent in 2022, substantially above pre-pandemic rates. Revenues from energy exports have been further boosted by significant increases in oil production volumes in line with the OPEC+ agreement's gradual relaxing of output restrictions. However, the higher import bill for both fuel and food products is putting a significant strain on the region's economies, and the situation is aggravated by the tightening of international financing conditions. Meanwhile, in the region's commodity-exporting countries, higher fiscal revenues from energy exports have endowed states with greater resources to provide relief to households from increased consumer prices, but in the region's commodity-importing countries, households are being squeezed, particularly by food prices, with very limited state support. We expect the region's growth to moderate in 2023 to 2.9 per cent, as a slowdown in international demand and increasingly tight monetary stances will temper the expansion in economic activity.

In Saudi Arabia, UNCTAD estimates growth of 6.6 per cent in 2022. The strong performance will be driven by the oil sector in line with the output increases contained in the OPEC+ agreement. For 2023, we expect growth to moderate but to remain robust at 3.9 per cent. Increased fiscal revenues from oil export earnings will continue to help finance the government's ambitious public investment plans, particularly for large-scale infrastructure projects. Continued tightening of monetary policy in 2023 to respond to United States policy will prove a drag on growth.

Türkiye, having registered an extraordinary growth of 11.0 per cent in 2021, is expected to decelerate abruptly in 2022 to 2.4 per cent. Weakening global demand and higher prices for imported commodities will cause a deterioration in the current account deficit; meanwhile, inflation topped 70 per cent by mid-2022, and this will dampen consumption growth. The sharp depreciation of the lira has added further upward pressure on prices and increased the costs of servicing the country's considerable foreign-currency denominated debt. For 2023, we expect growth to remain constant at 2.4 per cent, as a further softening of external demand, along with elevated prices for imported oil and gas, will continue to complicate growth prospects.

8. Central Asia

In the Central Asian region, UNCTAD expects growth of 3.6 per cent in 2022, as external demand will tend to weaken, but the rebuilding of European fossil energy stocks and elevated international oil prices will continue to benefit the region's energy exporters. A growth rate of 3.5 per cent is expected

for 2023, as fiscal support becomes more uncertain in a tight monetary environment and external demand weakens.

In Kazakhstan, growth returned and reached 4.0 per cent in 2021. Fossil energy exports contributed to narrowing the current account deficit, yet drought and higher global energy prices boosted inflation. Although inflation and continued monetary tightening will weigh negatively on economic activity, high energy exports and revenues are expected to bring GDP growth up to 2.7 per cent in 2022. In 2023, GDP growth is projected at 3.5 per cent.

9. South Asia

UNCTAD expects the South Asia region to expand at a pace of 4.9 per cent in 2022, as inflation increases on the back of high energy prices, exacerbating balance of payment constraints and forcing several governments (Bangladesh, Sri Lanka,) to restrict energy consumption. Moreover, the limited and delayed progress in relaxing vaccine-related intellectual property (IP) rights continues to leave the region vulnerable to future outbreaks. For 2023, UNCTAD expects the region's growth rate to decelerate slightly to 4.1 per cent.

India experienced an expansion of 8.2 per cent in 2021, the strongest among G20 countries. As supply chain disruptions eased, rising domestic demand turned the current account surplus into a deficit, and growth decelerated. The Production-Linked Incentive Scheme introduced by the government is incentivizing corporate investment, but rising import bills for fossil energy are deepening the trade deficit and eroding the import coverage capacity of foreign exchange reserves. As economic activity is hampered by higher financing cost and weaker public expenditures, GDP growth is projected to decelerate to 5.7 per cent in 2022. Going forward, the government has announced plans to increase capital expenditure, especially in the rail and road sector, but in a weakening global economy, policymakers will be under pressure to reduce fiscal imbalances, and this may lead to falling expenditures elsewhere. Under these conditions, the economy is expected to decelerate to 4.7 per cent growth in 2023.

10. Oceania

In Oceania, UNCTAD expects growth of 3.6 per cent in 2022, followed by 2.1 per cent in 2023. The region's performance is determined to a large degree by that of its largest economy, Australia, which accounts for over 80 per cent of the region's GDP. After rebounding 4.8 per cent in 2021, partly on the back of recovering external demand, the Australian economy further benefitted from spiking commodity prices in the first half of 2022. Like in many developed countries, the labour market appears tight, but inequality is high, and poverty is on the rise. In 2022, Australia is expected to grow by 3.9 per cent. Yet as longer-term challenges and new headwinds jointly erode domestic demand, and external demand slows, growth will moderate to 2.3 per cent in 2023.

11. Africa

Africa's economic activity is expected to expand by a moderate 2.7 per cent in 2022, following a rebound of 5.1 per cent in 2021. This reflects several new challenges, including high international food and fuel prices, financial shocks owing to the stronger-than-anticipated tightening of monetary policy in advanced economies and acute risks of food insecurity in many parts of the region. As a result, an additional 58 million non-poor Africans will fall into extreme poverty in 2022, adding to the 55 million Africans already been pushed into extreme poverty because of the pandemic (UNECA, 2022). In the context of a severe weakening of European and other trade partners, growth on the continent will continue decelerating, down to 2.4 per cent in 2023.

In Nigeria, the economy grew 3.1 per cent, year on year, in the first quarter of 2022, compared with 4.0 per cent in the fourth quarter of 2021. This marks the sixth consecutive quarter of economic

expansion, partly on the back of oil export revenues absorbed by the non-oil sector, including services and agriculture. In 2022, Nigeria's economy is expected to grow 2.9 per cent, as result of weak oil output caused by technical and security hurdles in a context of underinvestment.

In Egypt, domestic economic activity continued to expand relatively quickly in early 2022, driven by activity in tourism, non-petroleum manufacturing and trade. Yet the country made a request to the IMF for a new program in March 2022 when it came under new financial pressure. For the rest of the year, economic activity is expected to soften owing to the negative spillover of the war in Ukraine, leading to an annual growth forecast of 4.0 per cent.

In South Africa, growth in the first quarter of 2022 surprised on the upside, although a severe slowdown is expected in the second quarter, with flooding in the southeast of the country. While private investment has strengthened on the back of the recovery, public sector investment remains weak. Household spending has continued to expand but is likely to soften in the second half of the year, with higher inflation, lower asset prices and rising interest rates. Meanwhile, tourism, hospitality and construction should see stronger recovery as the year progresses. Other headwinds include subdued investment and business sentiment, elevated prices for food and key imported inputs, high indebtedness of the middle class and increased volatility of capital flows, which compound longer-term challenges, such as the high unemployment and inequality. As a consequence, the economy will show weak growth rates of 1.4 and 1.3 per cent in 2022 and 2023, respectively.

Ghana and Tunisia are in talks with the IMF for emergency loans. In late May 2022, the IMF and World Bank considered 16 low-income African countries to be at high risk of debt distress, while 7 countries – Chad, Republic of the Congo, Mozambique, São Tomé and Príncipe, Somalia, Sudan and Zimbabwe – were already in debt distress. Bright spots, such as Côte d'Ivoire and Rwanda, are expected to exhibit rapid growth in 2022. However, 33 African countries need external assistance for food, and acute food insecurity is likely to worsen in the next months in 18 of these economies.

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Chapter II

Trends in International Markets

A. INTRODUCTION

The extent to which the global economy is fragmenting and the consequences for its growth and stability are pressing questions for policymakers everywhere – and there are no clear answers. A discernible trend is the emergence of a rigid and fragile global economy after the global financial crisis (GFC). If this trend continues and becomes reinforcing, the damaging consequences for developing countries are likely to be significant.

The vulnerability of developing countries stems from the way the key international markets on which many depend have become both more concentrated and more volatile. This, as discussed in previous United Nations Conference on Trade and Development (UNCTAD) reports, is particularly true of financial markets, but the way innovative financial instruments, in the form of futures and options contracts, swaps, derivative instruments and so on, have allowed a handful of market speculators to influence the price of key commodities, such as food and energy, is clearly apparent in the current context. The vulnerability of developing countries is exacerbated by the lack of global safety nets to cushion the blow and repair the damage from unexpected shocks, such as the Covid-19 pandemic, and by the lack of policy coordination to ensure their vulnerabilities are taken into account when systemically important countries are pursuing their own policy agendas.

Given the unfavourable direction of the global economy outlined in the previous chapter, an immediate concern is the dangerous level of debt distress facing a growing number of developing countries. This is discussed in the next section. Section C explains how the breakdown of supply chains is raising wider concerns about the strength and direction of trade flows, whilst section D turns to the financialization of commodity markets.

B. GLOBAL FINANCIAL CONDITIONS AND DEVELOPING COUNTRY VULNERABILITIES

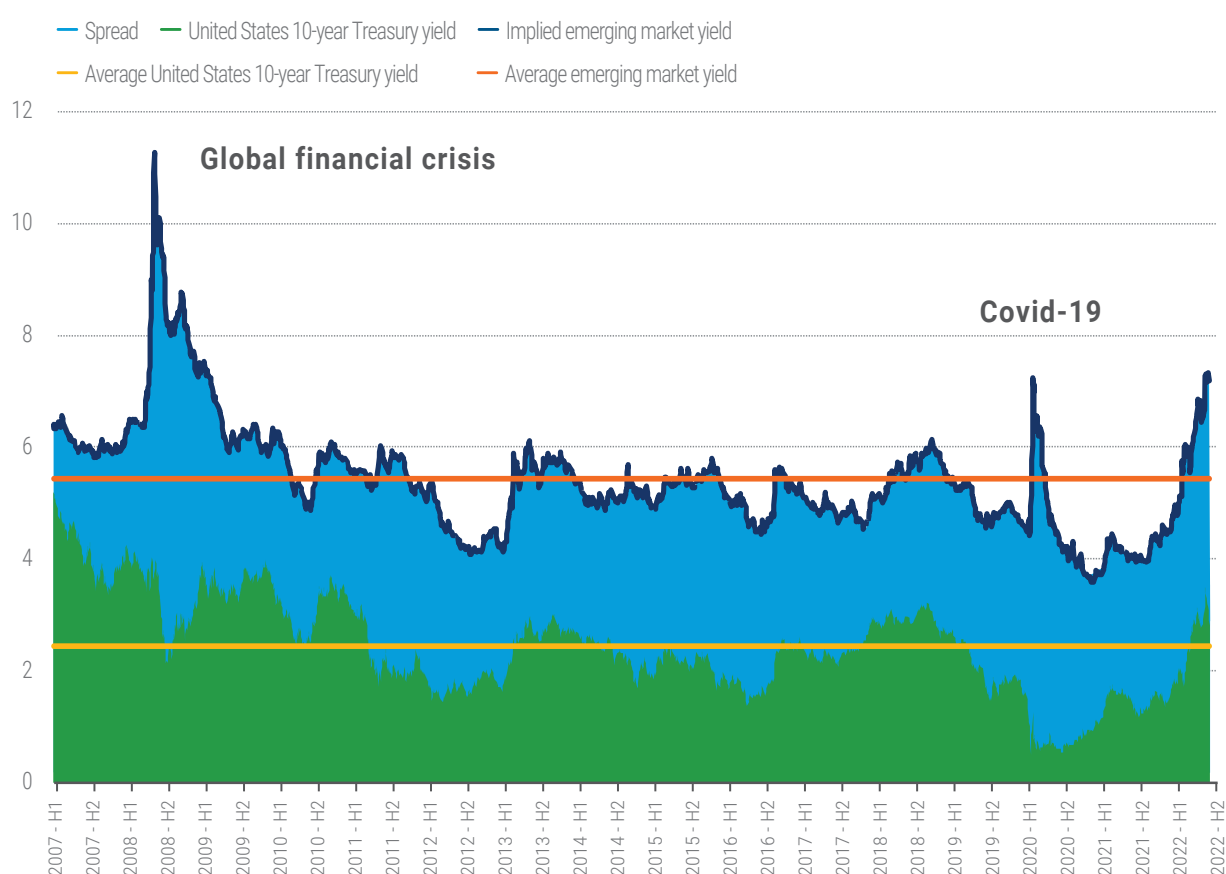
Over the decade and a half since the global financial crisis, many developing countries have seen their external financial positions deteriorate, first gradually and particularly since the Covid-19 shock more precipitously. As of mid-2022, the IMF assessed 55 per cent of Poverty Reduction and Growth (PRGT)-eligible countries⁸ to be at high risk of or already in debt distress – compared to fewer than 30 per cent in 2015. Overall, the IMF has warned that around 6 out of 10 low-income countries and 3 out of 10 emerging market economies are at or near debt distress.

Three immediate factors have been critical in pushing these countries further towards the financial precipice. First and foremost, after many perfunctory announcements over the past ten years, United States monetary policy has now embarked on a decisive tightening cycle that has seen the United States 10-year Treasury yield increase almost six-fold between mid-2020 and mid-2022 (figure 2.1). Given the continued dominance of the United States dollar in the world economy, this, as discussed earlier, threatens to reverse the global economic recovery, not least through balance-of-payment crises in the developing world prompted by United States dollar appreciations against their currencies and, therefore, also an increase in the dollar-denominated values of their external debt obligations and higher borrowing costs.

⁸ The 69 countries eligible to apply to the IMF Poverty Reduction Trust Fund (PRGT) include 25 low-income, 35 lower-middle income and 9 upper middle-income countries, based on World Bank income classifications. According to the IMF Debt Sustainability Framework, 30 of these 69 countries were deemed to be at high risk of debt distress and eight in debt distress, as of 31 May 2022.

Second, price hikes in some commodity markets add to inflationary pressures on a global scale. This has negatively affected developing country commodity importers but has benefited some developing country commodity exporters. While, for now, commodity prices for gas (United States), wheat and oil have returned to near pre-war levels, uncertainty remains as to the extent to which continuation of the war in Ukraine will affect commodity prices in the future. Third, the Covid-19 pandemic lingers on in many countries. This includes high debt burdens left by the pandemic in developing countries that remain unresolved.

Figure 2.1 Emerging market yield decomposition, 2007-2022 (percentage points)



Source: UNCTAD secretariat calculations based on ICE Bank of America (BofA) Emerging Markets External Sovereign Index.

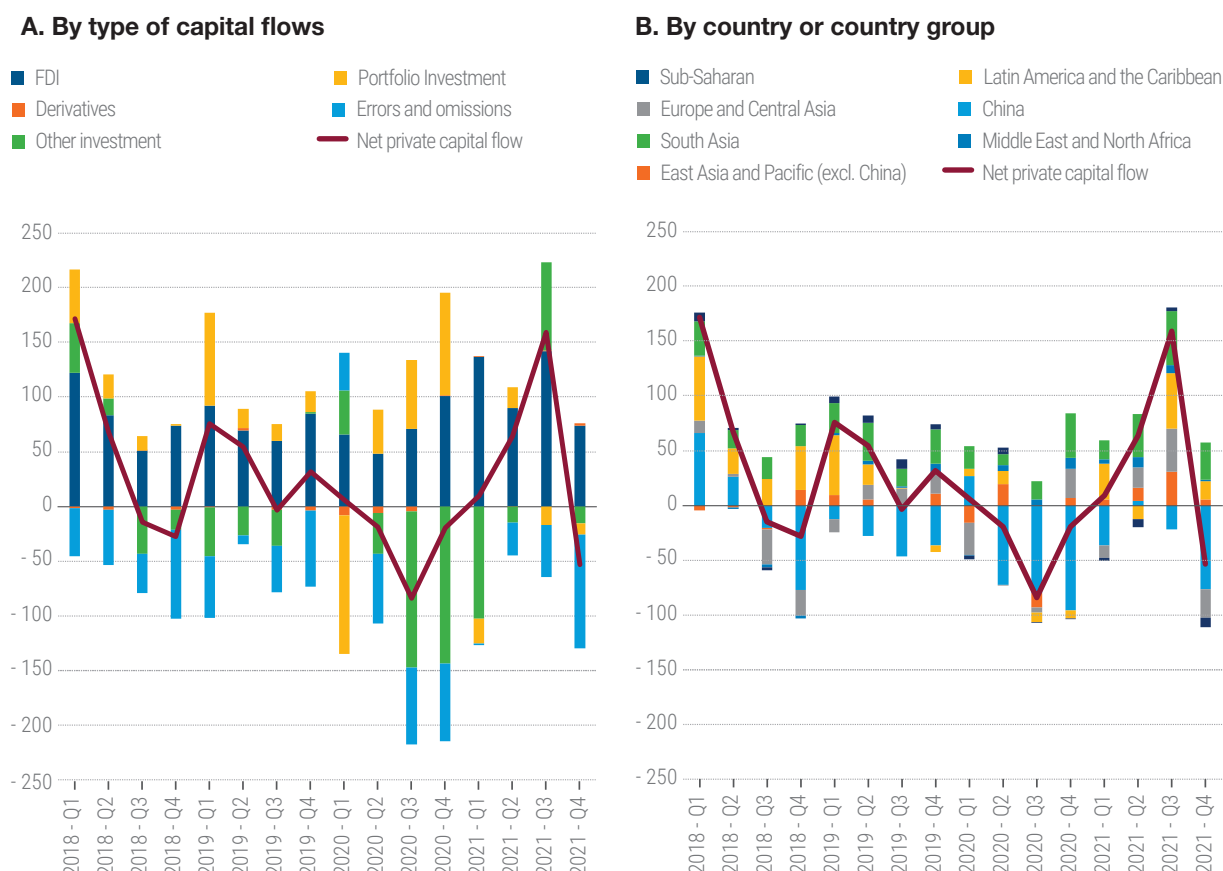
Note: The implied yield for external sovereign emerging market bonds equals the sum of the United States 10-year Treasury yield and the spread as measured by the ICE BofA. The average spread (of around 3 percentage points throughout the period) is measured by the difference between the two average yield lines.

1. Net capital flows to developing countries: mounting headwinds

The combination of these factors has resulted in renewed net negative capital flows from developing countries since September 2021, bringing to a halt the rebound of net capital flows to developing countries observed since the last quarter of 2020 (figure 2.2.A).⁹

⁹ Net capital flows refer to net non-resident inflows minus net resident outflows, including both private and official flows.

Figure 2.2 Net capital flows to developing countries, 2018-2021 (billions of dollars)



Source: UNCTAD secretariat calculations based on national data.

Note: Developing countries are low- and middle-income countries according to the World Bank income group classification. By region, the following countries are included: East Asia and Pacific (excl. China): Cambodia, Fiji, Indonesia, the Lao People's Democratic Republic, Malaysia, Mongolia, the Philippines, Samoa, Thailand, Timor-Leste, Tonga, Vanuatu, Viet Nam. Europe and Central Asia: Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Georgia, Kazakhstan, Kyrgyzstan, Republic of Moldova, North Macedonia, Russian Federation, Serbia, Tajikistan, Republic of Türkiye, Ukraine, Uzbekistan. Latin America and the Caribbean: Argentina, Belize, Plurinational State of Bolivia, Brazil, Colombia, Costa Rica, the Dominican Republic, Ecuador, El Salvador, Guatemala, Guyana, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Suriname. Middle East and Northern Africa: Egypt, Iraq, Jordan, Morocco, State of Palestine. South Asia: Afghanistan, Bangladesh, Bhutan, India, Nepal, Pakistan, Sri Lanka. Sub-Saharan Africa: Angola, Cabo Verde, Eswatini, the Gambia, Guinea, Lesotho, Madagascar, Mauritius, Mozambique, Namibia, Nigeria, Rwanda, São Tomé and Príncipe, South Africa, United Republic of Tanzania, Zambia.

This initial rebound was driven by a confluence of developments. Increases in net inflows of foreign direct investment (FDI) to developing countries in the last quarter of 2020, and again in the first and third quarters of 2021, were a main feature of this recovery phase (TDR, 2021). By contrast, net portfolio investment that had led the deterioration of net capital flows in the early phase of the pandemic, remained subdued and volatile throughout 2021, after initial rebounds in the last three quarters of 2020 when global investors in search for yield triggered record net flows of \$93 billion in the final quarter of 2020 alone (TDR, 2021). This pattern is driven mainly by non-resident portfolio flows to developing countries. However, portfolio diversification by residents in emerging-market economies has become an increasingly important component of net portfolio flow dynamics (JP Morgan, 2022). Finally, net official flows, recorded under “other investment”¹⁰ played a significant role in the resurgence of capital

¹⁰ Other investments include currency and deposits, trade credits and advances, private and official loans (including IMF loans and SDRs), guarantee schemes and other equities.

flows to developing countries in this period. Thus, the August 2021 allocation of special drawing rights (SDRs) as well as emergency lending by the IMF and the World Bank were the main driver behind this category's positive contribution in the third quarter of 2021.

However, with the deterioration of global financial conditions from September 2021, net capital flows to developing countries turned negative again in the last quarter of 2021, reaching \$52.3 billion or around 60 per cent of the highest net negative flows in the period of observation at the peak of the Covid-19 pandemic (third quarter of 2020). The first quarter of 2022 saw a slight recovery from this trend, with FDI inflows largely compensating for near record portfolio outflows of \$108.8 billion due to the sell-off of developing countries' bonds and equities, in part triggered by the war in Ukraine. This flight of portfolio capital was surpassed only in the first quarter of 2020 amidst the onset of the Covid-19 pandemic.

Both the initial rebound of capital flows to developing countries as well as the recent negative capital flow shock have affected developing country regions unevenly (figure 2.2.B). As previous reports have stressed, this reflects not only the dynamics of net foreign liabilities, but also the build-up of foreign assets by residents of large emerging market economies, led by China (TDR, 2019; 2021). Chinese "other investment" outflows (linked to overseas deposits, bank loans abroad and trade credit and advances) accounted for the bulk of "other investment" outflows from developing countries in the last quarter of 2020 and the first quarter of 2021.

From end-2020, when the Covid-19 crisis was seen by some to gradually come under control, through to the first quarter of 2022, South Asia was the recipient of the largest cumulative net capital inflows, equivalent to \$179 billion and led by large inflows of other investments. East Asia and the Pacific (excluding China) recorded net inflows of \$70.3 billion, linked mainly to high FDI inflows during this period. Net inflows to the Middle East and North Africa were smaller, amounting to \$36.2 billion, mainly as a result of inflows in other investment.

The remaining regions witnessed more volatile net capital flows over this period, marked by differing patterns. These were positive in Latin America and the Caribbean, a region that benefited from net positive capital inflows of \$121.5 billion since late 2020, with the bulk of these received since the third quarter of 2021. Thus, in the first quarter of 2022 alone, FDI to this region more than compensated for net portfolio outflows, resulting in net capital inflows of \$40.7 billion. These amounted to only \$9.9 billion in East Asia and the Pacific in the first three months of 2022, hovered around zero in other regions, and were strongly negative for China mainly due to portfolio outflows. Sub-Saharan Africa was the only region experiencing net capital outflows throughout the period from end-2020 and into 2022, totaling \$10.9 billion, due to portfolio and other investment outflows overshadowing official and FDI inflows. This is especially concerning given the high degree of external vulnerabilities of the region.

The overall outlook for developing countries remains subdued for now. According to the most recent data available for (selected) developing countries, the flight-to-quality from developing economies continued unabated during the second quarter of 2022, reaching levels comparable to those following the onset of Covid-19 pandemic by end-June (IMF, 2022b; Wheatley, 2022). This is also borne out in the data on emerging market sovereign bond spreads. As figure 2.1 shows, these spreads – an important indicator of sovereign financial risk and distress – have risen sharply between September 2021 and July 2022, following the United States Federal Reserve's more aggressive stance on monetary policy normalization in response to concerns about domestic inflation. Contrary to earlier episodes of steeply rising emerging market sovereign bond spreads in the wake of the global financial crisis and at the height of the Covid-19 pandemic, when 10-year United States Treasury bond yields actually fell, the current episode is clearly driven by emerging market bond spreads moving in tandem with the 10-year United States Treasury yield curve – a clear indicator of the central role played by the tightening monetary policy cycle in the United States in mid-2022.

Worst hit by these deteriorating financial conditions are primarily frontier economies that already suffered from severe balance of payment constraints and high external vulnerabilities from well before

the onset of the Covid-19 pandemic. Thus, for example, low- and middle-income countries, whose external sovereign bonds traded in distressed territory in June 2002 had already seen their bond yields rising to above 10 percentage points relative to the most common benchmark - the yield on 10-year United States Treasury bills – in mid-2019 (including Egypt, Türkiye, Pakistan, Uganda and Zambia). By contrast, for emerging market economies with larger and more liquid markets and with investment grade ratings, sovereign bond spreads have been relatively contained (Curran, 2022). This now seems to be changing to an extent, with external sovereign bonds of other larger emerging economies, such as Brazil and Colombia, seeing their bond spreads on the increase, if not yet in distressed territory (table 2.1). Given growing expectations of a United States (European Union) recession in 2023, the most likely scenario will be one comparable to earlier crisis points, in which further rising sovereign bond spreads with falling yields on 10-year United States Treasury bills.

But this only captures debt and financial distress in those developing countries that issue foreign currency-denominated sovereign bonds above minimum thresholds required for inclusion in relevant indices. Other assessment criteria include the IMF debt sustainability reports for countries eligible to apply to its Poverty Reduction and Growth Fund and, of course, countries already in default or undergoing sovereign debt restructurings as of July 2022. Table 2.1 provides a summary overview of countries meeting one or several of these criteria, at the time of writing.

Predictably, these developments have also resulted in widespread currency depreciations across developing countries in the first half of 2022 (figure 2.3). In addition to widening spreads of developing countries' external sovereign bonds, domestic currency depreciations further increase the servicing costs of debt denominated in foreign exchange. In all, 90 developing countries recorded nominal depreciations of their currencies against the dollar, of which 34 exceed 10 per cent. Countries with major depreciations are either net food importers and/or those with long-standing high external vulnerabilities. Those with only small depreciations are net commodity exporters or countries that have embarked on a monetary tightening cycle ahead of advanced economies (Box 2.1), since the increased interest rate differential created carry-trade opportunities.

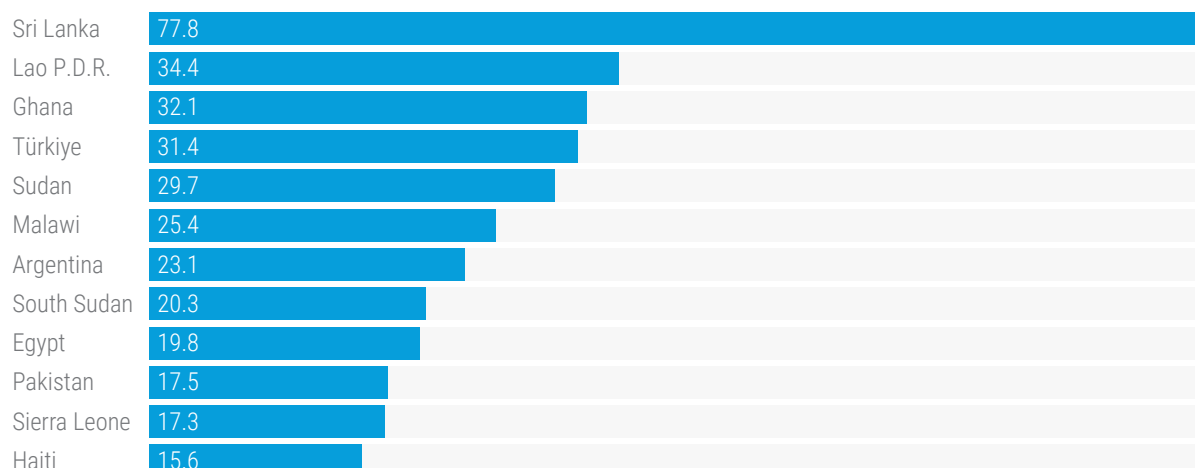
Table 2.1 Developing countries considered in or close to debt distress, mid-2022

	In default as of 30 June 2022	Undergoing sovereign debt restructuring as of 30 June 2022	Bond yields close to or above 10 percentage points relative to 10-year United States Treasury bills as of 30 June 2022	IMF debt sustainability assessments (in debt distress or at high risk of debt distress) for PRGT-eligible countries as of 31 May 2022
Low-income countries (LICs)	Zambia	Chad, Ethiopia, Mozambique	Uganda, Zambia	Afghanistan, Burundi, Central African Republic, Chad, Republic of Congo, Ethiopia, The Gambia, Guinea-Bissau, Malawi, Mozambique, Sierra Leone, Somalia, South Sudan, Sudan
Lower middle-income countries (LMICs)	Lebanon, Sri Lanka		Egypt, Pakistan	Cameroon, Cabo Verde, Comoros, Djibouti, Ghana, Haiti, Kenya, Kiribati, Lao P.D.R, Mauritania, Micronesia, Papua New Guinea, Samoa, São Tomé and Príncipe, Tajikistan, Zambia, Zimbabwe
Upper middle-income countries (UMICs)	Suriname			Dominica, Grenada, Maldives, Marshall Islands, St. Vincent and the Grenadines, Tonga, Tuvalu
Not classified	Venezuela (Bolivarian Republic of)			

Source: UNCTAD secretariat calculations based on IMF Debt Sustainability Framework (as of 31 May 2022), Refinitiv and World Bank income classification 2022-2023.

Notes: As of 30 June 2022, Brazilian sovereign bond (10-year maturity to keep comparison with 10-year United States Treasury bills) saw a spread of 9.9 per cent and Colombian bonds of 8.4 per cent (both up from previous year-on-year for date of 30 June).

Figure 2.3 Nominal exchange rate depreciations against the United States dollar, selected developing countries, January-July 2022 (percentage)



Source: UNCTAD secretariat calculations based on Refinitiv.

Note: Estimated change in per cent of the nominal exchange rate against the United States dollar between 1 January 2022 and 8 July 2022.

Box 2.1 Monetary tightening in developing countries

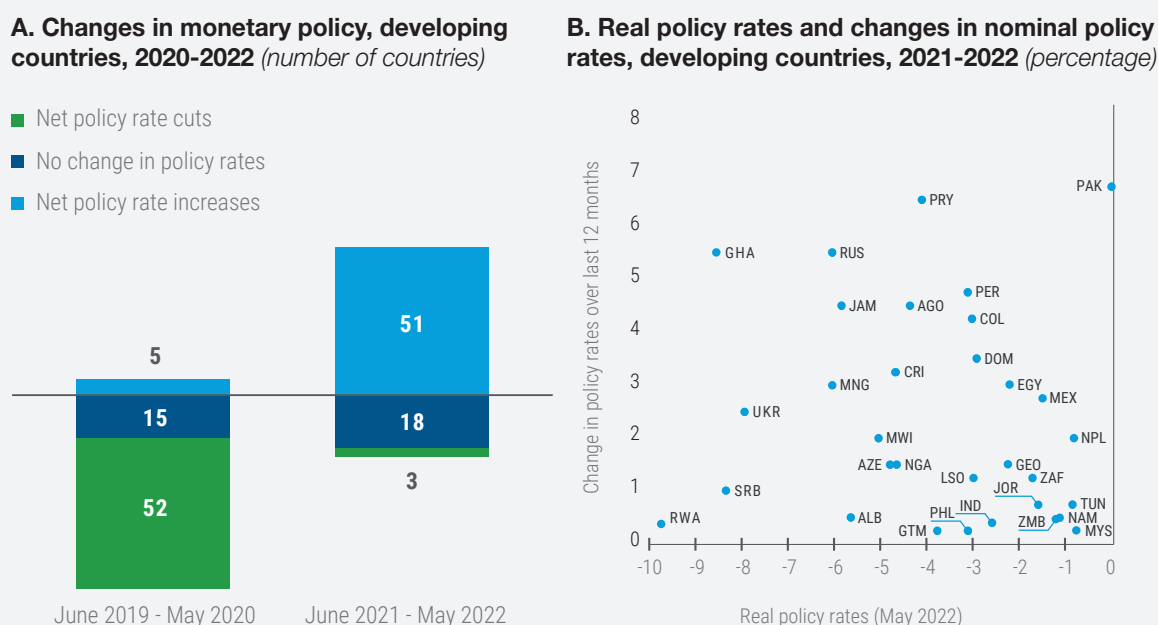
The combination of rising policy rates in advanced economies, higher domestic inflation rates and depreciating currencies is severely limiting the policy space available to monetary authorities in developing countries. This complex background explains the sharp contrast in terms of monetary policy responses in the early stages of the Covid-19 pandemic relative to the situation in 2022. Between June 2019 and May 2020, for a group of 72 developing countries, the median central bank policy rate declined from 5.0 to 4.5 per cent. At least 52 of these countries were able to cut rates during this period to support their response to the pandemic. By contrast, between June 2021 and May 2022, the median policy rate for this group increased from 4.0 to 4.9 per cent. At least 51 countries raised policy rates during this period (figure 2.B1.1A). This widespread tightening of monetary policy in developing countries is acting as a constraint on the efforts of authorities to sustain economic recovery in the aftermath of Covid-19.

In the current context, one of the most important risks faced by developing country governments is an overshooting of domestic monetary policy tightening. Central banks in these countries have tried to preempt the expected increase of policy rates in the United States by raising their own rates from the second half of 2021 (TDR, 2022). However, with United States monetary tightening transmitting inflationary pressures to developing countries through balance of payment crises and currency depreciations, compounded (until recently) by price hikes in core international commodity markets, monetary authorities in these countries come under pressure to extend the ongoing cycle of tightening, both in terms of rate hikes and duration (World Bank, 2022a). High domestic inflation rates turn policy rates negative in real terms and, therefore, broadly accommodative in many countries. An analysis of the situation for 56 developing countries shows that in at least 35 cases, policy rates have turned negative despite the implementation of nominal rate increases over the last 12 months ending in May 2022 (figure 2.B1.1A). This then calls for further monetary tightening.

This thinking relies heavily on central banks' wariness of the perceived risks of unanchored inflation expectations and wage-price spirals (BIS, 2022). These risk preferences inform their inclination to pursue

further rate hikes despite both the lack of evidence on systemic build-ups of wage-price spirals and the equally significant danger of triggering sharp domestic economic downturns (Storm, 2022). This dynamic highlights the blunt nature of the use of monetary policy tools to tackle the often divergent causes of domestic inflationary pressures (TDR, 2022).

Figure 2.B1.1 Monetary policy in developing countries



Source: UNCTAD secretariat calculations based on Refinitiv.

Notes: Panel A includes data for 72 countries with available data until May 2022. Panel B includes data for 56 countries with available data until May 2022. The real policy rate is estimated as the difference between the policy rate and national CPI figure for May 2022. Policy rates include reported central bank policy rates, discount rates or repurchase rates.

2. External debt sustainability in times of tapering

Clearly, these global financial conditions – and the United States monetary tightening cycle – put already fragile debt sustainability in many, though not all, developing countries in further and acute peril (UNCTAD, 2021). This is evident from the following brief analysis of the evolution of two core indicators of external debt sustainability in developing countries.

The first of these – the ratio of total external debt stocks to exports (of goods and services, including tourism revenues) – provides an indication of countries' external solvency given the importance of export revenues to service foreign-currency denominated debt obligations. For all income groups (low- and middle- income countries, according to the World Bank income classification and excluding China), this indicator rose from an average of 100 per cent in 2010 to 159 per cent in 2020 (figure 2.4.A). By 2021, this figure had again fallen to 127 per cent, reflecting the much stronger growth in export revenues compared to that of external debt stocks in this year. This is still 18 percentage points above the average value for this indicator at the height of the taper tantrum crisis in 2013 (108 per cent), but below the value for 2016 (142 per cent) when the first cycle of monetary tightening started. A core danger of current tightening financial conditions is precisely that this recent positive development will be reversed.

Disaggregating these data by income groups, low-income countries faced the most severe constraints throughout, with their external debt stocks still exceeding their export revenues by a factor of 2 in 2021. Lower middle-income countries saw their external debt sustainability eroded substantially as their ratio of total external debt-to-exports steeply from a relatively low value in 2013 (compared, for example to upper middle-income countries at this stage) to 118 per cent in 2021 (and a factor of 1.5 in 2020). Unsurprisingly, upper middle-income countries have fared better on average but have also seen their ability to service external foreign-currency denominated debt obligations through export revenues decline over the past decade.

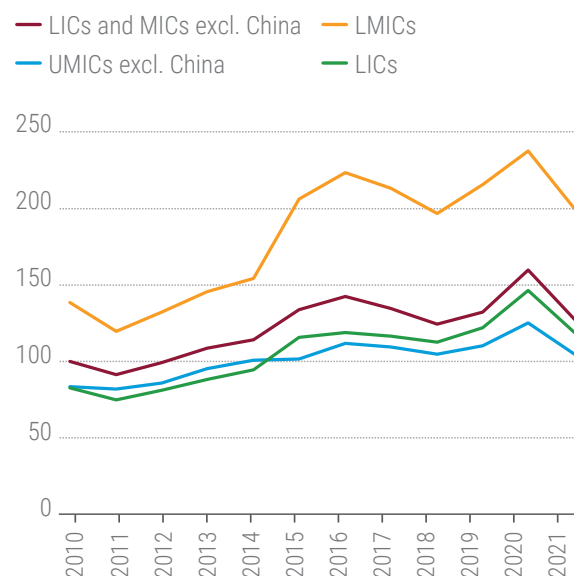
Most importantly, however, such group averages hide the fact that, in each income group, there can be significant “outliers” – that is several often-smaller countries in much more dire straits than the average picture would suggest. This is relevant since assessing the severity of debt distress in the developing world needs to be informed by country experiences. Figure 2.4B-D therefore provides a more detailed picture, at country-level, of changes in their ratio of total external debt stocks to their export revenues between 2016 – when monetary tightening first set in – and 2020, the last available year for country-level data. This shows quite clearly that the number of countries in each income group – with often very different institutional histories, current policy frameworks and operating at different per-capita income levels – whose position deteriorated in regard to this indicator is substantial (i.e. all countries above the 45-degree line in figure 2.4B-D).

The second core indicator is the ratio of debt servicing costs on public and publicly guaranteed debt to government revenues. This approximates the ability of governments to continuously service public (rather than total) external debt obligations, reflecting not only governments’ ability to marshal domestic resources for this purpose but also the changing costs of servicing such debt. As figure 2.5.A shows, a steeply increasing share of government revenues was needed to service external public sector debt obligations in the period 2010 to 2020. This is the case, on average, for all developing countries (low- and middle-income countries according to World Bank income classification), as well as for specific income groups, and is a clear reflection on the cost borne by many developing countries due to their integration into international financial markets. This has proved a double-edged sword for many and, especially, poorer and more vulnerable frontier developing countries: On the one hand, largely private financing provided much-needed immediate relief from external financing constraints, not readily available through multilateral channels. On the other, (re-) financing in international financial markets has arguably worsened external financial constraints in these economies in the longer-term due to their heightened exposure to market risks and associated high and highly volatile debt servicing costs.

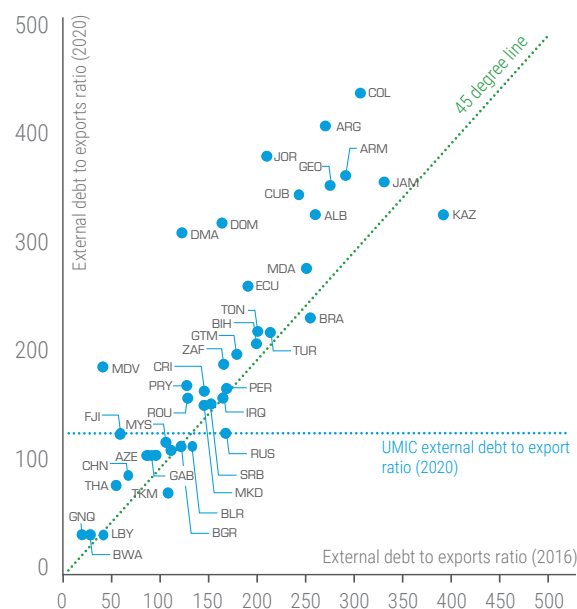
While this situation saw some improvement in upper middle-income countries in 2021 – one that is vulnerable to being reversed soon if adverse global financial conditions persist – there has been little, if any, reprieve in low- and lower-middle income countries. By 2021, these countries’ public sectors remained, on average, under high pressure to dedicate substantive and growing shares of their government revenues to servicing their external debt servicing obligations, compared, for example, to either the 2013 taper tantrum episode or the onset of monetary tightening in 2016. Here again, individual country experiences across income groups are telling and relevant, as depicted in figure 2.5.B for 2020 (the latest data available at country-levels). Clearly, a significant number of both low- and middle-income countries have seen their external public debt servicing costs rise to well above 20 per cent of their government revenue. This is not only not conducive to their own future growth prospects, let alone their ability to respond to higher benchmarks for inclusive and sustainable growth, but it is also destined to negatively rebound on global economic (inclusive and sustainable) growth prospects.

Figure 2.4 Total external debt stocks to export revenues, developing countries, 2010-2021
(percentage)

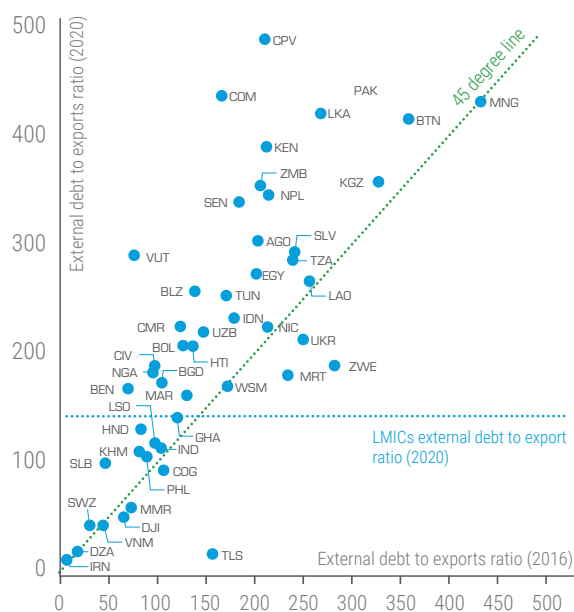
A. Income group averages



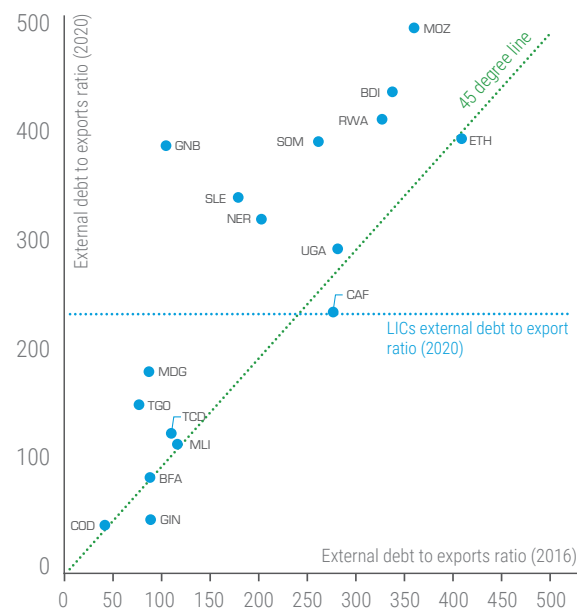
B. Upper middle-income countries



C. Lower middle-income countries



D. Low-income countries



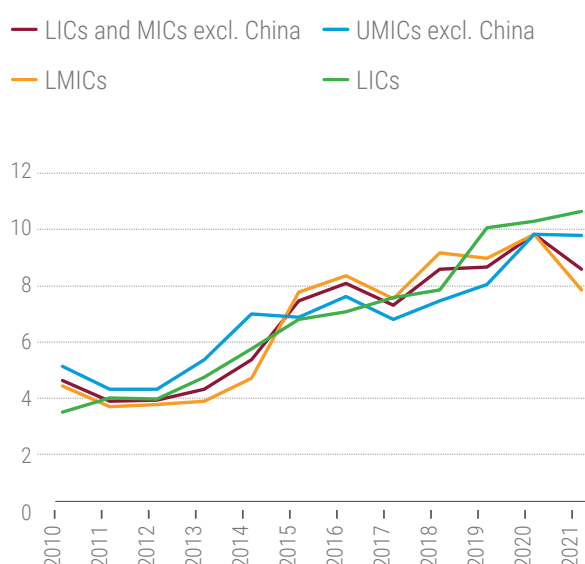
Source: UNCTAD secretariat calculations based on World Bank International Debt Statistics.

Such figures suggest that the deterioration of developing countries' external debt sustainability was more widespread across developing countries than indicated by the IMF LIC Debt Sustainability Framework. However, and has mentioned, the countries with a particularly perilous position in the three country groups are mainly economies which were already facing high pressures on their external debt positions before the Covid-19 pandemic. The pandemic, along with increasing climate-related shocks, the war in Ukraine and the current tightening of global financial conditions, has led them to the brink of debt distress or to default.

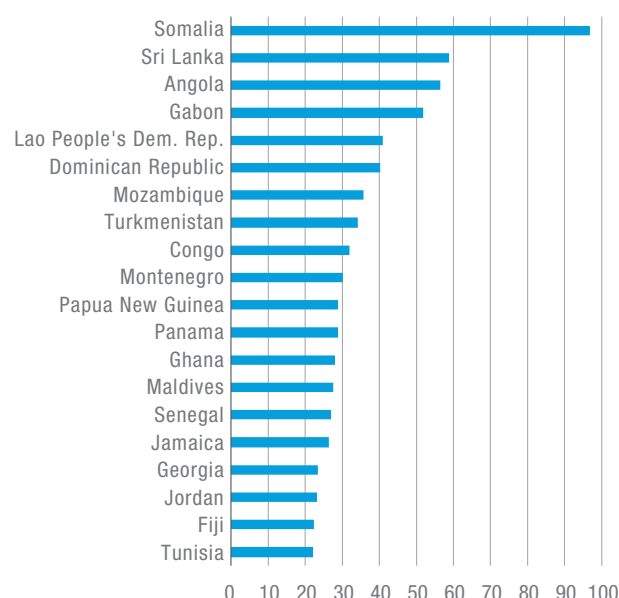
This means that the current situation, although very worrying, is different from the 1980s and 1990s when a few but very large developing countries faced acute financial and debt crises.

Figure 2.5 Servicing costs on public and publicly guaranteed external debt to government revenues, developing countries and groups, 2010-2021 (percentage)

A. Income group averages



B. Top 20 countries in 2020



Source: UNCTAD secretariat calculations based on World Bank data.

3. Policy responses by the international community

This analysis reinforces the warnings raised recently by the United Nations Global Crisis Response Group on Food, Energy and Finance. 94 developing economies, home to 1.6 billion people, are severely exposed to at least one of the dimensions of the interlocked crises outline above. The Group has emphasized that there is no way to respond to this challenge, without first addressing the deterioration of financial conditions in developing countries. Unfortunately, policy and financial commitments made by the international community in recent months have fallen short of what is required (United Nations, 2022a).

There are three relevant areas of multilateral action which require the implementation of additional measures based on a renewed sense of urgency. These include the provision of official development assistance (ODA), the allocation and effective deployment of SDRs and policies to effectively address debt distress in developing countries.

First, there is an imperative need for developed countries to meet their ODA commitments while protecting levels of assistance in key areas, including Covid-19 vaccination efforts and climate commitments, and particularly to least developed countries (LDCs). In 2021, ODA reached \$178.9 billion, equivalent to 0.33 per cent of GNI of the members of the Development Assistance Committee (DAC) (OECD, 2022). This figure is problematic for at least two reasons. First, it is less than half of the established commitment of 0.7 per cent of GNI. Over the last 50 years, the systemic failure of DAC members to meet their pledges means that developing countries have lost over \$5.7 trillion in developing financing (OXFAM, 2020). Second, resources allocated to LDCs are under threat because of the declining share of grant financing as well as the expected increase of in-donor country refugee costs (Eurodad, 2022).

Second, developing countries have made active use of their share of resources received through the allocation of \$650 billion in SDRs by the IMF in August 2021. At least 69 developing countries have included SDRs in government budgets or have deployed them for fiscal purposes for a total of \$81 billion since this allocation (CEPR, 2022). Additional resources are required that could be deployed through different mechanisms. These include the operationalization of commitments to reallocate SDRs towards the IMF Poverty Reduction and Growth Trust (PRGT) and the new Resilience and Sustainability Trust (RST), a new emission of SDRs in 2022, and in addition, establishment of an SDR development link in SDR allocations as long advocated by UNCTAD (UNCTAD, 1965).

Third, piecemeal measures to provide short-term debt relief are inconsistent with the magnitude of the challenges faced by debt countries in terms of both existing liabilities and future financing needs. Actions ought to focus on two broad areas. First, establishment a multilateral legal framework for sovereign debt restructuring to facilitate timely and orderly debt crisis resolution with the involvement of all official (bilateral and multilateral) and private creditors (TDR, 2015). The framework would facilitate the provision of debt relief linked to a debt sustainability assessment that incorporates long-term finance needs, including for the achievement of the 2030 Agenda and the Paris Climate Agreement (TDR, 2019). Second, establishing a publicly accessible registry of debt data for developing countries to address debt transparency challenges. Following the UNCTAD Principles for Responsible Sovereign Borrowing and Lending, this registry would allow the integration of debt data by both lenders and borrowers at the level of specific transactions in a way that ensures interoperability of data across direct and indirect sources of reporting (UNCTAD, 2012; Rivetti, 2021; Eurodad, 2019).

Box 2.2 Developing countries' sovereign defaults and restructurings in 2022

The deterioration in global financial conditions has not triggered a sharp increase in the number of countries that are either in sovereign default or undergoing a debt restructuring during the first half of 2022. In total, there are five countries classified in default – Lebanon, Sri Lanka, Suriname, Bolivarian Republic of Venezuela and Zambia – and a further three undergoing a debt restructuring as of July 2022 – Ethiopia, Chad and Mozambique. Except for Sri Lanka, all the ongoing cases of default and restructuring started in previous years. In the case of defaults, the duration of each open event remains below the average length of a default over the last 50 years, estimated at 58 months (figure 2.B2.1.A). In contrast, in the case of debt restructurings, the duration of each open event is already above the historical average, estimated at 11 months (figure 2.B2.1.B).

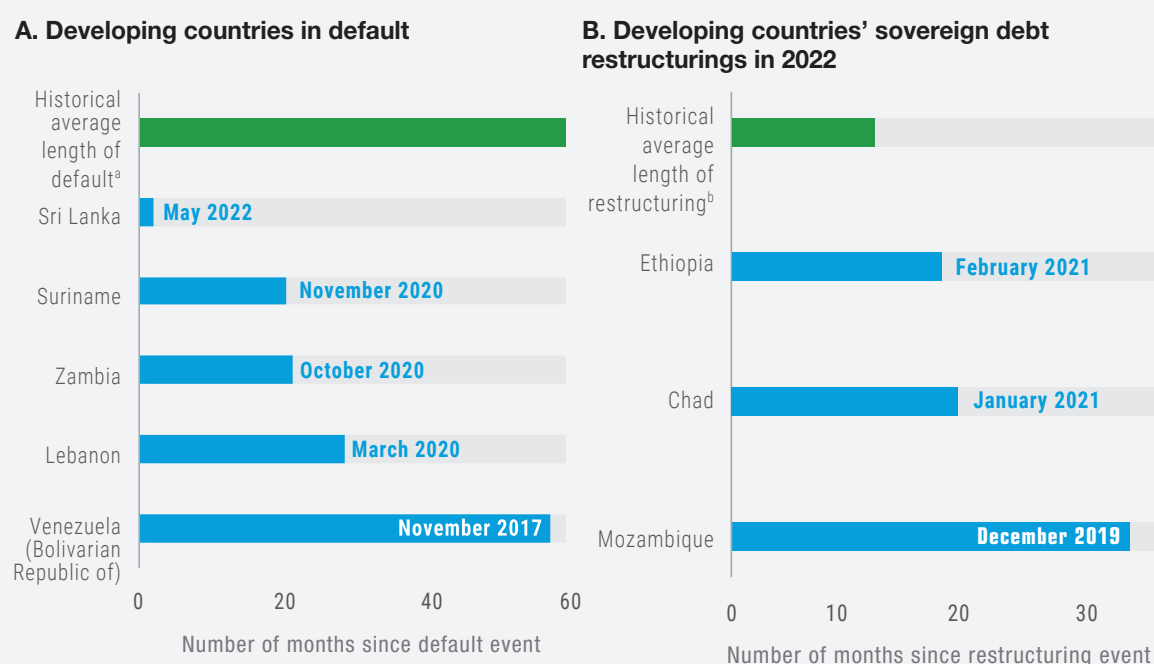
The situation faced by these countries raises three pressing concerns. First, debt distress has already caused a severe degree of economic and social disruption in these countries. Further delays in addressing their debt challenges places them at risk of steeper economic output losses (Asonuma et al., 2019). Second, the combination of elevated debt levels, higher interest rates and the growing likelihood of a global economic slowdown or recession raise the risks of a renewed series of debt crises, as last seen in the 1980s (World Bank, 2022a). As a result, a substantial number of countries might be effectively prevented from mobilizing resources towards achieving the SDGs as they spend most of the rest of the

decade grappling with the consequences of debt distress. Third, the existing “non-system” for sovereign debt resolution is not suited to address these problems (Ocampo, 2017). In the context of an increasingly diverse creditor base, developing countries in debt distress are trapped by strategic creditor choices which are more responsive to repeated inter-creditor disputes across countries than to the economic and developmental considerations of a specific debt restructuring negotiation.

Against this background, efforts to enhance the G20 Common Framework (CF) can be considered a step towards, but not a substitute, for a permanent and comprehensive debt restructuring mechanism (United Nations, 2022a). Of the eight countries that are either in default or undertaking a restructuring in 2022, four are eligible to join the Common Framework. This includes Chad, Ethiopia, Zambia and Mozambique. The first three have opted to participate in the initiative since early 2021. With the exception of Zambia, for which an Official Creditor Committee, including China, was eventually set up under the CF on 16 June 2022 and subsequently moved quickly to help unlock a \$1.3 billion IMF loan to the country (Cotterill and Wheatley, 2022), the CF has achieved little progress so far to accelerate the process of debt crisis resolution for participating countries.

Previous TDR reports have raised concerns over an approach to sovereign debt restructuring that focuses on official bilateral creditor preferences as an effective way to address the manifold external debt challenges faced by developing countries (TDR, 2015). Thus, for example, Zambia still will have to negotiate the exact terms of debt relief under the CF as well as find a way to bring on board private creditors on comparable terms.

Figure 2.B2.1 Developing countries’ ongoing sovereign defaults and restructurings in 2022



Source: S&P Global Ratings (2022); Asonuma and Trebesch (2016).

Note: Panel A includes countries classified in default by S&P Global Ratings as of July 2022. Default date as reported by S&P.
^a Average length of post-default restructurings from default to debt exchange between 1978 and 2020, as defined by Asonuma and Trebesch (2016). Panel B includes countries undergoing a debt restructuring, including participation in the G20 Common Framework (Chad and Ethiopia) or facing ongoing litigation (Mozambique), but which are not classified in default by a rating agency. Restructuring date refers to application to the G20 Common Framework and start of litigation.

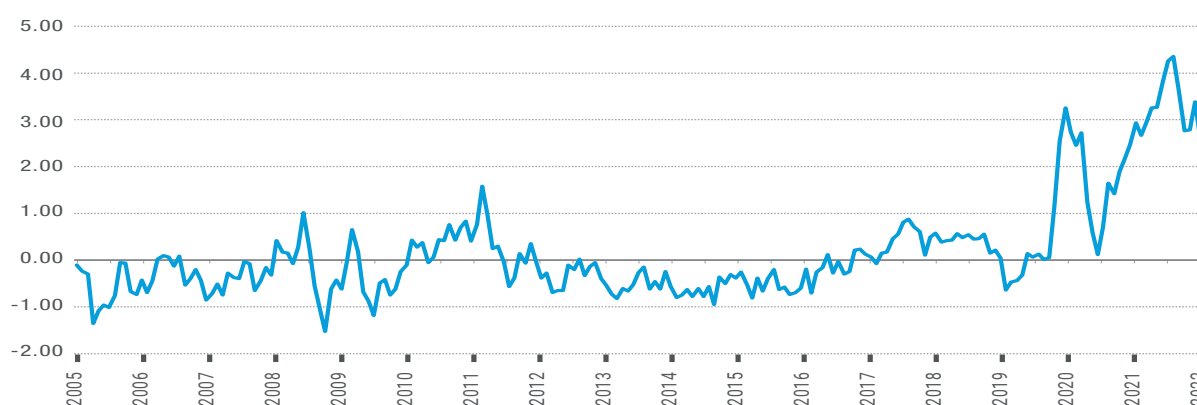
^b Average length of strictly and weakly preemptive debt restructurings between 1978 and 2020 as defined by Asonuma and Trebesch (2016).

C. TRENDS IN INTERNATIONAL TRADE

Despite the outbreak of war in Ukraine and subsequent sanctions imposed against the Russian Federation, as well as continued lockdowns in China, affecting particularly Shanghai, world trade has shown resilience in the first half of 2022.

Before the emergence of these new headwinds, there was a sense that other difficulties that had hampered the movement of goods around the world since 2020 would gradually ease. Freight rates started to decline after the third quarter of 2021 while the disruptions in international supply chains and other logistical eased after it peaked in late 2021 (figure 2.6).

Figure 2.6 Global supply chain pressure index (GSCPI), January 2005 - June 2022
(standard deviations from average value)



Source: Benigno et al. (2022).

Note: The index is normalized such that a zero indicates the index is at its average value, with positive values representing how many standard deviations the index is above this average value (and negative values representing the opposite).

Robust merchandise imports – emanating primarily from Europe, the United States and parts of the developing world, like “Emerging Asia excl. China” and “Latin America” – supported the growth of merchandise trade in the first half of 2022 (figure 2.7). This partially reflected pent-up demand relating to the legacy of the pandemic-driven spending shift from services towards goods that could not be satisfied earlier because of the supply bottlenecks. It also resulted from other positive factors such as the appreciation of the dollar in the case of the United States, the relative dynamism of intra-regional trade in Europe, and favourable terms-of-trade effects in some large emerging economies due to elevated energy prices.

Elsewhere, demand for foreign goods has been more muted. One notable case is China, where monthly data show merchandise imports between January to May 2022 5.6 per cent below their average during the same period last year. Meanwhile, CPB estimates also pointed to a significant contraction in the imports of the “Eastern Europe / CIS” group, following the outbreak of the war in Ukraine.

In terms of exports, patterns since the Covid-19 outbreak have varied. Within advanced economies, by mid-2022, Asian exports stood way above their pre-Covid-19 levels. This contrasts with the United States and especially the United Kingdom, where exports remain significantly below their historical peaks. In between these two extremes stand Europe and the “other advanced economies”, laying slightly above their pre-Covid-19 heights. Within the emerging economies, the picture is also mixed. In

China, “other developing Asian economies” and Latin America, the V-shaped recovery was extremely rapid, while exports continued to grow afterwards. This led to average levels for the first five months of 2022 that were between 6 and 14 per cent above their pre-Covid-19 maxima. Meanwhile, in “Africa and Middle East” and in “Eastern Europe / CIS”, similar figures remained about 5 per cent lower than their pre-Covid-19 peaks.

Altogether, these developments contributed to an averaged year-on-year growth of 4.3 per cent in real terms for world trade during the first five months of 2022, if one takes the simple average between the growth of exports (3.0 per cent) and imports (5.5 per cent).

Turning to the components of exports allows a better grasp of the underlying patterns behind these aggregates. For goods, estimates of world seaborne exports from Cerdeiro et al. (2020), which track maritime merchandise trade by their respective vessels in real time, show the following. For the three main types of vessels, containers, bulk and oil/chemicals,¹¹ data show a significant synchronized rebound taking place in the second quarter of 2022 (figure 2.8.A). Besides these three main vessel types, gas shipments and vehicles also registered an upturn during the first half of the year. This contrasts with foodstuff, the only vessel type that did not perform well during this period (figure 2.8.B). This results mostly from the blockaded grain exports in the Black Sea, which affected net food-importing countries in Africa and parts of Asia, since some of them are highly dependent on cereals coming from the two countries currently at war (United Nations, 2022a). In late July, however, grain shipments from Ukraine started again after an agreement with the Russian Federation was signed. At present, it is still unclear how long it will take for exports to normalize but prices of key grains, including wheat and corn, saw immediate falls and have already returned to pre-war levels.

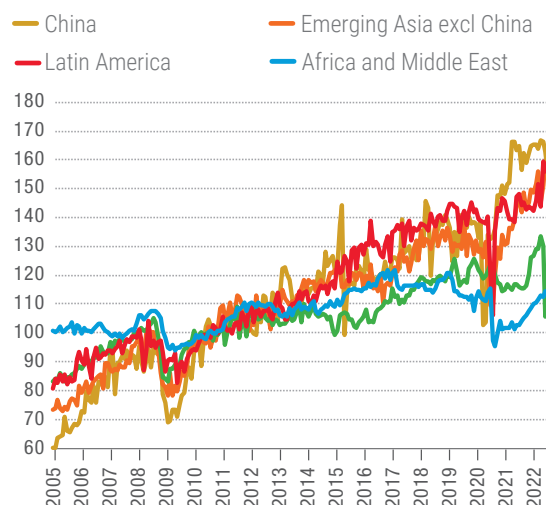
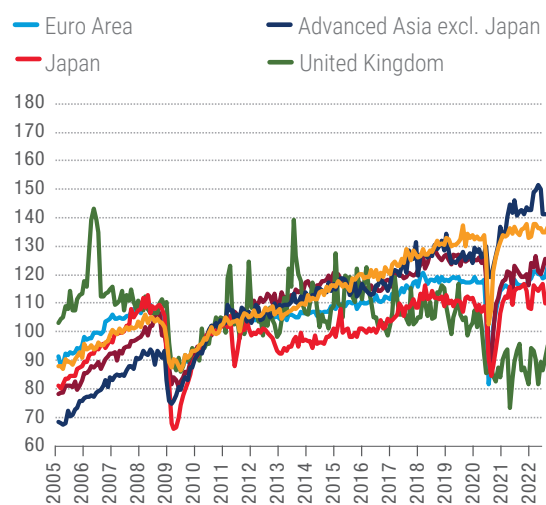
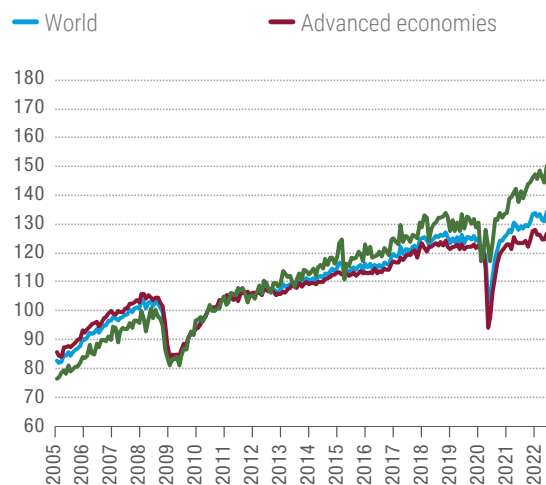
Turning to trade in services, recent patterns from the subcomponents of this catch-all aggregate depict a rather favourable picture after many of these sectors were hard hit by the pandemic. Starting with tourism, the sector continues to recover at a strong pace. This is a boon for the largest component of trade in services, which accounted for one fourth of this aggregate in 2019 before dropping to one tenth in 2020 and 2021 during Covid-19. More precisely, international tourism saw a strong rebound in the first five months of 2022, with arrivals reaching almost half the levels of the same period of 2019. By regions, Europe and the Americas continued to lead the recovery. Europe welcomed more than four times as many international arrivals as in the first five months of 2021. In the Americas, arrivals more than doubled over the same period. Despite the strong rebound, arrivals remained 36 per cent and 40 per cent below 2019 levels in Europe and the Americas, respectively. The Middle East and Africa also saw strong growth of about 150 per cent in January-May 2022 over 2021 but remained about 50 per cent below 2019 levels. Asia and the Pacific saw arrivals almost double, though numbers were still 90 per cent below 2019, as some borders remained closed to non-essential travel (UNWTO, 2022a). In this context UNWTO has revised upwards its forecast for 2022 due to stronger-than-expected results in the first quarter of 2022. It expects international tourist arrivals to reach 55–70 per cent of 2019 levels in 2022 depending on the scenarios it considers for the rest of the year. In parallel, the percentage of experts seeing a potential return of international arrivals to 2019 levels in 2023 has increased from 32 per cent in January 2022 to 48 per cent in May, reflecting rising optimism among tourism experts worldwide, building on strong pent-up demand, in particular intra-European travel and travel from the United States to Europe (UNWTO, 2022b).

Turning to transport, which accounts for about one sixth of the total trade in services, the recovery has continued over the course of 2021 and in early 2022. For air passenger transport services, IATA data show that the seasonally-adjusted international revenue passenger kilometres (RPK) – an airline industry metric reflecting the number of kilometres travelled by paying passengers – had exceeded the 2019 levels for almost all main routes by the end of second quarter of 2022, after growing steadily since the beginning of 2022. Two key segments differ strongly from this encouraging development:

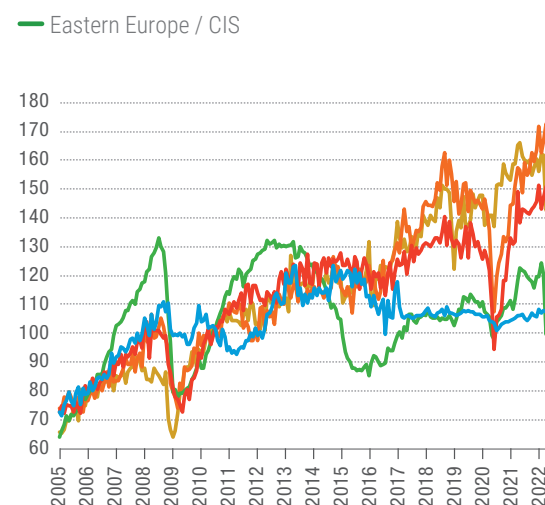
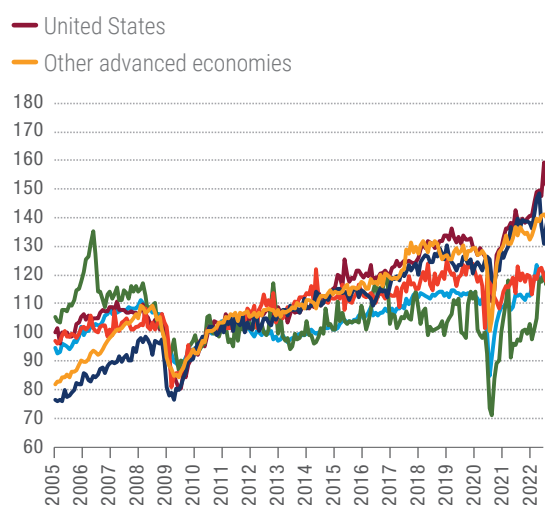
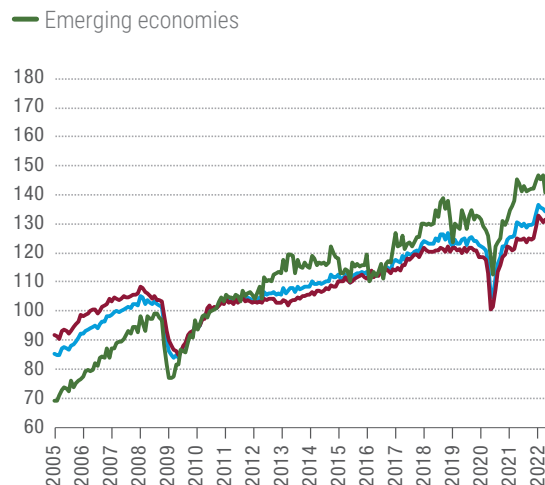
¹¹ Containers represent roughly half of the world maritime transport in terms of metric tons of cargo, while bulk and oil/chemicals account for slightly less than one fifth of the total each.

Figure 2.7 World merchandise trade, January 2005-May 2022 (index numbers, average 2010 = 100)

Exports



Imports

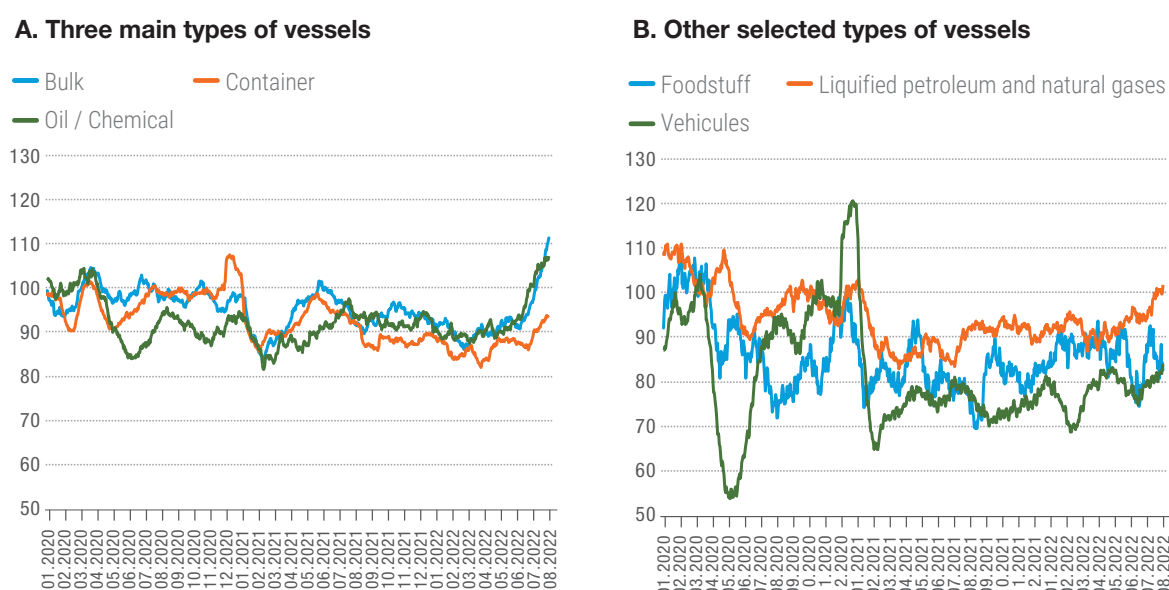


Source: CPB Netherlands Bureau for Economic Policy Analysis, World Trade Monitor database.

Note: Country group classification relies on Ebregt (2020).

“Asia-Europe” and “Asia-North America”. For these two routes, international RPKs were still severely depressed (May 2022) at about 65 per cent below the 2019 level, despite progressing since January 2022 when this figure stood at 80 per cent.¹² Meanwhile, trends in air cargo has shown an almost opposite evolution. This specific service declined almost 10 per cent year on year in late 2021, early 2022, after an intense activity during the first three quarters of 2021, which lay way above pre-pandemic trends. Overall, under the current conditions, the revenues of the commercial airlines for passengers are expected to reach \$498 billion in 2022, compared to \$607 billion in 2019, while for cargo, revenues are forecast to \$191 billion in 2022 from \$100 billion in 2019.¹³

Figure 2.8 Metric tons of world exports by vessel type, 1 January 2020 - 7 June 2022
(index numbers, average 2019 = 100; 31-day centred moving averages)



Source: UNCTAD secretariat calculations based on Gerdeiro et al. (2020) and AIS data collected by MarineTraffic (available at UN COMTRADE Monitor).

Note: Underlying data behind the 31-day centred moving average go until 22 June 2022.

In the other broad categories of trade in services, the recovery has continued across the board, with export revenues in 2021 exceeding the 2019 figures, except for construction which remained 8 per cent below its pre-pandemic level. Trade in “ICT” and “insurance and pensions services” registered the largest growth over these two years, about 30 per cent. During the same period, “financial services”, “personal, cultural, and recreational services” and “other business services” grew between 12 and 18 per cent.

Despite such positive development in the first half of 2022, the outlook for international trade is rather grim as the global economy reached an important crossroad around midyear. In the second half of 2022, risks remain mostly tilted to the downside and trade growth is expected to weaken. This results from a combination of different factors including, inter alia, continued supply chain disruptions, weakened demand tapering demand for consumer durables, unduly aggressive monetary policy, and elevated freight charges. Such worries seem already visible in inventories and new export orders, both leading indicators for trade, which were subdued in July 2022. Except for China’s new order

¹² IATA (2022). Air Passenger Market Analysis - May. 7 July. Available at <https://www.iata.org/en/iata-repository/publications/economic-reports/air-passenger-monthly-analysis---may-2022/>

¹³ IATA (2022). Industry Statistics Fact Sheet June 2022. 20 June. Available at <https://www.iata.org/en/iata-repository/publications/economic-reports/airline-industry-economic-performance---june-2022---data-tables/>

figure, which has rebounded in the aftermath of the recent lockdown, those of other major economies have declined or stabilized below the 50-threshold, marking the difference between improvement and deterioration. As a result, and despite the broad uncertainties that lie ahead, it is expected that global trade will grow almost at par with the global economy in 2022, namely in the range of 2 to 4 per cent. This would represent a sharp deceleration from the 2021 figure, whose current estimates point to a range of 7 to 10 per cent in constant prices, depending on whether one considers world exports or imports, given the challenges that trade statisticians are facing to get reliable price indices for these variables since many countries still have to provide their final numbers for 2021.

Beyond 2022, the prospects for trade remain relatively weak, mirroring the expected deceleration of economic growth discussed in the previous chapter and suggesting a return to the subdued long-term trend prior to Covid-19.

Certainly, the Declaration at the conclusion of the 12th Ministerial Conference (MC12) of World Trade Organization provided some positive elements and the reaching of an agreement suggested the multilateral trading system remains relevant in difficult, as well as in good, times. However, many of the elements were indecisive with the details still pending and it remains to be seen to what extent they can boost international trade in the near future. The outcomes of value to developing countries are mainly concerned with the emergency responses to food insecurity and the Covid-19 pandemic, notwithstanding the resistance of some advanced economies to agree to waiving the TRIPS legislation that could help developing countries combat the pandemic. Moreover, not being able to resolve the issues around fully and well-functioning dispute settlement system poses an ongoing challenge to multilateralism.

In this context, there is still a long way to achieve an inclusive, transparent, and development-friendly multilateral trading system that serves the three pillars of sustainable development and allows developing countries to have sufficient policy space to pursue pragmatic development policies adapted to local conditions. In the pursuit of this objective, chapter IV of this Report argues that, while a constructive and cooperative approach to multilateralism must remain paramount, open developmental regionalism could support this transition.

D. COMMODITY MARKETS

While the market for commodities has been historically characterized by sharp movements in international prices, the fluctuations observed since the onset of the pandemic in early 2020 have been startling not only in terms of their magnitude but also in the sudden reversals in trajectories. It is important to bear in mind that the effects of these abrupt price movements are not limited to the returns to international investors, for whom commodities are just another form of financial asset. Rather these swings in international prices are having a heavy and real impact on economies and individuals, particularly in the developing world.

Not only are developing countries seeing an outsized impact of these price movements on their current account balances – complicated further by the fact that any deterioration in these balances necessitates financing precisely at a time of increasingly scarce and costly international financing conditions – they are also experiencing a disproportionately large knock-on effect on domestic inflationary pressures as these raw materials account for a far larger share of their consumer baskets than those of developed countries. Ultimately, these sudden price swings are having a direct impact on the welfare and livelihoods of some of the most vulnerable populations across the globe, both as small-scale producers and as consumers of these basic goods.

Even before the outbreak of Covid-19, the last decade had seen a period of elevated volatility in commodity markets, with multiple shocks causing both steep declines and rises in international prices. This is in stark contrast to the first decade of the twenty-first century, during which a turbocharged demand for commodities from a rapidly growing and industrializing Chinese economy produced a considerable and sustained increase in commodity prices across the board. The heightened volatility in commodity markets since the global financial crisis in 2008 has only been exacerbated in the last two years by severe and largely unprecedented shocks on both the demand and supply side.

The outbreak of the Covid-19 pandemic in early 2020 precipitated an abrupt drop in commodity prices as lockdowns were imposed and economic activity slowed to a crawl across the globe. The aggregate commodity price index fell by 25 per cent from January to April (figure 2.9). While the fall in prices was broad-based, energy commodities registered the largest drop (54 per cent), followed by metals (16 per cent) and food (9 per cent). Thereafter, a rapid bounce-back in activity, particularly in China, coupled with severe disruptions to supply, transport and logistics produced a sharp recovery in commodity prices. The aggregate index rose by just over 50 per cent between April and December 2020, finishing the year over 10 per cent above the level observed at the end of 2019.

The same factors driving the upward movement in prices in the latter half of 2020 continued into 2021. The aggregate index posted an annual increase of 54.7 per cent over the course of 2021 (table 2.2), with energy commodities again registering the largest change (85.8 per cent), followed by food (29.9 per cent) and metals (20.7 per cent). These upward price pressures remained through the first two months of 2022, as all commodity groups registered further increases.

Table 2.2 World primary commodity prices, 2008-2022 (percentage change over previous year)

Commodity groups	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022 ^a
All commodities ^b	33.4	-31.6	24.3	28.6	-3.0	-3.7	-7.9	-36.2	-9.4	17.4	16.0	-7.4	-15.8	54.7	55.7
Non fuel commodities ^c	22.2	-17.8	26.1	18.9	-12.7	-6.5	-8.0	-18.9	2.3	9.1	-2.2	0.1	4.2	33.9	14.3
Non fuel commodities (in SDRs) ^c	18.3	-15.6	26.9	15.1	-9.8	-5.9	-8.0	-11.9	3.0	9.1	-4.2	3.0	3.5	31.1	19.2
All food	32.6	-10.4	12.0	24.0	-6.5	-9.6	-0.8	-15.6	3.6	-1.3	-6.5	-2.0	6.6	29.9	23.9
Food and tropical beverages	31.1	-2.2	11.6	23.6	-9.9	-9.1	3.8	-14.2	2.2	-1.6	-6.7	0.3	3.6	21.0	22.3
Tropical beverages	19.2	1.1	19.8	31.2	-22.4	-19.8	24.1	-10.3	-3.3	-3.1	-8.5	-5.1	4.8	28.3	49.8
Food	34.9	-3.2	9.1	21.1	-5.6	-6.0	-1.2	-15.4	4.0	-1.2	-6.1	1.9	3.3	19.0	15.1
Vegetable oilseeds and oils	35.2	-24.1	13.0	24.8	0.7	-10.5	-9.6	-18.8	7.0	-0.5	-6.2	-6.9	13.7	49.0	26.5
Agricultural raw materials	8.4	-16.4	37.0	24.5	-19.2	-8.8	-11.8	-13.3	-0.4	5.3	-1.8	-3.9	-2.1	13.5	5.5
Minerals, ores and metals	19.7	-12.9	33.6	20.5	-6.9	-9.5	-12.8	-17.2	4.6	11.3	1.3	6.2	15.5	20.7	5.3
Minerals, ores and non-precious metals	17.5	-25.4	39.0	12.2	-16.8	-2.0	-14.6	-24.8	1.4	25.7	2.6	3.4	3.7	43.6	7.9
Precious metals	23.4	7.5	27.5	30.8	3.4	-15.8	-11.0	-9.9	7.1	0.4	0.0	8.9	26.3	3.6	2.5
Fuel commodities	37.9	-38.6	23.1	32.0	-0.5	-1.2	-7.5	-44.4	-17.5	25.9	27.5	-12.6	-32.0	85.8	91.2
Memo item:															
Unit value of exports ^d	10.9	-9.4	4.4	11.9	-2.3	0.8	-1.2	-11.9	-4.0	5.1	6.7	-2.6	-0.5	15.0	n.a.

Source: UNCTAD secretariat calculations, based on UNCTAD, Commodity Price Statistics Online; and UNCTADstat

Note: In current dollars unless otherwise specified.

a Percentage change between the average for the period January to May 2022 and January to May 2021.

b Including fuel commodities and precious metals. Average 2014-2016 weights are used for aggregation.

c Excluding fuel commodities and precious metals. SDRs = special drawing rights.

d Unit value of merchandise exports of developed countries (M49).

The outbreak of war in Ukraine therefore came at a time of already historically high prices across the various commodity categories, and it only exacerbated these upward price pressures. Moreover, the war has had a truly global impact on commodity markets due to the key role played by the Russian Federation and Ukraine in international food, mineral and energy supplies. The Russian Federation is not only the world's largest natural gas exporter, but also the second largest oil exporter, as well as a leading supplier of aluminum and nickel. Likewise, both the Russian Federation and Ukraine are key global suppliers of various grains. Between them, the two countries provide approximately 30 per cent of world exports of wheat, as well as 20 per cent of maize and over 50 per cent of sunflower oil (United Nations, 2022b). Perhaps even more crucially, the Russian Federation and neighboring Belarus account for approximately 20 per cent of global fertilizer exports. A combination of factors generated by the war, including production disruptions, interruptions to transportation links – particularly the shutting down of Ukraine's ports on the Black Sea – and the imposition of sanctions on Belarus (before the war) and on the Russian Federation, have put a severe constraint on the supply of these materials from these countries to the world. Though sanctions to the Russian Federation explicitly excluded food and fertilizers, exports of these suffered declines due to a 'chilling effect' in the private sector (foreign insurers, lenders, traders, and shippers) which, afraid of reputational risks, further retaliatory action, often over-complied and 'self-sanctioned'; a clear result of this was a noted increase in trade transaction costs, in the form of higher interest rates, insurance premiums, and shipping rates for goods coming from the Russian Federation, including grains and fertilizers. Speculation and financialization of the markets have also played an important role as explained before (see Box 1.3). The result of which has been international supply shortages and acute spikes in prices, reflected in an increase of 15 per cent in the aggregate commodity price index in the 2 months following the outbreak of the war (figure 2.9).

While the increase in prices has been broad-based, certain commodities have been more affected than others. As is customary, and consistent with the Russian Federation's key role in global energy supply, the most drastic spike in prices was observed in energy commodities, which rose by 25 per cent in the two months following the war in Ukraine. Initial sanctions against the country did not target the Russian Federation's oil and gas exports, precisely for fear of unsettling global energy markets. However, the potential for disruptions to Russian supply as well as avoidance of Russian crude by oil traders owing to concerns of possibly violating financial sanctions imposed on the Russian Federation economy alarmed oil markets, particularly as tight global oil supply – largely due to the very gradual relaxing of output restrictions introduced by OPEC+ members as per the agreement reached in April 2020 despite a faster than anticipated surge in global oil demand since then – was already applying significant upward pressure on prices. As a result, the price of the Brent crude oil benchmark rose rapidly from just under 100 dollars on the eve of the war to over 120 dollars only two weeks later.

Subsequent announcements by the United States banning oil imports from the Russian Federation, by the United Kingdom to phase out Russian oil imports by the end of the year, and by the European Union to ban seaborne oil imports from the Russian Federation by the end of 2022, as well as prohibiting shipping insurance for oil exports from the country, exerted further pressure on oil markets. However, the release of 180 million barrels from the United States' strategic petroleum reserves as well as the readiness of both China and India to receive Russian oil exports – and thus take advantage of the significant discount at which the country's Urals brand of crude oil trades compared to other benchmark prices – proved sufficient to ensure that global oil supplies did not tighten further.

For its part, the natural gas market has been particularly sensitive to the war given the dependence of numerous European countries on natural gas supplies from the Russian Federation. Given the fixed distribution systems (i.e. pipelines) required to deliver gas, ready substitutes for these energy products are not easy to come by. There still exist different types of gas pricing: fixed, regulated or cost-related mechanisms; prices linked to crude oil or oil products; market, spot or hub-based prices. In the United States and the United Kingdom, privatization and market-based pricing was already well underway by the end of the 1980s. In the European Union, the process started later: in 2005, nearly 80 per cent of its gas was sold on an oil-linked basis, by 2018 that figure had fallen to around 25 per cent with

75 per cent of gas sold at spot or hub prices (and regulated prices had virtually disappeared) (Stern and Imrisovic, 2020). Basically, even long-term contracts price the entire purchase based on the price of the last barrel exchanged on the spot market. On the contrary, Asian markets, which used to import 70–75 per cent of LNG before the war in Ukraine, remain largely dominated by oil-linked or fixed pricing (Stern and Imrisovic, 2020). Globally, spot prices dropped in 2019 due to large LNG supply. In the European Union, that affected pricing of pipeline gas from Gazprom to the considerable advantage of member states. Then, ahead of winter 2021/22, Asian economies rushed for new long-term contracts securing greater volumes ahead of time and rely less on spot cargoes. So, what determined a good deal for Europe in 2019 turned bad in 2021/22, well before the war in Ukraine and despite gas supply based on long term contracts being fully guaranteed (Stern and Imrisovic, 2020; Sharples, 2021).

Hence, the liberalization of the gas market and the choice of market-based pricing rather than based on cost-based agreements with producers has proved problematic for Europe, a move which Asian countries have not yet made. As gas spot prices in Europe skyrocket, with the main beneficiaries the Russian Federation and the United States, the region just became the first world importer of United States LNG but still cannot avoid dependence on Gazprom supply (Celi et al., 2022). On the contrary, countries which have been able to establish fairer long-term relationship with producers are now enjoying lower energy prices and reliable delivery. Those who have maintained control of domestic energy companies and/or their retail price formation have also been able to keep the distributive implications of domestic inflation in check (Storm, 2022) as shown by the difference between the GDP and the private final consumption expenditure deflator in Indonesia and China. The decision by Germany to halt the Nord Stream-2 Baltic Sea gas pipeline project, as well as the European Union's pledge to reduce Russian gas imports by two-thirds by the end of the year and the intermittent shutting off of gas flows to the continent by the Authorities of the Russian Federation has provoked a surge in European natural gas prices, increasing by more than four-fold in April compared to levels a year earlier (figure 2.9). Moreover, since the European Union's commitment to reduce its reliance on Russian natural gas supplies depends on the bloc increasing its imports of Liquefied Natural Gas (LNG) from other countries, LNG prices have also registered increasing upward pressures since the outbreak of the war. LNG prices stood almost 30 per cent higher in June compared to January, and over double the level registered a year earlier in June of 2021 (UNCTAD secretariat calculations based on data from Japan Import Price Index for LNG). These price movements are further increasing the import bills of LNG-importing developing countries, and could even potentially price out some developing countries from the LNG supplies on which they depend to meet their energy needs.

Perhaps the area in which the impact of the war has been most damaging to developing nations has been in the precipitous rise in food prices. Even before the war broke out, however, food prices were already approaching historic highs, with the subsequent adverse consequences for the most vulnerable populations across the globe. Before the war, it was estimated that food insecurity touched the lives of an estimated 800 million people around the world (FAO, 2022).

Since the Russian Federation and Ukraine are, respectively, ranked the third and seventh largest producers of agricultural goods, the repercussions of the conflict on global food supplies and prices have been widespread and considerable. While some countries, particularly in the case of the European Union, have been able to make up for the shortfall on certain agricultural imports by tapping regional producers or alternative sources, this has not been the case for most developing nations who lack the regional partners and global presence to ensure the provision of additional agricultural stocks in times of global supply squeezes.

The outsized impact of the war in international food markets is reflected in the sharp jump in the aggregate price index of grains between February and April, at just over 16 per cent (figure 2.9). The two countries' key role in global wheat supplies translated into a surge of over 30 per cent in international wheat prices during this period. Moreover, the shortfall in wheat supplies coming from the Russian Federation and Ukraine has hit Africa and the Middle East particularly hard as these regions rely on these two countries for an outsized share of their wheat imports. For its part, maize prices also saw precipitous increases in the aftermath of the war, rising by more than 20 per cent in the following

two months. Largely unrelated to the war, soybean prices have also remained at elevated levels since the beginning of the year due to adverse weather conditions in producing countries, namely Argentina, Brazil and the United States.

In reaction to growing domestic price pressures on staple food items, a number of countries instituted food export restrictions in an effort to bring down prices. While such measures may have provided some relief in the short-term domestically, they have exacerbated upward price pressures internationally.

An important additional factor weighing on current and future food prices has been the disruption to worldwide fertilizer supply from the war. As mentioned earlier, together the Russian Federation and neighbouring Belarus account for a substantial chunk of worldwide fertilizer exports. The 2021 sanctions on Belarus international sales of potash – a key ingredient in fertilizers – have intensified the already sharp upward trend in prices observed since mid-2020. According to data from the World Bank, while the aggregated price of food rose by almost 80 per cent from May 2020 to June 2022, that of fertilizers increased by just shy of 230 per cent over this same period (World Bank, 2022b).

Moreover, the introduction of a fertilizer export ban by China in an attempt to alleviate domestic price pressures has only added to the tight supply conditions internationally. The scarcity and steep price increases of fertilizers has important implications for food markets, as these factors will inevitably translate into a reduction in their usage by farmers, thereby lowering crop yields and provoking a further increase in food prices. The situation is even more dire for many small-scale producers in developing countries, for whom the lack of access to or prohibitively high prices of fertilizers will translate directly into increased hunger and poverty rates.

Like the developments in energy and food markets, industrial metals also registered sharp increases since the war broke out in late February. The industrial metals index rose by 9 per cent between April and February, with the price of aluminum and nickel (for both of which the Russian Federation is an important global supplier) registering substantial increases.

However, true to the sudden reversals observed in the last two years, talk of a sustained upward trend in commodity prices – with some analysts even prognosing another super-cycle similar to that seen in the first decade of this century – was quickly quashed as substantial declines were observed in the price of a range of commodities from April onwards. The aggregate commodity price index dipped by 12 per cent between April and July, with the prices of industrial metals and grains registering declines of 28 per cent and 21 per cent, respectively. Grain prices by mid-year had returned to the levels observed prior to the war, while in the case of industrial metals the downward movement in prices brought price levels close to those prevailing at the beginning of 2020, prior to the pandemic. With regards to energy commodities, the decline between April and July was more moderate, at just 1 per cent. However, comparing energy prices from their peak in early June to their value at the end of July, we observe a sharp decline of 18 per cent, with the notable exception of European natural gas prices which have remained near historical highs (figure 2.9).

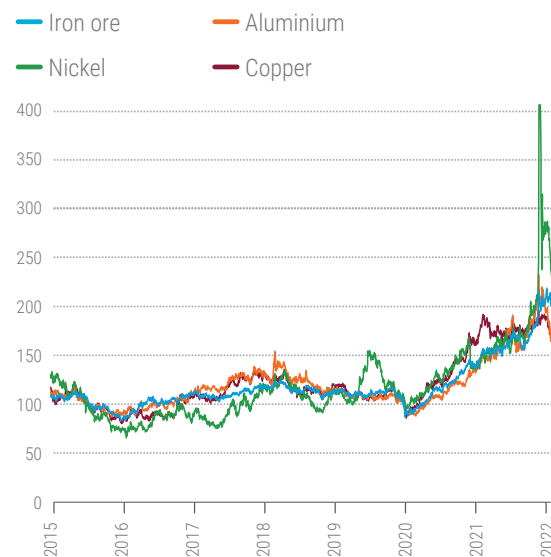
A confluence of factors lies behind this generalized retreat in commodity prices, chief among which is a steeper than anticipated tightening of monetary policy in developed economies and a subsequent deceleration in economic growth, thereby softening the global demand for these raw materials. Similarly, a sharp slowdown of expansion of the Chinese economy, partly explained by strict lockdowns in response to new Covid-19 outbreaks but also by more long-term challenges and weaknesses in certain key economic sectors (see section D, chapter I), has dampened demand for commodities. This is particularly so in the case of industrial metals for which Chinese demand is an outsized component of global demand. On the supply side, two United Nations-brokered agreements with the Russian Federation, Türkiye and Ukraine – the Black Sea Grain Initiative to get grains out of Ukrainian ports, and the *Memorandum of Understanding between the Russian Federation and the Secretariat of the United Nations on promoting Russian food products and fertilizers to the world markets*, managed to ease upward price pressures on these products, and led to a 5-month streak of declines in the FAO Food Price Index.

Figure 2.9 Daily commodity price indices by commodity group and product, Jan. 2015–July 2022
(index numbers, 2015 = 100)

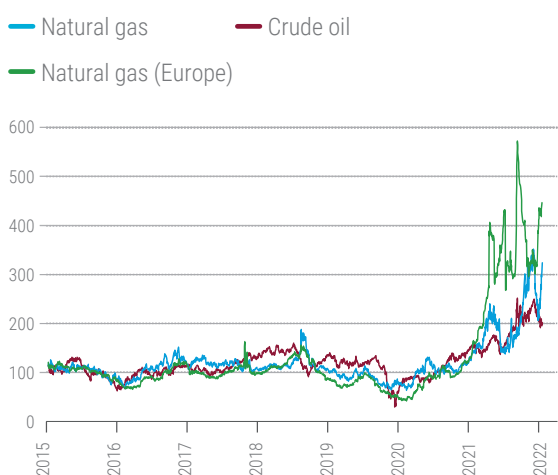
Commodity groups



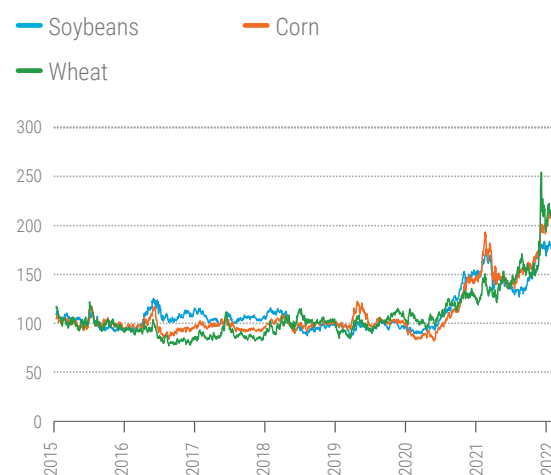
Industrial metals



Energy



Grains



Source: UNCTAD secretariat calculations based on Refinitiv data.

Note: Price indices correspond to Dow Jones Commodity Index, except "Natural Gas (Europe)" which corresponds to Hamburg Institute of International Economics (HWWI) Natural Gas Europe price index and "Iron Ore" which corresponds to Credit Suisse Commodity Benchmark (CSCB) iron ore TR index.

However, as important as these physical demand factors on recent price dynamics are the financial factors lying behind price movements. The recent drop in prices points to the ever more financialized nature of commodity markets. As commodities have increasingly become a financial asset, huge quantities of money are traded daily on commodity futures throughout global markets, with investors' decisions having an outsized impact on prices. In fact, part of the recent downturn in prices is crucially linked to the impact of the tightening of monetary policy in the developed world on investors' decision calculus (see box 2.3). Successive rate hikes by the United States Federal Reserve between March

and July, totaling 225 basis points, have precipitated a significant increase in real interest rates. As a result, in April real yields on United States Treasury securities moved back into positive territory for the first time since March of 2020 and continued their upward trajectory, motivating investors to shift financial investments away from commodities towards such positive yield-bearing assets. These financial developments have played an important role in the recent retreat observed in commodity prices.

Although the prices of various commodity groups had by mid-year returned to levels similar to those observed before the outbreak of the war, it is important to remember that such prices do still represent historically high levels. Moreover, the recent drop in dollar-denominated international commodity prices has not translated into a significant easing of domestic inflationary pressures on these products in many developing countries as rapidly depreciating local currencies – an inevitable consequence of the abrupt tightening of monetary policy in developed economies – have kept local prices of many energy and staple food products at exorbitantly, and often prohibitively, high levels. As a result, poorer households in the developing world continue to suffer difficulties in covering their basic needs, while governments in numerous developing countries see their already limited fiscal resources eaten into due to the substantial energy and food subsidies they provide.

Looking to the latter part of 2022 and into 2023, heightened uncertainty on both the demand and supply side will translate into continued volatility in commodity markets, further complicating the picture for developing economies who are particularly vulnerable to such price swings. Broadly speaking, commodity prices are expected to remain elevated through 2022 and 2023 due to a combination of slowing growth and dampening demand that will be offset by continued supply and transportation constraints, as disruptions resulting from the war are expected to have a long-term impact on the supply of raw materials from both the Russian Federation and Ukraine.

Box 2.3 The war in Ukraine: a shock too far for global food systems?

The war in Ukraine has served as a powerful reminder that local disturbances can carry global consequences. Between them, the Russian Federation and Ukraine are major exporters of vital agricultural commodities, including wheat, maize and sunflower oil, as well as fertilizers (United Nations, 2022a). The disruption to these markets has increased the pressure on international food supply chains, with demand, purchasing power, distribution, and production already under stress even before the war began.

The war comes on the heels of over a decade of turbulence in global food markets. This period started with several episodes of high and volatile food prices between 2007 and 2013. After 2015, the incidence of hunger started to rise, despite remarkable progress in China (FAO, 2020). Then Covid-19 struck at livelihoods, disrupting global and local food systems, although food workers were quickly dubbed “essential” and some local systems could adapt quickly to the changed conditions and were able to continue supplying food. Many governments in the world also helped food distribution systems by providing pandemic relief to their citizens in the immediate aftermath of the economic lockdowns.

The war represented a distributional shock. Ukrainian grains, for example, were still there, ready to be exported, but the primary export route via the Black Sea was abruptly closed. Initial uncertainty over how long the war would last inevitably sent prices higher. Existing contracts lapsed and buyers and traders scrambled to find new suppliers. The immediate implications of the supply shock were especially severe for the Middle East and

North Africa, a region that imports most of its grain from the Russian Federation and Ukraine. Behind that abrupt change, longer-term threats to agricultural production and storage in the region loomed large. The war also sent energy prices soaring, affecting fertilizer production costs even as both Belarus (before the war) and the Russian Federation’ fertilizer exports were cut off. High energy prices also make the whole value chain more expensive, including the costs of food storage, processing and distribution.

The importance of exports from the region and uncertainty of how long the war would drag on also fueled speculation. Excessive speculation on commodity markets likely amplified the price increases for grains that followed the start of the war in Ukraine (Russell, 2022). Changes in futures prices for wheat were even more extreme, increasing by 50 per cent in the globally price influential Chicago futures market in February 2022, subsequently falling by 18 per cent in March.

Futures and forward contracts are normal market instruments, improving liquidity conditions by helping participants involved in producing, trading or consuming those goods to arrange a set price at a determined point in the future. Speculators have different objectives, betting on the direction of price movements. When many speculators enter into trades on agricultural markets with the same assumptions around crop, climatic and political conditions, they can amplify price movements in ways that are delinked from actual and anticipated supply and demand.

The German research institute ZEF (2022) found that the share of non-commercial traders (speculators) holding long positions (buying) in hard wheat and corn rose sharply to 50 per cent in early 2022, a situation that often corresponds to price spikes. Lighthouse Reports, an investigative journalism NGO, reported that in April 2022, investors pumped \$1.2 billion into two major agricultural Exchange Trade Funds (ETFs track market prices for a basket of commodities), compared to just \$197 million for the whole of 2021. Agricultural price indices are often a small share of the total ETF price index, but when energy prices are weighted more heavily in the ETF index formula, agricultural prices follow energy price trends. The United States and the European Union instituted some controls on financial speculation in physical commodity futures contracts in the wake of the 2009 financial crisis, but the controls have been weakened since.

For people who live in low-income, import dependent countries, even short-lived exaggerated price swings can have long term effects on food prices, increasing the incidence of food insecurity. Price swings delinked from supplies, especially when amplified by investors' expectations, disrupt planning for future crops and food supplies. In addition, the opacity and high levels of concentration in supply chains create the real risk that consumer prices will continue at historically high levels, even as farmgate and export prices have started to fall. New approaches to diversifying risk, including the establishment of grain reserves and encouraging planting of a broader variety of cereals suited to local climate and cultural conditions, would increase the stability of food supplies and prices.

More comprehensive information about supply chains could aid that process. The Agricultural Markets Information System (AMIS) was set up by the G20 after the 2007–2008 food price crisis to increase transparency in markets. For the most part, countries utilize reserves to smooth out supplies to national markets, although there are some important experiences with regional grain reserves in Asia, under the auspices of ASEAN, and in West Africa. While exact information on food stocks is difficult to gather, AMIS reports that “[l]ed by traditional holders of large public reserves such as China and India, grain stocks in developing countries more than doubled between the mid-2000s and today (FAOSTAT, 2020).” Of course, the existence of food stocks is not enough. They must also be available to stabilize markets. IPES-Food reports that the greatest knowledge of how much grain is at any given place in the world at any given time is knowledge held by private companies, in particular the “ABCD” of grain traders: Archer-Daniels Midland, Bunge, Cargill and Louis Dreyfus (Farchy and Blas, 2021). With those firms accounting for 70–90 per cent of global grain trade, their reserves are likely to be sizable. And with commodity speculation mounting, they have a clear incentive to hold stocks back until prices are perceived to have peaked (IPES Food, 2022).

On the demand side, financial speculators rushed into wheat futures, commodity swaps and agriculture-linked exchange traded funds (ETFs), immediately following the start of the war in Ukraine. The share of speculators in buy-side wheat futures contracts has increased from 23 per cent of open interest in May 2018 to 72 per cent in April 2022 (Agarwal et al., 2022). By April 2022, seven in ten buyers of futures wheat contract were investment firms, investment funds, other financial institutions and commercial non-hedgers whose aim was to profit from the rise in prices; Agarwal et al. (2022) find that investment firms increased

their presence in the buy side of the wheat futures market in Paris from 4 per cent of open interest in 2018 to 25 per cent in April 2022, and investment funds increased their presence from 1 per cent to 21 per cent of open interest. Data from the CFTC also show increased speculative activity in wheat in the Chicago Board of Trade (CBOT), as is clear from the strong growth in Exchange Traded Funds (ETFs) linked to agricultural commodities in 2022. Financial investors are cashing in on rising food prices.

Public food stocks could play a role to stabilize markets and offset the concentrated power of the big private traders. Debates on international food security and stockholding often pit arguments to use free trade and global markets as the ultimate reserve against the long history of national public stocks as a tried and trusted food security mechanism. In fact, stocks and trade can usefully be seen as complementary strategies. If under perfect free trade conditions, public stocks create a market distortion, under actual open trade conditions—a context rife with market failures and distortions, including highly concentrated market power—public stockholding can be seen to offer important benefits. Ideally, public stocks will be thoughtfully integrated into commercial markets, to limit the power of either government or the private sector creating a widespread price shock. Note that stocks occupy a difficult terrain in economic policy where commercial and public interests meet and to some extent collide. Neither a purely private sector nor a purely government-controlled response is likely to prove as effective as policies that recognize the need for co-existence. Public stocks can provide a form of collateral in open markets, protecting against supply shocks that may curtail imports unexpectedly by bridging the gap before imports resume.

Some progress along those lines was made when countries at the WTO agreed in 2013 to refrain from challenging the way India procured food for its public stocks program until the rules of the Agreement on Agriculture could be revised to the satisfaction of all WTO members. The eventual negotiation of such a solution is a necessary first step. Those rules should include safeguards to ensure that public stocks are not dumped on international markets, where they could undermine farmers and food production in other countries.

The Ukraine crisis also showed a new wave of export bans and restrictions on foodstuffs from exporting countries. Things have eased a little since the spring of 2022 but the WTO rules in this regard remain inadequate, deepening the qualms net food importers already experience in trusting their food security to international markets (Espitia et al., 2022).

Other factors deepening the effects of higher food and fuel prices include the deepening debt crisis, a problem that has never really gone away, but that has risen again sharply due to the pandemic and the continued failure to force creditors to do something about the crippling effects public indebtedness has across developing countries. An estimated 60 per cent of least developed and other low-income countries were at high risk of or already suffering in debt distress, spending an average of 16 per cent of their export earnings simply to service their external debt—and Small Island Developing States averaged more than 32 per cent (see section B above). In 2022, these countries have seen the cost of their food imports rise, while their ability to pay has been eroded by the cost of servicing their debt, which has risen with rising interest rates, a higher valuation of the dollar, and higher risk premiums due to increased volatility in commodity futures and bond markets.

The crisis sparked by the war in Ukraine and the subsequent shocks to global supplies of grains and fertilizers drives home the imperative for diversification in which countries grow critical food crops. The unfolding climate catastrophe illustrates the need to diversify which crops are grown, both to respond to an increasingly erratic climate and to improve nutritional diversity. Global cooperation on those issues, as well as enhanced coordination on the regulation of markets, trade and reserves, could help to build resilience against the future shocks that are certain to arise.

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