Chapter I

Current Trends and Challenges in the Global Economy

Crisis averted?
How to future-proof against systemic shocks

Today's global economic landscape is characterized by growing inequalities and divergence of growth paths between key regions. The world economy is flying at "stall speed", with projections of a modest growth of 2.4 per cent in 2023, meeting the definition of a global recession. Cautiously, the outlook for 2024 suggests a modest growth improvement (2.5 per cent), contingent upon the euro area's recovery and the avoidance of adverse shocks by other leading economies.

While many economies will grapple with divergent recovery paths, deepening inequalities and mounting pressures of indebtedness, global growth is unlikely to rebound sufficiently to pre-pandemic trends. This means that urgent needs like food security, social protection, and climate adaptation risk not being addressed.

Compounding these issues is the absence of adequate multilateral responses and coordination mechanisms. Without decisive action, the fragility of the global economy and an array of diverse shocks risk evolving into systemic crises. Policymakers must navigate these challenges on multiple fronts to chart a more robust and resilient trajectory for the future.

To avert tomorrow's potential crises, this report urges policymakers to adopt a policy mix prioritizing the reduction of inequalities and the delivery of sustainable, investment-led growth and development.

Recommendations include

- Central banks must strengthen international coordination with a greater focus on long-term financial sustainability for the private and public sectors, and not just on price stability;
- Policymakers must enable advocate concerted increases of real wages and make concrete commitments towards comprehensive social protection;
- Investment in the energy transition process in developing countries must be actively pursued, by making technology and finance available and affordable, requiring stronger multilateral cooperation and appropriate agreements in the World Trade Organization (WTO), the International Monetary Fund (IMF) and the World Bank.

A. INTRODUCTION

The global economy is flying at "stall speed", with projected growth in 2023 of 2.4 per cent, meeting the conventional criteria for a global recession. The entire global economy, except East and Central Asia, has slowed since 2022. On a brighter note, inflation, while still above pre-pandemic years, is coming under control in many parts of the world. The banking crises that erupted in March 2023 did not lead to financial contagion, and commodity prices are down from their peaks in 2022. A small improvement in global growth is expected in 2024, contingent on the recovery in the euro area and other leading economies avoiding adverse shocks.

While there is a glimmer of hope on the horizon, celebrations of success would be inappropriate. Global growth, while showing some signs of improvement, has not sufficiently rebounded to pre-pandemic rates. This challenge compounds the difficulty of meeting critical needs such as food security, social protection, and climate adaptation, especially given the weakened foundation resulting from the global health pandemic.

Against this background, 2023 may turn out to be an inflection point in a fragile and uneven global recovery. Without adequate multilateral policy responses or coordination mechanisms, today's brittle economies and diverse shocks might evolve into tomorrow's systemic crises. This scenario is a threat to the multilateral system and global economic stability. Policymakers need to operate on multiple fronts to chart a stronger, more resilient trajectory for the future.

Analysis shows that three worrying trends are emerging in 2023:

- Divergent recovery paths in the context of slower growth across major regions;
- Deepening inequalities in income and wealth;
- Growing pressures of indebtedness and thinning policy autonomy in developing economies.

These three factors build onto an increasingly complex interplay between economic, climate and geopolitical risks. Growing inequalities within countries are a source of weak global demand and continue to hold back investment and growth. Divergence of low-growth trends between key regions, as well as within the Group of Seven and the initial BRICS countries (Brazil, the Russian Federation, India, China and South Africa), indicates that there is no clear driving force to propel the world economy onto a robust and sustainable recovery track.

"There is no clear driving force to propel the world economy onto a robust and sustainable recovery track."

Historically, growth divergence has led to uncoordinated domestic policy actions with negative global repercussions, especially for developing countries. Today, policy discussions in advanced economies often overlook systemic links and multilateral forums for policy coordination, such as the Group of 20 (G20), are not remedying the problem. This can hinder international cooperation and prevent the global economy from taking a sustainable recovery path.

The prospects for developing countries are especially concerning. Development requires a favourable external environment, characterized by strong global demand, stable exchange rates and affordable financing. Developing countries' ability to accelerate growth, strengthen productive capacities, decarbonize and meet their financial obligations is fundamentally dependent on steady and strong global demand. But international policy coordination centres on central banks that prioritize short-term monetary stability over long-term financial sustainability. This trend, together with inadequate regulation in commodity markets and continuous neglect for rising inequality are fracturing the world economy.

These threats are amplified by the uncertain impact of slower than expected growth in China and a deceleration of the economies in Europe, many of which have all but ground to a halt. They are particularly concerning given the present context, marked by a slowdown in the investment cycle, the impact of geopolitical conflicts on the structure of trade, food and energy security and the mounting costs of climate change and transition, all compounded by uncertainty in the outcome of the of the 2024 United States elections. Even if growing

financial risks in the larger economies do not trigger sharper shocks, a development crisis is already unfolding, with countries across the global South facing increasing debt service obligations.

For people and planet, further rounds of monetary tightening to obtain quick disinflation in the advanced economies would mean more economic and social disruption at a time when recovery has stalled. An ongoing slowdown diminishes prospects for trade and investment, prompting a further loss of momentum, higher inequality and debt burdens expanding relative to gross domestic product (GDP).

Against this context, 2024 is unlikely to show substantial improvement. A strategy of growth in the global North becomes less feasible if high levels of debt (chapters II and V) and inadequate financial regulation threaten financial stability and food security (chapter III), and while income is increasingly retained by capital owners rather than workers (figure I.1). In the face of a crisis, previous coordination efforts have tended to ignore sectors or countries that are not considered systemically relevant, thus compounding the very crisis they sought to resolve. This mistake should be avoided at all costs.

"Monetary policy in advanced economies should take into account the damage that high interest rates can cause, in terms of structural change, climate adaptation and debt sustainability."

This Report presents an alternative response, in which the pace of disinflation takes into consideration the impact of high real interest rates not only on inflation indicators, but also on economic activity, employment, income inequality and fiscal stability. In an interconnected world in which developing countries are potential engines of economic growth, policymakers in advanced economies should take into account the damage that high interest rates can cause to long-term investment – both in terms of structural change and climate adaptation – as well as debt sustainability. In the current international financial architecture, policy space is easily curtailed by movements in financial markets, with heavy impacts on social policies, investment and employment generation.

To address these problems, this Report suggests that:

"A policy mix is needed to attain financial sustainability, help lower inequalities and deliver inclusive growth."

1. Reducing inequality should be made a policy priority in developed and developing countries, keeping close watch on the labour share. This requires concerted increases of real wages and concrete commitments towards comprehensive social protection. Monetary policy is not to be used as a sole policy tool to alleviate inflationary pressures. With supply-side problems still unaddressed, a policy mix is needed to attain financial sustainability, help lower inequalities and deliver inclusive growth.
2. In light of growing interdependencies in the global economy, central bankers should assume a wider stabilizing function, which would help balance the priorities of monetary stability with long-term financial sustainability.
3. Internationally, a systemic approach to regulating commodity trading generally, and food trading in particular, needs to be developed within the framework of the global financial architecture.
4. To help address the crushing burden of debt servicing and the threat of spreading debt crises, reforms are needed to the rules and practices of the global financial architecture. This architecture should ensure reliable access to international liquidity and a stable financial environment that promotes investment-led growth. Given the failure of the current architecture to facilitate the resilience and recovery of developing countries from debt stress, it is crucial to establish a mechanism to resolve sovereign debt workouts. This should be based on the participation of all developing countries and have agreed procedures, incentives and deterrents.
5. Finally, the energy transition would require not only fiscal and monetary agreements among the G20, but also agreements within the WTO to implement technology transfer, and within the IMF and World Bank to provide reliable access to finance. Without eliminating the incentives and regulatory conduits that make cross-border speculative investment so profitable, private capital is unlikely to be channelled to measures to help adapt to climate change.

The chapter is structured as follows. Section B examines the emerging risks to post-COVID-19 growth trend at the global level. It finds that divergence within key regional blocks and between major economies clouds the fragile growth of 2023, with downside risks lingering into 2024. Section C analyses the sectoral contribution to global demand growth in G20 economies. Section D identifies some of the key dimensions of the asymmetry between growing corporate concentration on the one hand and thinning fiscal policy space on the other. Section E discusses credit, investment and the impact of monetary policy on income and wealth inequality. Section F explores inflation, distribution and the easing or persistence of inflationary trajectories. Section G looks at labour costs and inequality. Section H concludes.

B. GLOBAL GROWTH LANDSCAPE: DIVERGENCE UNDER THE CLOUDS OF UNCERTAINTY

The growth of the world economic output is expected to decelerate to 2.4 per cent in 2023, before registering a small uptick to 2.5 per cent in 2024. (table I.1). These are among the lowest growth rates of the last four decades, outside of crisis years. Moreover, the figure for 2023 is below the conventional threshold of 2.5 per cent which marks recession in the global economy. These projections are subject to downside risks which have increased in recent months.

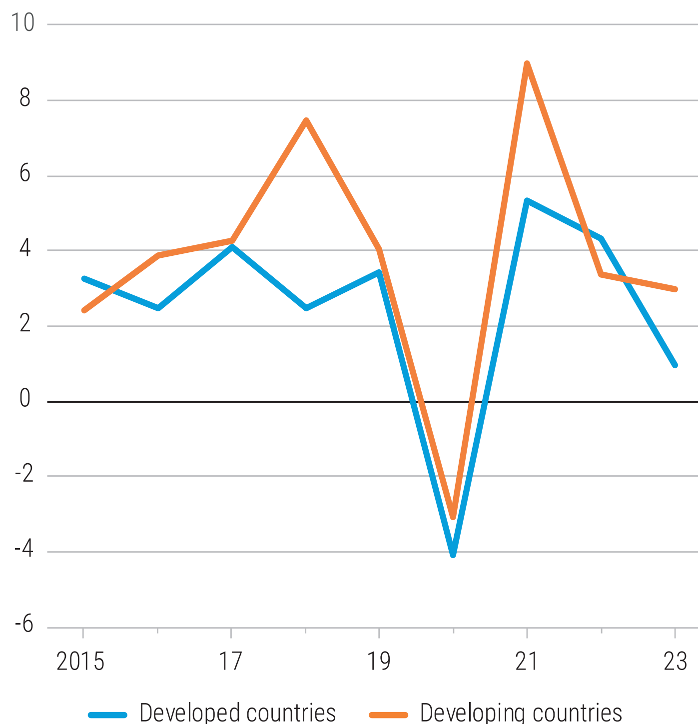
All regions, except for East and Central Asia, are expected to post slower growth this year than in 2022, with the largest drop (2.3 points) occurring in Europe. Likewise, among G20 countries, only Brazil, China, Japan, Mexico and the Russian Federation are expected to see a growth improvement, with considerable variation. Of particular concern, given the ambitious development and climate targets set by the international community with a 2030 delivery date, growth in 2023 and 2024 is also set to fall below the average for the five-year period before the pandemic, in all regions. Latin America is the exception, where growth in the earlier period was particularly weak (ECLAC, 2023).

In 2023, global growth showed uneven deceleration. Larger emerging economies are unlikely to provide a robust offset to slower growth in advanced economies. With tighter monetary policy, low investment (figure I.1), and limited government spending, the world economy is experiencing a lacklustre recovery reminiscent of the aftermath of the 2008–2009 financial crisis.

Figure I.1 Private investment is slowing down sharply again

Growth of private investment

(Percentage change)



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

Note: GDP at constant 2015 prices, PPP.

Table I.1 World output growth, 1991–2024

(Annual percentage change)

Country groups	1991–1999[a]	2000–2009[a]	2010–2014[a]	2015–2019[a]	2019	2020	2021	2022	2023[b]	2024[b]	Revision for 2023[c]
World	2.9	3.3	3.2	3.0	2.5	-3.2	6.1	3.0	2.4	2.5	+0.3
Africa	2.4	5.5	2.7	3.0	2.6	-2.4	4.5	3.1	2.7	3.0	+0.2
North Africa (incl. South Sudan)	2.7	5.3	-1.9	4.1	2.3	-3.3	4.8	1.9	2.9	3.0	+0.1
South Africa	2.7	4.0	2.5	1.0	0.3	-6.0	4.7	2.0	0.0	1.0	+0.3
Sub-Saharan Africa (excl. South Africa and South Sudan)	2.0	6.4	6.3	2.9	3.4	-0.9	4.2	4.0	3.2	3.4	+0.2
America	3.4	2.5	2.4	1.9	1.7	-3.8	6.0	2.5	2.0	1.8	+0.9
Latin America and the Caribbean	3.2	3.5	3.4	0.1	-0.3	-7.1	6.7	3.9	2.3	1.8	+1.0
Central America (excl. Mexico) and the Caribbean	2.8	4.4	3.6	3.0	2.2	-8.6	8.2	4.8	2.9	2.9	+0.4
Mexico	3.0	1.9	3.2	2.1	-0.2	-8.0	4.7	3.0	3.2	2.1	+1.4
South America	3.4	3.9	3.4	-0.9	-0.7	-6.6	7.2	4.0	1.9	1.6	+0.9
Argentina	4.6	3.8	2.7	-0.3	-2.0	-9.9	10.4	5.0	-2.4	-0.6	-1.9
Brazil	2.9	3.6	3.2	-0.4	1.2	-3.3	5.0	2.9	3.3	2.3	+2.4
North America	3.4	2.3	2.1	2.3	2.3	-3.0	5.9	2.2	1.9	1.8	+0.9
Canada	2.8	2.3	2.6	2.0	1.9	-5.1	5.0	3.4	1.3	1.0	-0.8
United States	3.5	2.3	2.1	2.3	2.3	-2.8	6.0	2.1	2.0	1.9	+1.1
Asia (excl. Cyprus)	4.3	5.6	5.7	4.8	3.7	-0.9	6.5	3.6	3.9	3.9	-0.0
Central Asia	-4.4	8.3	6.8	3.4	3.8	-1.2	5.3	4.5	4.5	3.8	+0.1
East Asia	4.4	5.6	5.8	4.8	4.0	0.4	6.7	2.4	3.8	3.8	-0.1
China	11.0	10.6	8.6	6.8	6.0	2.2	8.4	3.0	4.6	4.8	-0.2
Japan	1.2	0.9	1.4	0.9	-0.4	-4.3	2.2	1.0	2.3	0.9	+0.7
Republic of Korea	6.8	4.9	3.6	2.9	2.2	-0.7	4.2	2.6	0.9	2.1	-1.0
South Asia	4.7	6.3	5.4	6.0	3.7	-3.8	7.7	5.8	5.2	5.2	+0.1
India	5.9	7.2	6.6	7.0	4.6	-6.0	8.9	6.7	6.6	6.2	+0.6
South-East Asia	5.3	5.4	5.6	5.0	4.3	-3.9	4.0	5.4	3.9	4.2	-0.1
Indonesia	4.8	5.2	5.8	5.1	5.0	-2.1	3.7	5.2	4.2	4.1	-0.4
Western Asia (excl. Cyprus)	4.1	5.0	5.5	2.9	1.4	-3.2	6.3	6.6	3.3	2.7	+0.2
Saudi Arabia	1.7	4.0	5.8	1.9	0.8	-4.3	3.9	8.7	2.5	2.9	-1.0
Türkiye	3.9	5.0	7.6	4.3	0.8	1.9	11.4	5.6	3.7	1.9	+1.1
Europe (incl. Cyprus)	1.3	2.2	1.2	2.1	1.8	-6.0	5.8	2.9	0.6	1.2	+0.1
European Union (27 Members)	1.9	1.8	0.8	2.2	1.8	-5.7	5.6	3.4	0.4	1.2	-0.3
Euro area	1.9	1.6	0.6	2.0	1.6	-6.1	5.4	3.4	0.4	1.2	-0.3
France	1.8	1.6	1.1	1.7	1.8	-7.8	6.8	2.5	0.9	1.2	-0.1
Germany	1.6	1.0	2.0	1.8	1.1	-3.7	2.6	1.8	-0.6	1.1	-0.6
Italy	1.5	0.7	-0.8	1.1	0.5	-9.0	7.0	3.7	0.6	0.8	-0.1
Russian Federation	-5.9	6.2	3.1	1.2	2.2	-2.7	5.6	-2.1	2.2	1.9	+3.6
United Kingdom	2.3	2.0	1.8	2.1	1.6	-11.0	7.6	4.1	0.4	0.4	+0.4
Oceania	3.7	3.2	2.8	2.7	2.1	-1.8	5.1	3.5	1.8	1.5	-0.1
Australia	3.7	3.3	2.8	2.5	1.9	-1.8	5.2	3.7	1.9	1.5	+0.0
Memorandum items:											
Developed countries	2.3	2.2	1.7	2.1	1.8	-4.2	5.4	2.4	1.4	1.5	+0.4
Developing countries	4.9	6.4	5.8	4.4	3.6	-1.6	7.1	3.9	3.9	4.0	+0.1

Source: UNCTAD calculations, based on United Nations Global Policy Model; United Nations, Department of Economic and Social Affairs, National Accounts Main Aggregates database, and *World Economic Situation and Prospects* (WESP): Update as of Jun-2023; ECLAC, 2023; Organisation for Economic Co-operation and Development (OECD), 2023; International Monetary Fund (IMF), *World Economic Outlook*, spring 2023; Economist Intelligence Unit, EIU CountryData database; JP Morgan, Global Data Watch; and national sources.

Note: The composition of the five geographical regions follows the M49 standard of the United Nations Statistics Division. The distinction between developed and developing countries is based on the updated M49 classification of May 2022. Calculations for country aggregates are based on GDP at constant 2015 dollars.

[a] Average.

[b] Forecasts.

[c] Revisions relate to comparisons with forecasts presented in April 2023 in an UNCTAD *Trade and Development Report* update.

So far in 2023, four main factors have shaped the global outlook. Each introduces considerable uncertainty into near-term projections:

1. International prices of oil, gas and food have returned to late 2021 levels eliminating a powerful driver of inflation. However, retail prices in many countries remain higher than pre-pandemic averages, putting pressure on household budgets. While relief from major supply-side drivers of inflation would allow governments to address profiteering domestically, most major central banks continue to signal the likelihood of ongoing elevated interest rates.
2. The United States, comprising a quarter of the world economy, has displayed resilience throughout two years of rising consumer price inflation (April 2020–June 2022), despite a year of blanket disinflation policies (11 interest rate hikes in 18 months) and sporadic financial market disruptions. Key parts of the economy, buoyed by employment and nominal wage growth, have sustained consumption and spending. While unemployment has reached historic lows, the employment rate remains at recession levels, standing at 58 per cent of the population. Additionally, weakness in the manufacturing sector and recent aggregate figures[1] have heightened the risk of a sharper slowdown in the latter half of 2023.
3. In China, lifting of the remaining COVID-19-related restrictions has helped sustain the recovery which began in 2022 and which enabled a revamp of industrial production. The country's economic growth relies less on exports than in the past (table I.2) and the government continues to enjoy considerable fiscal space. However, persistent weaknesses in the real estate sector pose challenges, including potential financial stress, reduced job creation, constrained consumer spending and delayed investments. Additionally, escalating geopolitical tensions are disrupting how China dominates key global value chains, clouding prospects in some of its frontier technology sectors, at least in the short-term. Authorities in China have responded to slower-than-expected growth with a mix of monetary expansion, supply-side incentives and regulatory tightening. The overall impact of these measures as well as their spillover effects, particularly on neighbouring economies, remains uncertain.
4. Concern over growth prospects in China risks overshadowing the deteriorating economic health of the European economy. While growth in China has now decreased approximately 30 per cent compared to the pre-COVID-19 average of 2015–2019, growth in Europe has decreased approximately 70 per cent. With a share of the global economy similar to that of China (approximately 18 per cent in purchasing power parity, higher at current exchange rates), the global consequences of the slowdown in Europe are at least twice as heavy as those of the slowdown in China. Continuing monetary tightening in the euro area risks tipping the region into recession in 2024.

Post-pandemic growth performance in the leading developed and emerging economies over the past three years points to divergent recovery pathways. On the one hand, differences reflect country positions in the international monetary and financial hierarchy, which defines the scope of autonomy policymakers enjoy when formulating macroeconomic responses to shocks. The favourable position of developed countries in this hierarchy helped them to manage a swift turnaround from the initial shock of the pandemic.

"Post-pandemic growth performance in the leading developed and emerging economies over the past three years points to divergent recovery pathways."

However, these routes depend on governments' willingness to deploy policies for longer-term growth plans. Advanced economies, aside from the United States and Japan, struggled to maintain a steady recovery after the 2020 pandemic shock. The United States stabilized through an aggressive use of industrial policy, widening the gap with other developed countries. Austerity-constrained Europe lagged behind (figure I.2.A). Among developing countries, China and India saw strong recoveries, while other BRICS members benefitted from favourable export conditions. South Africa stands out as an exception (figure I.2.B).

[1] Data released during the summer of 2023.

Table I.2 Developing countries have been generating critical global demand

Growth of demand stance of institutional sectors, G20 countries, 2022

(Annual percentage change)

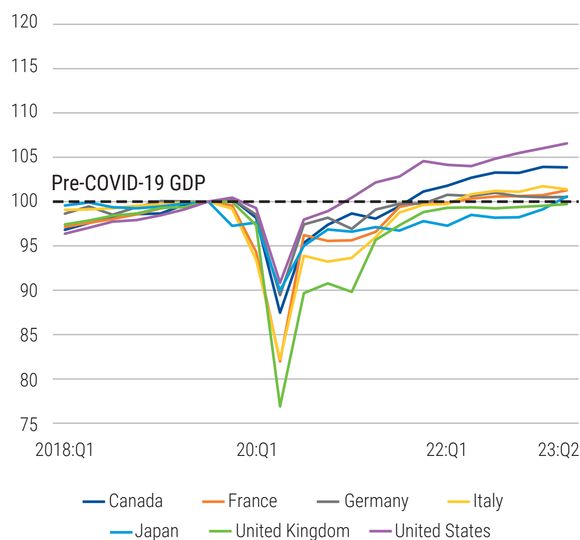
	GNI	Private	Government	External
Developed countries				
Australia	3.6	2.8	0.7	0.0
Canada	3.2	0.0	0.8	2.4
France	2.2	0.8	-0.3	1.7
Germany	2.1	0.0	0.0	2.1
Italy	3.3	0.7	-0.4	3.0
Japan	2.1	-0.4	-1.8	4.3
Republic of Korea	2.7	-0.4	0.6	2.5
Russian Federation	-1.8	-0.2	2.4	-4.0
United Kingdom	3.8	2.2	-1.6	3.2
United States	2.0	0.8	0.1	1.1
Developing countries				
Argentina	5.3	1.9	2.5	1.0
Brazil	2.9	0.1	0.6	2.2
China	3.3	1.3	2.0	0.0
India	6.7	3.5	1.7	1.5
Indonesia	4.7	-1.3	0.4	5.6
Mexico	2.7	0.3	-0.1	2.5
Saudi Arabia	8.2	-1.8	1.8	8.2
South Africa	2.2	2.6	1.9	-2.3
Türkiye	6.1	5.3	0.8	0.0

Source: UNCTAD calculations based on the United Nations Global Policy Model and database.
Note: GNI: gross national income.

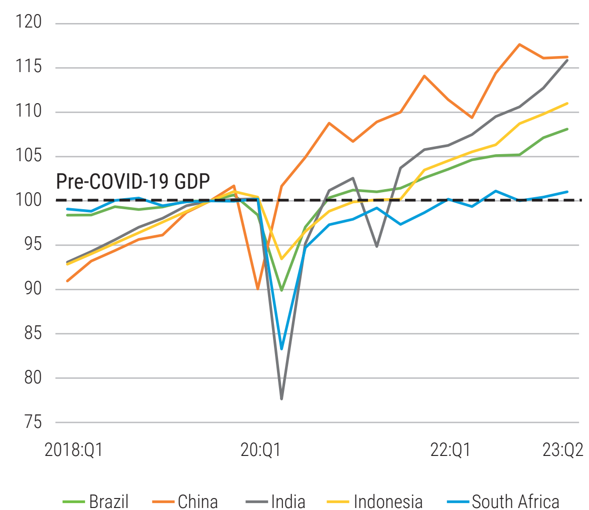
Figure I.2 Real GDP levels recovering separately

(Index numbers, third quarter of 2019=100)

A. G7 countries



B. Selected developing countries



Source: UNCTAD calculations based on Refinitiv data.
Note: Data is seasonally adjusted.

C. LEADING ECONOMIES IN AN INTERDEPENDENT WORLD

To further assess the outlook for global growth, table I.2 illustrates the sectoral contribution to global demand growth in G20 economies. It shows that export sectors in developed countries are growth drivers in those countries. They tap global demand rather than generate demand for developing countries. At the same time, many developing economies positively contribute to global demand by importing more than they export. South Africa is an extreme case, with substantial growth in private sector demand. However, the external sector has absorbed a substantial part of that demand, partly due to a 20-year depreciation of the rand, which has made import costs higher.

As a guide to understanding how different sectors affect domestic growth prospects, table I.2 distinguishes the private sector (households and businesses) from the government and the external sector (the rest of the world). Numbers indicate the portion of economic growth generated by each sector, considering the positive effect of its spending and the negative effect (on growth) of its saving. The advantage of this approach lies in its straightforward rearrangement of national accounts data. It adheres to the accounting convention that fully distributes value added in production as income to workers, businesses, and the government.

Looking ahead, a “soft landing” for the **United States** economy still seems possible. This would imply that GDP growth is already close to hitting its low point (sparing the country a recession, conventionally defined as two consecutive quarters of negative growth), along with a small uptick of unemployment and moderate disinflation. In fact, disinflation has largely happened with the rate of annual price increases coming down two thirds from 8.9 per cent in June 2022 to 3.0 per cent in June 2023. This is bound to drive up the real cost of capital, which remained negative until early 2023. GDP growth in the United States is expected to slow from 2.1 per cent last year, to 2.0 per cent in 2023 and 2024.

The slowdown has been mainly policy-induced, owing to the combination of monetary tightening and a neutral fiscal policy. Recent signals from the Federal Reserve suggest interest rates will remain high for the remainder of the year, with further rises not ruled out. The fiscal stance is expected to turn recessionary next year in line with the latest congressional agreement on the Federal debt ceiling, pushing growth lower in 2024.

Uncertain developments in several specific domestic factors in the United States economy will have a bearing on prospects for the global economy. A drop in key asset prices is a worrying sign that financial markets may not be able to withstand higher interest rates much longer. Bank shares have been sliding since earlier this year, a movement that preceded both the global financial crisis and the sovereign debt crisis in Europe, as have the values of 10-, 15-, and 20-year treasuries compared to early 2020. Over this period, holders of 20-year treasuries have borne a-17 per cent loss. Given their ubiquity in structured financial asset portfolios, large write-downs of treasuries would likely be destabilizing.

“Uncertain developments in several specific domestic factors in the United States economy will have a bearing on prospects for the global economy.”

On the other hand, the policy interest rate (Federal Funds Rate) may fall in 2024. Nevertheless, small rate cuts are not effective at reversing growth deceleration and a large cut would run counter to the stated objective of monetary policy normalization (Federal Reserve Board, 2022). If unemployment begins to increase and real wages stagnate, the growth rate of consumption would likely slow, blocking any quick response of residential investment to reductions in interest rates.

The rest of North America is expected to follow the business cycle of the United States, with differences in outcome largely due to national policies. In **Canada**, more aggressive monetary policy and ongoing withdrawal of COVID-19 stimulus spending have led to a downward correction of 2023 growth projections. In **Mexico**, prospects have improved as the economy has benefited from less aggressive monetary tightening and an inflow of new investment to establish new manufacturing capacity, triggered by the bottlenecks that emerged in East Asia in 2021 and 2022.

In South America, Argentina and Brazil (which together account for almost 70 per cent of the region's output) are experiencing different developments. In **Brazil**, booming commodity exports and bumper harvests are driving an uptick in growth, from 2.9 per cent in 2022 to 3.3 per cent in 2023. However, negative demand forces are weighing on growth. These include the delayed impacts of monetary tightening, which started at the end of 2021, and which pushed the Brazilian real short-term interest rate to 9 per cent by the beginning of this year. This is in addition to growing private debt, especially by households, during the COVID-19 crisis. Significant fiscal expansion in 2023 should offset these recessive forces, but the fiscal impulse for 2024, although still subject to political negotiations, is expected to turn negative, reducing GDP growth below 3 per cent.

Argentina is experiencing both a recession and accelerating inflation. On the real side, a severe drought has raised the price of food and power, driving up an already high inflation rate, with significant negative effects on the purchasing power of households, especially among the poorest segments of the population. On the monetary side, the rise in inflation has triggered a run on foreign currency and currency depreciation. Fiscal policy turned contractionary because high inflation erodes real spending faster than it erodes tax revenues, but the induced fiscal tightening has not been sufficient to control inflation.

In this outlook, the darkest clouds hover over **Europe**, where the sharp rise in energy costs through most of 2022 and early 2023, as well as stubborn food price inflation and reduced household purchasing power are exerting downward pressure on consumption. Some governments partially absorbed the energy price increases but are now reducing fiscal spending to offset deficit pressures. While the euro area is still expected to experience marginal positive growth in 2023, it is on a knife edge.

The second quarter of 2023 saw the euro area narrowly avoid recession, in no small part due to an unexpected investment surge, which was more statistical artefact than renewed productive capacity: a reflection of the acquisition of intellectual property rights by a number of multinationals in Ireland (Bank of Italy, 2023; Arnold, 2023). The decision of the European Central Bank (ECB) to raise interest rates by the end of September is already casting a shadow over prospects for the fourth quarter, increasing the risk of tipping the euro area into a recession.

Overall, the largest economies in Europe, with the exception of Germany, are still projected to continue growing, primarily driven by exports. This highlights their market power vis-à-vis their trading partners in the face of price increases. Growth will, to a lesser extent, also be driven by private consumption and investment. Germany, France, Italy and the United Kingdom, are on a path of slowing demand growth. **Germany** experienced three quarters of negative growth in the last year and, in 2022, a record fall of real wages. But both the private sector and the government recorded a small surplus, spending less than their incomes and overall subtracting approximately 4 per cent from the country's economic growth. The export sector more than made up for this, bringing total growth barely into positive territory. This has not continued in 2023. **France** also "exported" its way out of a recession in 2022, but its private sector was a net contributor to aggregate demand. The government engineered a contraction of its net demand, continuing to reduce its net borrowing after the peak of 2020, while the external sector contributed almost 80 per cent of the country's growth.

Italy followed a similar pattern but with a less pronounced impact of reduced government net borrowing and an external sector that contributed approximately 90 per cent of growth. The labour share recovered somewhat in 2022 but not as result of improving workers' compensation. Rather, real wages fell, but productivity fell more, leaving the labour income share at a record low level and the profit share at a record high level. In the **United Kingdom**, the labour share fell drastically in 2021 and this continued in 2022, losing approximately 3 per cent of GDP to profits. Government net borrowing was also cut substantially, which led the government sector to subtract from aggregate demand rather than contribute to it. However, private sector spending, financed increasingly with debt accumulation and sustained by a resurgence in household consumption of services, along with support from the external sector, kept the economy out of a recession, albeit barely. Tentative data suggests that this might not be the case in the second half of 2023.

In the **Russian Federation**, economic growth has been slowed by a large reduction of net external demand, likely related to the economic response to the war in Ukraine. The overall volume of oil and gas exports, the country's main source of foreign currency, has not changed dramatically: exports of natural gas reportedly fell by 32 per cent in 2022, mainly as a result of shifting demand from Europe, which imported less piped gas and more liquified gas via tankers. However, oil exports, amounting to the majority of energy exports (75 per cent), remained mostly stable at 3 million barrels per day. Small volume changes notwithstanding, the revenue from oil and gas exports dropped by nearly half (47 per cent) in the first half of 2023 following the decrease of international prices, a trend that the Russian Federation responded to by cutting production. Whether this will yield the desired result remains to be seen. Meanwhile, the currency has posed another challenge. The rouble remained mostly stable through 2022, thanks to effective capital controls, but it has since depreciated sharply, compounding the problem posed by falling oil prices and further hindering the country's ability to purchase foreign commodities and manufactures. So far, the government has been able to pick up the slack in demand by increasing its net borrowing, in no small part thanks to a comfortably low sovereign debt ratio (23 per cent of GDP), but financial pressures are likely to intensify towards the end of the year. Based on all these factors, GDP growth is projected to be 2.2 and 2 per cent in 2023 and 2024, respectively.

Energy price and currency woes have affected **Türkiye**, too. The country was hit hard by high energy prices in 2022 but retained strong domestic demand throughout the first half of 2023 thanks to strong fiscal support, an effective programme of transfers to households, and a 10-point cut of the policy interest rate. However, while the latter provided stimulus to domestic demand, it placed pressure on the currency. The lira has been depreciating since before the pandemic, with a severe loss of value occurring earlier in the second quarter of 2023. Overall, projections for the country's economy are growth at 3.7 per cent in 2023, decelerating to 1.9 per cent in 2024.

In **Japan**, economic growth was driven last year by a surge in external demand, caused in large part by the pent-up global demand for automobiles and by a weaker yen. At the same time, government spending on goods, services and transfers fell, turning the public sector into a net saver. This year the currency has appreciated vis-à-vis the dollar and depreciated vis-à-vis the renminbi, leading to weaker net exports. External demand has continued to be strong while moderate inflation and a national agreement on wage growth have reinvigorated consumer demand. On the other hand, the contractionary stance of fiscal policy has continued, leading to a projected growth of 2.3 per cent this year and of 1.2 per cent in 2024. With sustained external demand and strong domestic demand, the main risks to the outlook come from the policy mix, notably a faster reduction of the fiscal deficit and a possible tightening of monetary policy.

In **China**, government net demand has remained the main driver of economic growth, while the external sector has exercised a drag on demand, contrary to frequent portrayals of the world's largest developing economy as purely export-driven. But it must also be noted that recently, the private sector in China has played a less relevant role as a driver of growth than it did it even in the aftermath of the global financial crisis. The relative weakness of the private sector to generate growth points to the ongoing challenge of establishing a deeper domestic market, which has left China more dependent today on fiscal expansion than it was a decade ago. The weakness in private sector demand in China is a source of uncertainty for global economic prospects. A deflating real estate bubble and a chain of financial crises among large developers, which started even before the pandemic struck, have caused significant losses in the construction sector and for owners of real estate and other affected assets. The government has responded with a series of measures aimed at reducing leverage in real estate finance (a major incubator of financial risk) and, more recently, cutting interest rates to stimulate aggregate demand. Meanwhile, domestic demand remains stable and key financial indicators have not yet exhibited concerning swings: bank share prices have decreased moderately (less than in the United States or Europe), demand for sovereign bonds has remained buoyant, and the renminbi has appreciated compared to other leading currencies in the region (although it has depreciated against the United States dollar). These factors together suggest GDP growth of 4.6 per cent in 2023 and 4.8 per cent in 2024. This is somewhat below the government target of 5 per cent, but still well above the average figure in advanced economies.

In **India**, the external sector – alongside the private and government sector – has contributed to domestic growth, partly helped by many countries redirecting trade flows away from the Russian Federation, with which India maintains a direct relationship. Growth in 2022 moved back in line with pre-pandemic rates and is expected to continue into next year. However, other indicators still suggest caution: with rates of unemployment still standing at 8.5 per cent in June 2023, employment remains disappointingly low by historical standards. Inequality has also significantly increased – as suggested by data on real wages and the labour share – which could hinder growth.

Indonesia has recently exhibited a shift from growth driven by private sector demand to a more export-oriented pattern, facilitated by the recent commodity boom, including for nickel. Robust growth this year is expected to continue into 2024. The government has been reducing its net borrowing since 2020 and its net claims on income are now absorbing aggregate demand rather than contributing to it. Investment and employment creation have also slowed, in a concerning sign for an economy whose growth has begun to be driven by commodities.

D. CORPORATE CAPTURE AND THE DEMISE OF FISCAL POLICY

"A functioning international financial architecture would isolate governments from these pressures and nudge them to adopt policies that favour growth, development and the necessary structural investments."

In 2010, this Report warned that fiscal retrenchment – the rapid rolling back of emergency support during the global financial crisis – would backfire. A few years later, economists from several international financial institutions expressed a mea culpa for advocating (premature) fiscal austerity (Blanchard and Leigh, 2013). After the devastating pandemic in 2020 and 2021, growth in most G20 countries is still much lower than it was in the 2010s, but primary fiscal balances (i.e., the balances that exclude interest payments, therefore the more easily controllable parts of governments' budgets) have quickly turned positive (figure I.3). This largely results from the high pressure faced by governments to reduce deficits to continue to have access to international credit markets. A functioning international financial architecture would isolate governments from these pressures and nudge them to adopt policies that favour growth, development and the necessary structural investments.

Figure I.3 illustrates how fiscal policy is considered at best, a shock absorber, subject to limited and temporary action (Bernanke, 2008) before a return to austerity. This approach has been proven to exacerbate boom–bust cycles and diminish the desired impact from emergency measures, including corporate capture as a contributing factor (Crouch, 2009; Costantini, 2020; TDR, 2021, 2022). In turn, this represents a reduction in States' ambition to strategically shape the economic trajectory and comprehensively address heightened inequalities.

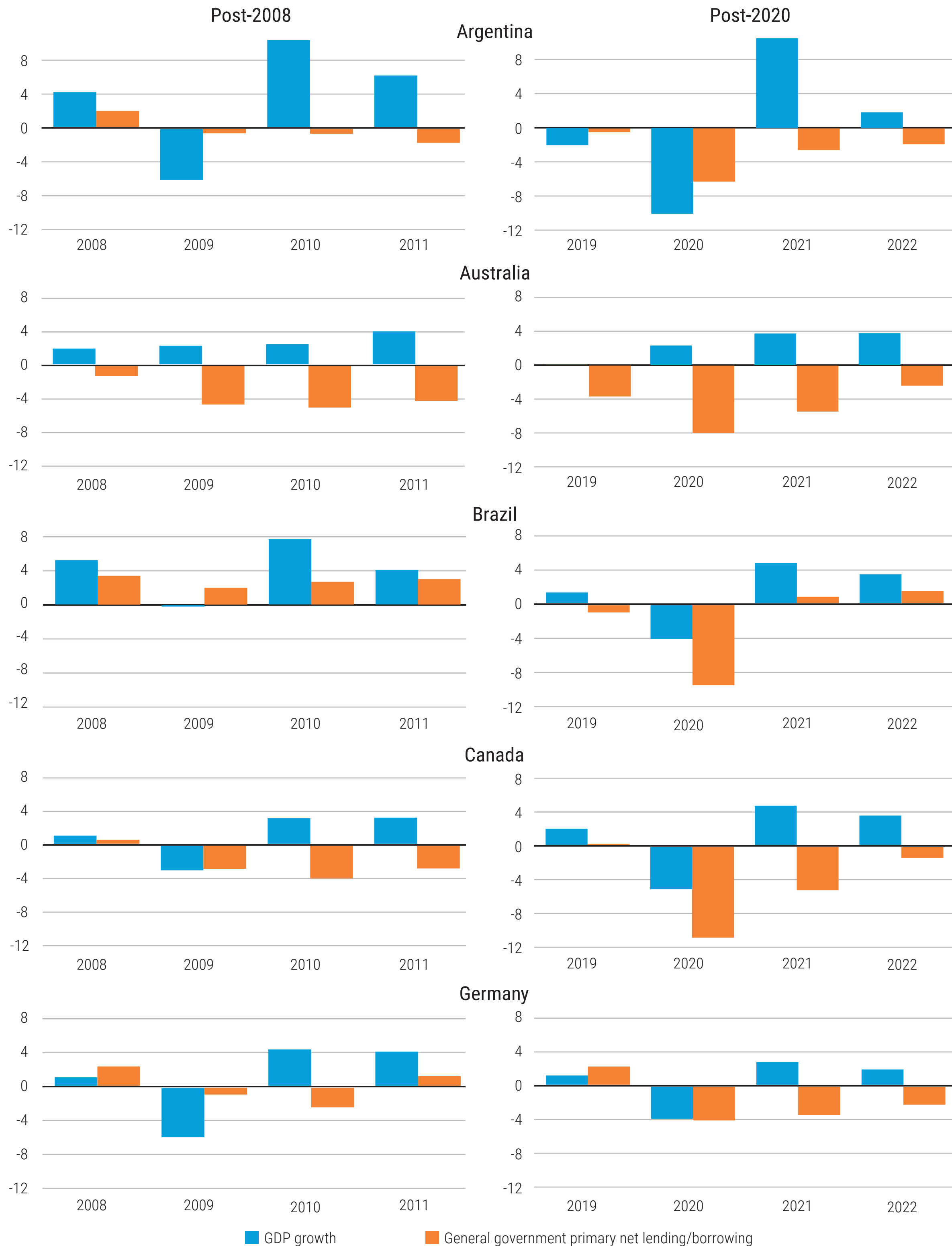
This problem has played out differently in developed and developing countries. Driven by inflationary fears, developed countries with sufficient fiscal space have tended to limit themselves to smoothing out the cycle, on both its downswings and upswings, around a mediocre normal. For most countries, this fiscal framework tends to drive up debt-to-income ratios, due to subdued growth and costly emergency spending. Meanwhile, the growing concentration of market power by large corporations and the influence of high net worth individuals reduce the ability to raise tax revenues (figure I.4). In an era of compounding crises that increasingly require public resources to address systemic disruptions, the asymmetry between growing corporate consolidation and the thinning fiscal space need to be addressed by revisiting dominant economic paradigms and, critically, the policy decisions based on them.

"The asymmetry between growing corporate consolidation and the thinning fiscal space needs to be addressed by revisiting dominant economic paradigms and, critically, the policy decisions based on them."

Figure I.3 Rushed withdrawal of fiscal support: Post-2008 and post-2020

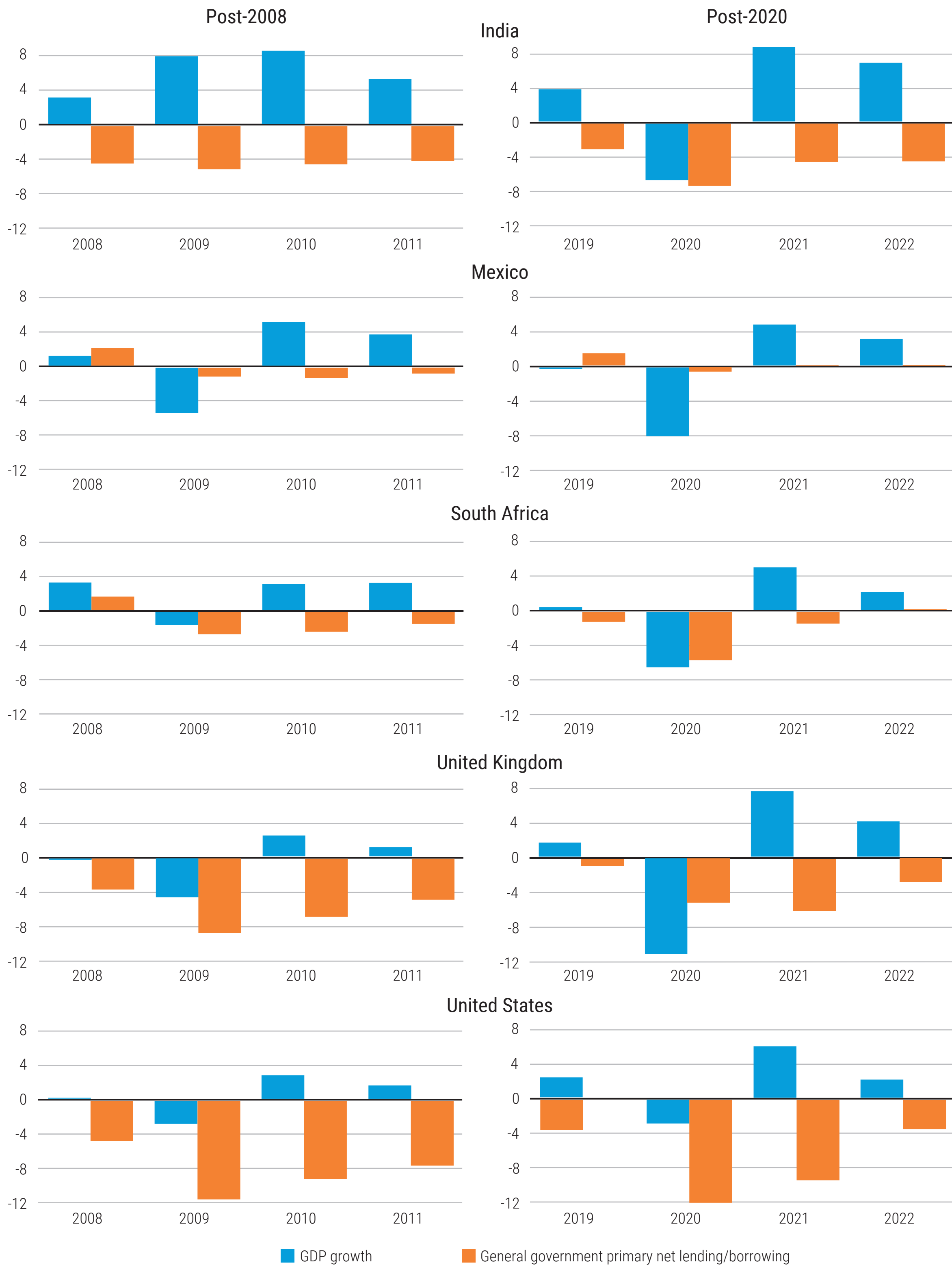
Real GDP growth and government primary net lending as a share of GDP, selected countries

(Percentage)



Source: UNCTAD calculations based on IMF World Economic Database.

Figure I.3 Rushed withdrawal of fiscal support: Post-2008 and post-2020 *(cont.)*
Real GDP growth and government primary net lending as a share of GDP, selected countries
(Percentage)

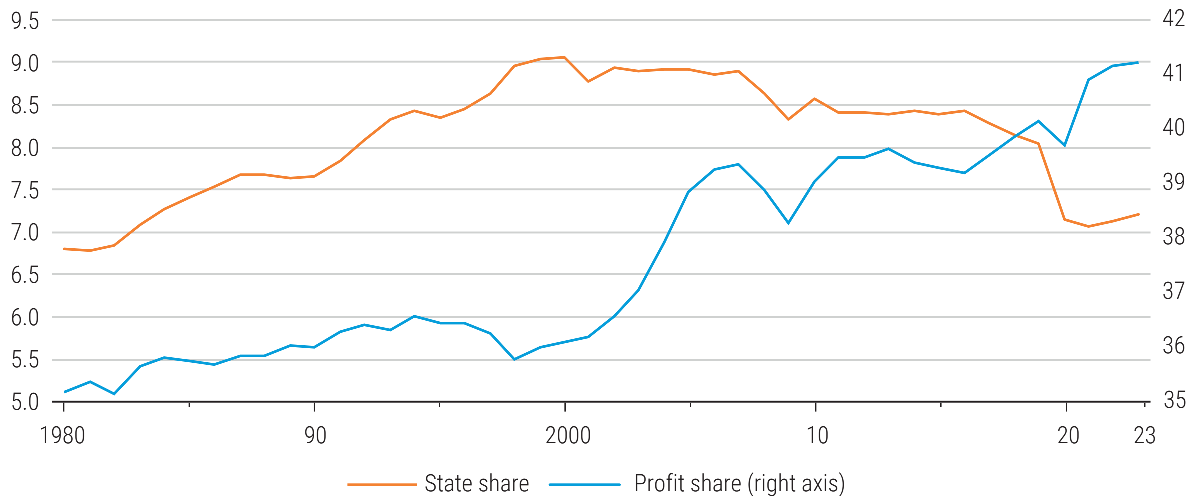


Source: UNCTAD calculations based on IMF World Economic Database.

Figure I.4 Globally: Rising profit share, shrinking fiscal space

Shares of operating profits and indirect taxes (net of subsidies)

(Percentage of GDP)



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

Note: GDP at constant 2015 prices, PPP.

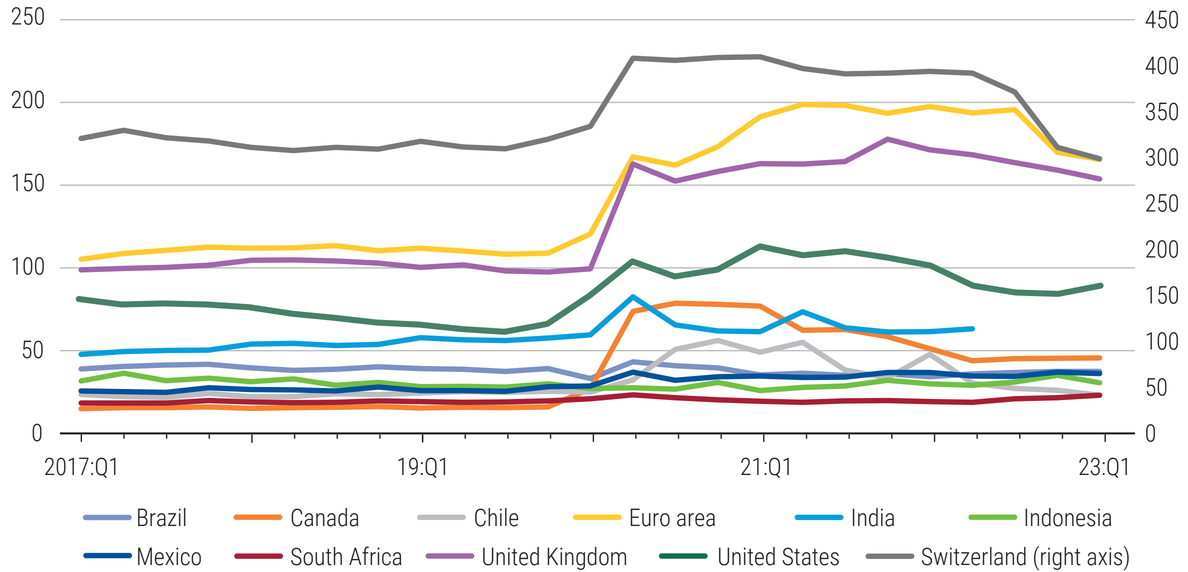
E. CREDIT, INVESTMENT AND THE ROLE OF MONETARY POLICY

From 2010–2021, with inflation subdued and often below target (see box I.2) and investment remaining stagnant, quantitative easing and record low interest rates were the policies of choice for many central banks, including in developing countries (TDR 2022: chapter III). While this central bank activism, which included regular purchases of bonds and assets of private corporations, contributed to a period of relative financial stability even during the shock of the pandemic, it did so by inflating asset prices and financial profits, which drove up inequality further. Meanwhile, fiscal austerity and low wages discouraged private investments and hampered productivity growth.

When inflation finally picked up in late 2021, central banks began “normalizing” their policies, scaling back their balance sheets (i.e., selling assets on the open market) and raising interest rates. But these moves were immediately met with sell-offs in several markets, prompting many central banks to adopt a slow pace of balance sheet reduction and, in some cases, to quickly resume asset purchases (figure I.5). Also, interest rate increases have been met with less opposition overall, partly because after their initial declines, stocks have rebounded markedly. In this context, it is also worth noting the actions of the United States Federal Reserve, which has recently experimented a hybrid policy of quantitative easing alongside interest rate hikes, suggesting that if a conflict arises between the priorities of price stability and financial market buoyancy, the latter is likely to prevail.

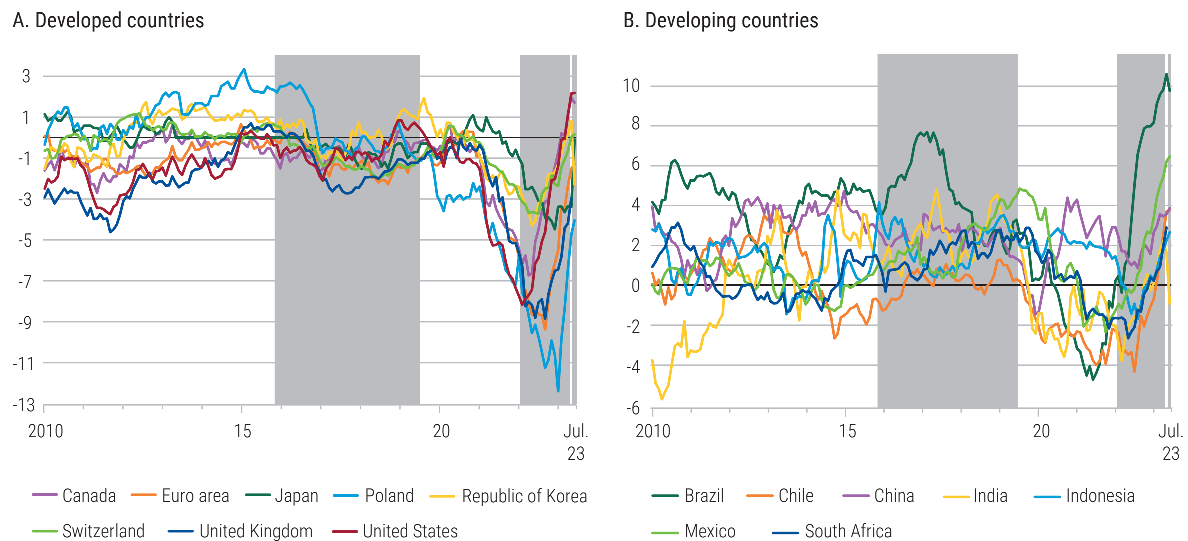
But more importantly, private credit creation – which is driven by financial sector profits and perceived risks, not policy priorities – has not followed the descending pattern of central bank credit. Where private credit has contracted, it has mostly done so much less than central bank credit. As a result, real interest rates are still close to zero in the United States and at or near record lows in many other developed countries (figure I.6). On the other hand, developing countries do not appear to benefit from this aspect of financialization, as they are experiencing markedly higher real interest rates.

Figure I.5 Central banks have only partly retrenched from the pandemic expansion
Monetary base to GDP
(Percentage)



Source: IMF International Financial Statistics and Federal Reserve Economic Data.
Note: Q1: first quarter.

Figure I.6 Though real rates have rebounded they remain low in some developed countries... but credit conditions are considerably less favourable in developing countries
Consumer price index deflated policy rates, selected developed and developing countries
(Percentage)



Source: UNCTAD calculations based on data from Bank of International Settlements.
Note: Grey areas refer to periods during which the policy rates were rising in the United States.

In fact, the interest rate hikes by central banks in developed countries may have limited effects domestically, but they wreak havoc in developing countries. Especially for countries with weaker currencies, higher interest rates in advanced economies can easily cause significant capital outflows, which puts more pressure on the currency, drives up inflation and can easily cripple the productive system.

"Interest rate hikes by central banks in developed countries have limited effects domestically, but wreak havoc in developing countries."

This in turn, exacerbates inequality and compromises livelihoods. Developing countries are then under strong pressure to raise their own interest rates, sacrificing their financial stability to defend their monetary stability – an impossible choice in the best of times. With a muted fiscal policy, increased cost of credit affects the most fragile sectors and regions of the world economy, leading to reduced investment, stagnant wages, limited employment growth and liquidity stress. The hardest hit are the unemployed and low-to-medium earners, as well as firms and governments with high external debt in developing countries (chapter II).

The unbound response of private credit explains the divergence of total credit from investment (figure I.7), as pointed out in previous editions of the *Trade and Development Report*. In leading developed and developing economies, bumper credit creation in the early 2000s did not trigger fast investment demand, nor did it do so during the pandemic years. Some localized increase in capital formation may well be due more to inflation itself, which encourages the accumulation of inventories (not picked up in the charts below). Clearly, credit has continued to be channelled more towards financial assets rather than real investment.

The decoupling of investment and credit and the persistence of low real interest rates in key economies indicate that the immediate effect of monetary tightening is a worsening of income and wealth distribution, with only an indirect impact on economic growth.

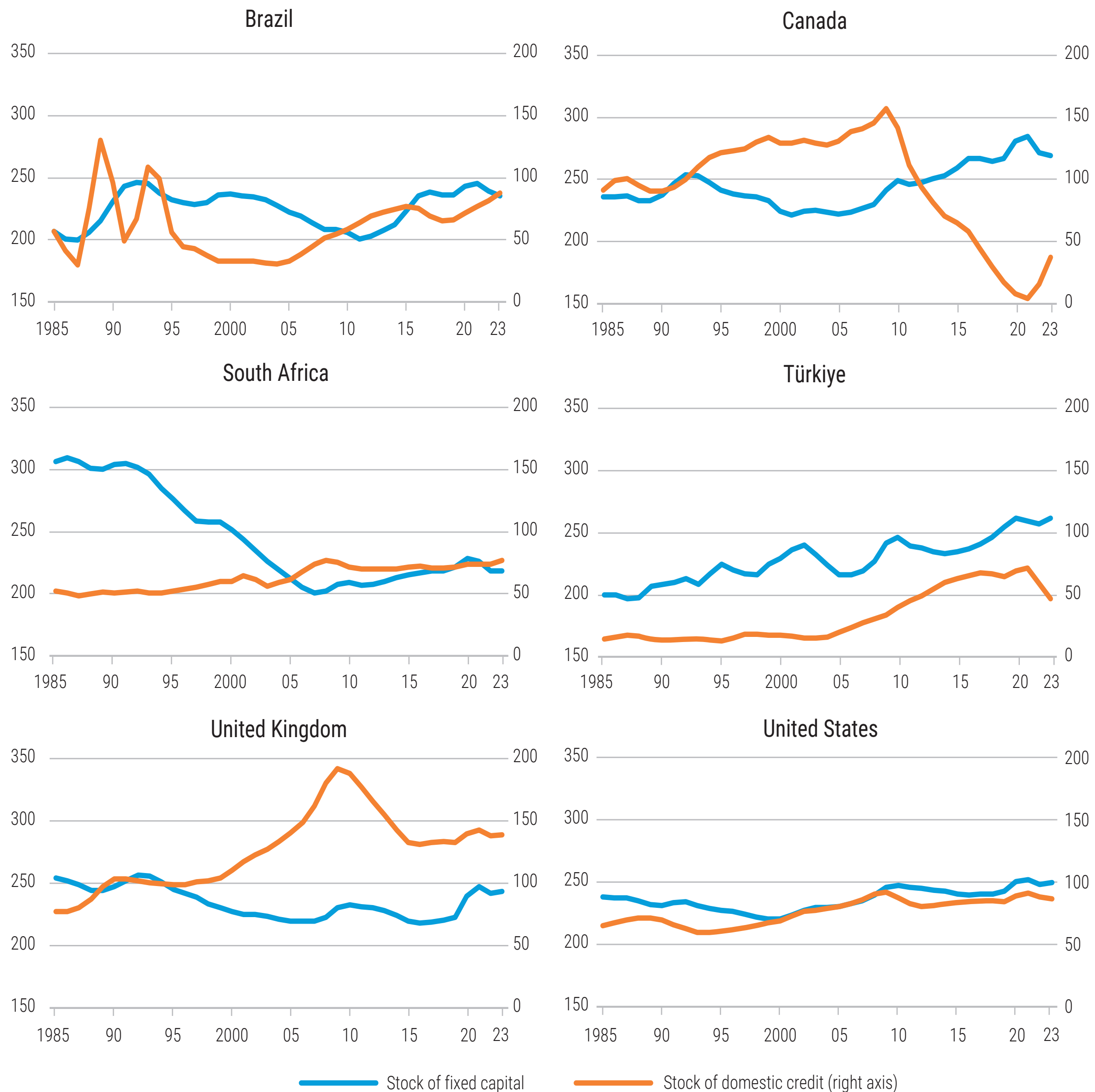
"... the immediate effect of monetary tightening is a worsening of income and wealth distribution, with only an indirect impact on economic growth."

Of course, a hierarchy of safety applies to the different public and private means of money creation. As financial stability is the main concern of monetary institutions, their approach is a pragmatic one, with activity focused on markets that appear to be systemically relevant. As a result, liquidity is not guaranteed everywhere, and pockets of gluts and scarcity persist. The distribution of liquidity creation typically exhibits a North–South divide, although at times speculative inflows of capital are invested in developing regions (chapters II and V). In 2023, as the market for high yield corporate bonds in developed countries has become less attractive due to the rising costs of credit, high yield seekers have focused on developing countries with market access. Meanwhile, in the United States, corporate bankruptcies have picked up, a concerning trend that has likely contributed to the decision by the Federal Reserve to increase purchases again (figure I.5).

Recent developments in monetary policy clearly confirm that financial markets can, for long periods of time, remain largely detached from the performance of the rest of the economy and be sustained by prevailing conventional expectations. They can thrive when the rest of the economy is struggling and investment is down – as in 2020 – but if they do freeze up, the rest of the economy is hit hard, as in 2008. Therefore, the massive expansion and appreciation of financial assets, as has been observed in recent years, creates huge risk, with negligible benefits for many non-financial businesses (particularly smaller companies), and the vast majority of workers. In terms of policy design, monetary policy does have a large, if underappreciated, impact on income and wealth inequality. However, if the desired outcome is to create a sound macroeconomic environment that promotes capital formation and employment creation in leading sectors, then monetary policy cannot play the lead role. Fiscal and industrial policies remain the protagonists.

"... if the desired outcome is to create a sound macroeconomic environment that promotes capital formation and employment creation in leading sectors, then monetary policy cannot play the lead role."

Figure I.7 Investment and credit remain decoupled
Stocks of fixed capital and domestic credit
(Percentage of GDP)



Source: UNCTAD calculations based on the United Nations Global Policy Model and database.
Note: GDP at constant 2015 prices, PPP.

F. INFLATION AND DISTRIBUTION

After 2020, inflation accelerated along similar trajectories in most countries, but in 2023, as inflation began to decrease, the paths diverged.

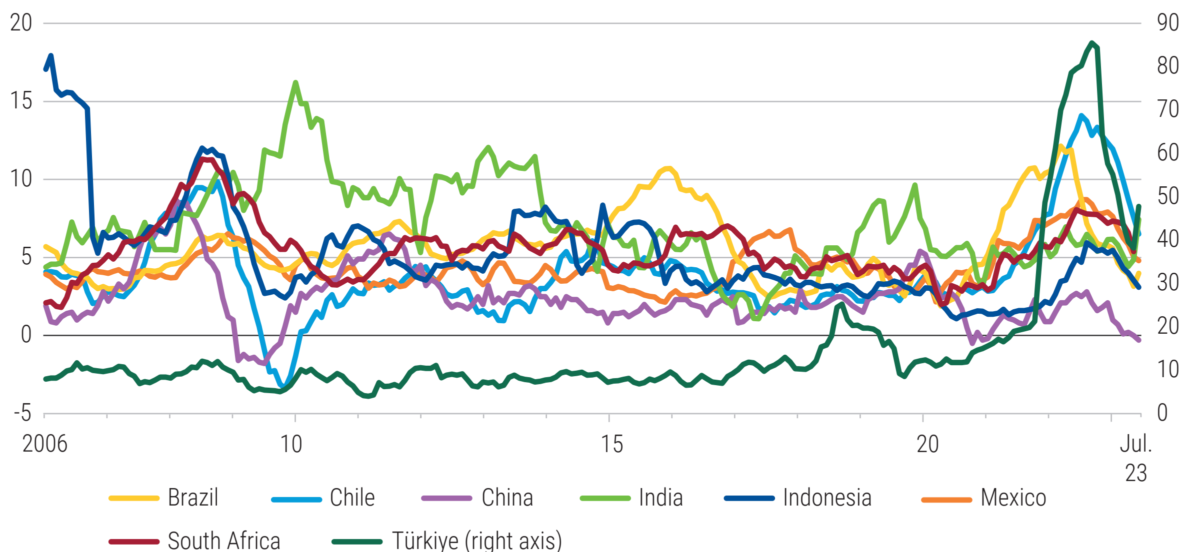
Signs of an inflation pick-up began to appear in the United States in the early months of 2021. Various temporary and lasting triggers contributed to this. These include four main factors: (a) changes to global trade patterns that impacted import costs; (b) a surge in consumption expenditure by the wealthy, who benefited from the stock market gains fuelled by extra-loose monetary policy; (c) small increases in the real wages of the lowest paid occupations; and (d) the ability of producers and retailers to raise prices in order to recoup cost increases and increase profit margins (Bivens, 2022; Konczal and Lusiani, 2022; Hayes and Jung, 2022; Schnabel, 2022; Storm, 2022; Weber and Wasner, 2023).

Concerns that inflation was extending beyond the expected transitory period that would normally accompany recovery from a deep economic shock only began towards the end of 2021, as an initial easing of rising prices was reversed. Failure to distribute effective vaccines worldwide prolonged the pandemic, causing temporary factors to linger on, eventually interacting with a largely anticipated initial increase in commodity prices. Then, as the war in Ukraine began, some commodity prices spiked, raising inflation rates further, especially in the European Union (see TDR, 2022 for a discussion). Despite the supply-side origins of this new round of inflationary pressure, leading central banks, beginning with the United States Federal Reserve, embarked on monetary tightening sooner than had been previously signalled.

Figure I.8 Inflation rates have remained in line with historical standards in most developing countries

Monthly consumer price index growth, selected developing countries

(Year-on-year percentage change)



Source: OECD Statistics and national sources.

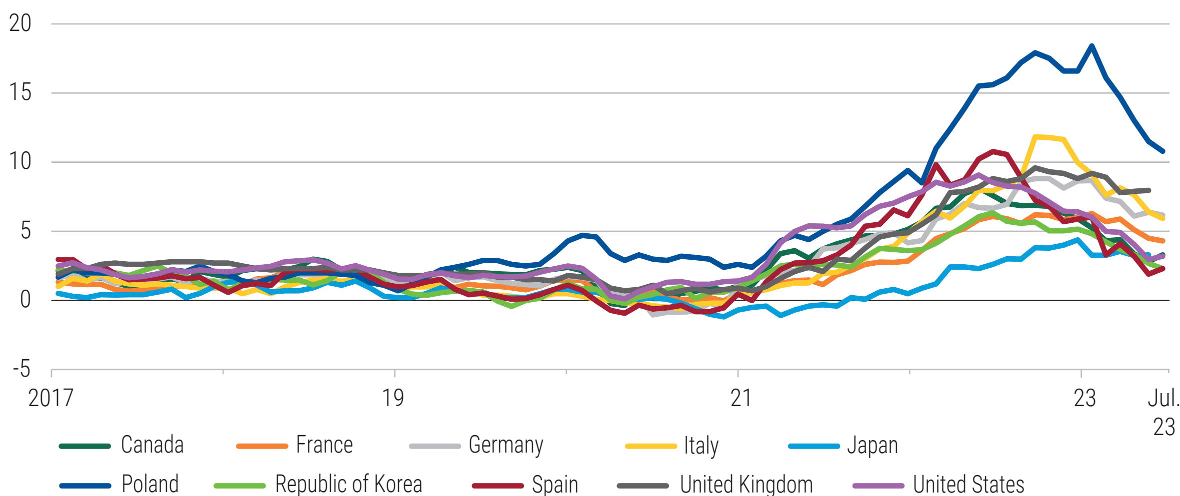
While inflation has been driven by the movements in the international prices of key energy and food commodities, beginning in late 2021 and early 2022, national outcomes differed depending on market structure and the capacity (and willingness) of their governments to offset the transmission to consumer prices. Furthermore, as the Federal Reserve began to raise interest rates, the dollar appreciated against other currencies, further intensifying import price inflation, especially for net importers of energy and food. This was particularly the case in countries which have liberalized the wholesale and retail energy sectors, such as the European Union, resulting in a swift transmission of international price changes to domestic consumers (TDR, 2022). It was also the case in many developing countries, where previous financial vulnerabilities and weak currencies left them doubly exposed.

As of mid-2023, as prices of key commodities eased, inflation around the globe has followed, albeit at an uneven pace (table I.3). In some cases, core inflation remains persistent and above the recent historical average, showing an ongoing persistence of rising corporate markups and localized exposure to supply chain disruptions. Among developed economies, the euro area has followed a markedly different path compared to Japan and the United States (figure 1.9).

Figure I.9 Inflation rates are down in developed countries and some prices are falling

Monthly consumer price index growth, selected developed countries

(Year-on-year percentage change)



Source: OECD Statistics and national sources.

Table I.3 Inflation eases at different rates across countries, due to their economic structures

Consumer Price Index (CPI) inflation and contributions of food and energy, selected countries, January 2022–June 2023

(Year-on-year percentage change and shares)

		Yearly	Quarterly	Monthly			Weight	Yearly	Quarterly	Monthly			Weight
		2022	First quarter 2023	April 2023	May 2023	June 2023		2022	First quarter 2023	April 2023	May 2023	June 2023	
		Chile						**France**					
Annual CPI inflation		11.6	11.8	9.9	8.7	7.6		5.2	6.0	5.9	5.1	4.5	
Contribution to total inflation	Food	29.4	34.1	28.8	28.1	30.1	19.3	20.1	37.7	38.6	42.2		14.4
	Energy	13.5	8.6	6.2	5.0	2.1	7.5	40.4	17.3	10.9	3.8		8.9
	Non-food	56.2	56.0	64.0	65.9	67.1	73.2	40.8	44.8	50.7	54.6		76.6
		Germany						**Mexico**					
Annual CPI inflation		6.9	8.2	7.2	6.1	6.4		7.9	7.5	6.3	5.8	5.1	
Contribution to total inflation	Food	21.8	29.5	27.9	28.2	25.0	11.9	43.3	34.1	28.8	28.1	30.1	25.8
	Energy	32.6	14.2	8.3	4.5	4.4	7.4	6.7	8.6	6.2	5.0	2.1	10.0
	Non-food	46.1	56.4	64.3	68.2	71.4	80.7	48.8	56.0	64.0	65.9	67.1	64.2
		South Africa						**Türkiye**					
Annual CPI inflation		7.0	7.3	7.1	6.6	5.4		72.3	54.3	43.7	39.6	38.2	
Contribution to total inflation	Food	22.6	32.4	33.6	30.8		17.1	30.1	32.5	31.4	33.7		25.4
	Energy	28.6	11.2	7.6	7.0		8.5	21.2	8.5	3.6	-5.6		12.1
	Non-food	48.1	56.3	58.7	61.9		74.3	50.6	59.1	65.7	72.9		62.5
		United Kingdom						**United States**					
Annual CPI inflation		10.9	18.1	7.8	7.9	8.0		8.0	5.8	4.9	4.0	3.0	
Contribution to total inflation	Food	13.1	19.1	23.3	22.1		9.5	11.8	14.2	11.8	11.6	12.8	8.3
	Energy	38.9	33.3	8.8	6.7		6.5	25.8	3.0	-8.4	-23.7	-46.3	8.2
	Non-food	56.4	52.3	66.8	69.1		84	64.2	80.1	93.5	110.0	135.8	83.5

Source: UNCTAD calculations based on OECD Statistics data and national sources.

Note: “Weights” are percentages of the national total CPI; 2022 weights are used for 2023 contributions.

I

Three factors need to be considered to fully understand recent price dynamics.

1. As the cost of key inputs accelerates, several circumstances allow firms to gain higher profits by setting their prices following the general increasing trend, even if the goods were produced when inputs were cheaper. Oligopolies and vertically integrated firms in particular were in a privileged position and have taken advantage of the general inflation to increase their profit margins. For them, the increased cost of credit has had a very limited impact, as the growth of their revenues has more than kept up with it (figure I.10).

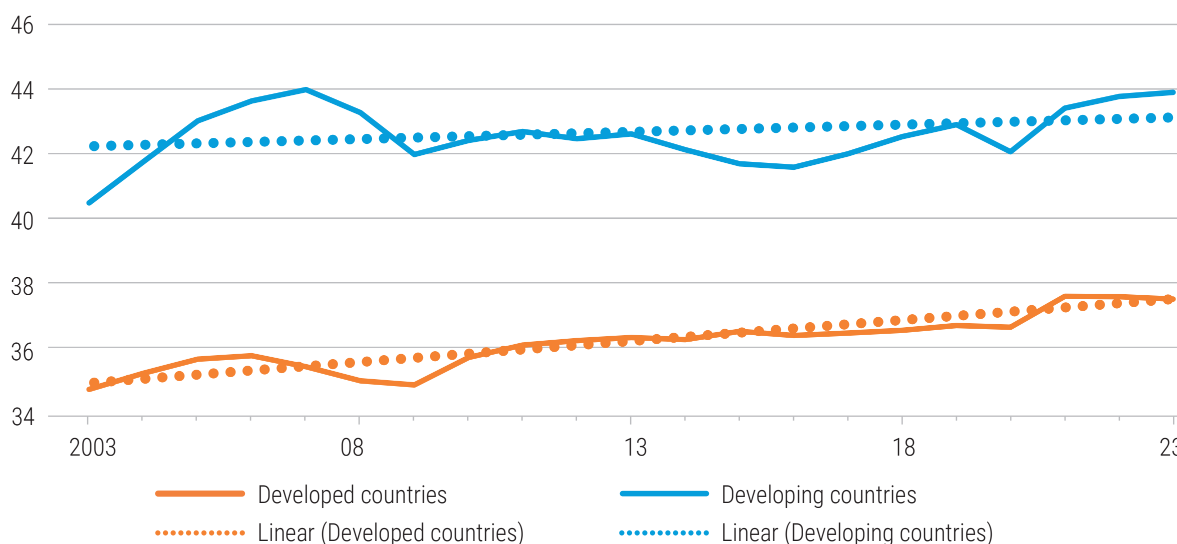
2. Second, falling energy and food prices in international markets may well reduce inflation, but this does not signal a decrease in the price of most retail goods and services: at best these will remain stable at their elevated levels. Furthermore, depending on market power and regulation, domestic prices of food and energy will keep increasing even if the international prices of the commodities they use as key inputs decrease. This means that wages will have to increase to regain the real purchasing power lost with inflation. Whether current policies are consistent with this scenario is doubtful (see section E above). Policymakers should consider how to tackle income inequality while also addressing the unchecked capacity of businesses in critical sectors of the economy to pass higher labour costs through to increased prices.

"Food prices remain well above pre-pandemic averages: an unsustainable level for many households, especially in developing countries that are net importers of food."

3. Third, key factors of uncertainty and instability in international markets have not been addressed. The emergence of new players in commodities trade, such as the United States, now a net exporter of oil and gas, and of new restrictions to manufacturing trade, such as those relating to chips and semiconductors, evidently matter. But the structural problem relates to the organization of markets and trade, which are heavily exposed to asymmetric regulations and profiteering (chapters II and III, also TDR, 2022). Food prices, for instance, remain well above pre-pandemic averages: a largely unsustainable level for many households, especially in developing countries that are net importers of food.

"Policymakers should consider how to tackle income inequality while addressing the unchecked capacity of businesses to translate higher labour costs into increased prices."

Figure I.10 Profit shares have increased above their long-term rising trends
Income from profits and rents
(Percentage of GDP)



Source: UNCTAD calculations based on the United Nations Global Policy Model and database.
Note: GDP at constant 2015 prices, PPP.

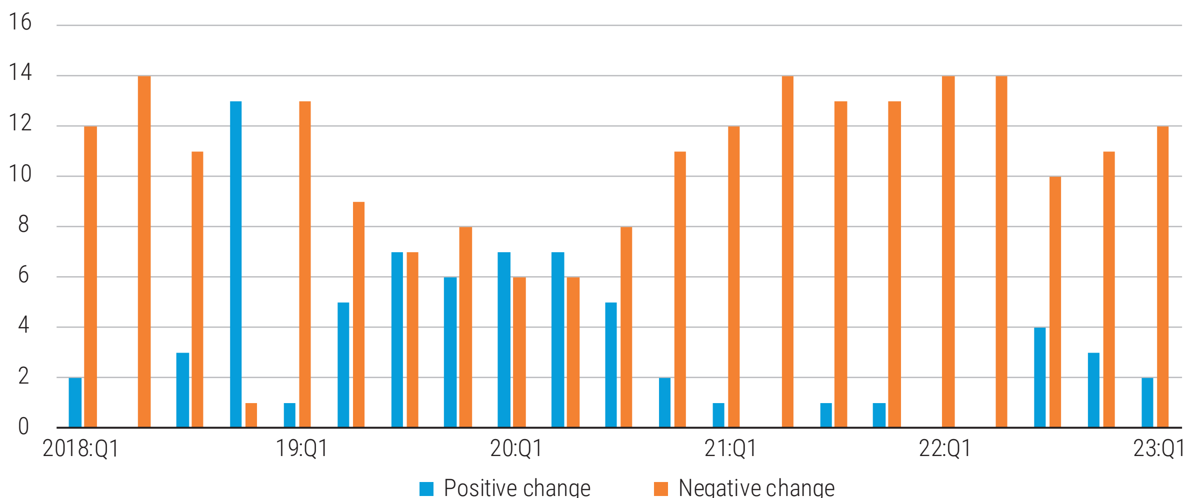
G. LABOUR COSTS AND INEQUALITY

During the past six years, wage growth has lagged behind price inflation in most economies, causing substantial decreases of real wages (figure 1.11). By contrast, markups and profits have more than kept up, with significant sectoral differences, reflecting a number of factors, most significantly, market power.[2]

In the European Union, high coverage of collective bargaining has delayed wage claims longer than elsewhere after the rise of inflation. Most contracts were signed in 2021 and did not anticipate the subsequent price changes. But contracts signed in 2022 were not "revised up" to include the full increase in inflation. In addition, governments have sometimes opted for one-off tax breaks on compensation rather than let real wages grow (Bank of Italy, 2022). This clearly derails any prospects that this period of inflation can lead to a rebalancing of income distribution. Only in France and in the Kingdom of the Netherlands has the trend been somewhat more favourable to workers, due to more frequent bargaining. Moreover, in France, the minimum wage is indexed to inflation.[3] Overall, in Europe, hourly wages have mostly been on a declining trend, at least since 2018. This fact is hidden in annual wage statistics, which only report negative growth in 2022. This shift is largely due to the substantial increase in worked hours after 2020, which impacted annual wage statistics.

In the United States, the Employment Cost Index shows that the pandemic interrupted a positive trend in real total compensation. This trend had been particularly favourable for workers in the retail, trade, food and accommodation industries. Inflation induced a plunge across industries. Only as inflation started slowing in the third quarter of 2022 did real wages and salaries begin to recover, although remaining far below previous levels. Typically, low wage sectors and lower wage occupations have seen their real compensation fall less quickly and have recovered faster than others, pointing to a closer link with subsistence levels. These lower wage sectors remain far below the previous rising trend (figure I.12).

Figure I.11 Wages have not kept up with inflation
Change in real hourly wages by quarter
(Number of surveyed countries)



Source: UNCTAD calculations based on ILO and BIS data.
Note: The sample is limited to 14 countries: Brazil, Chile, France, Germany, India, Ireland, Italy, Japan, Mexico, Poland, South Africa, Spain, Switzerland, United States.

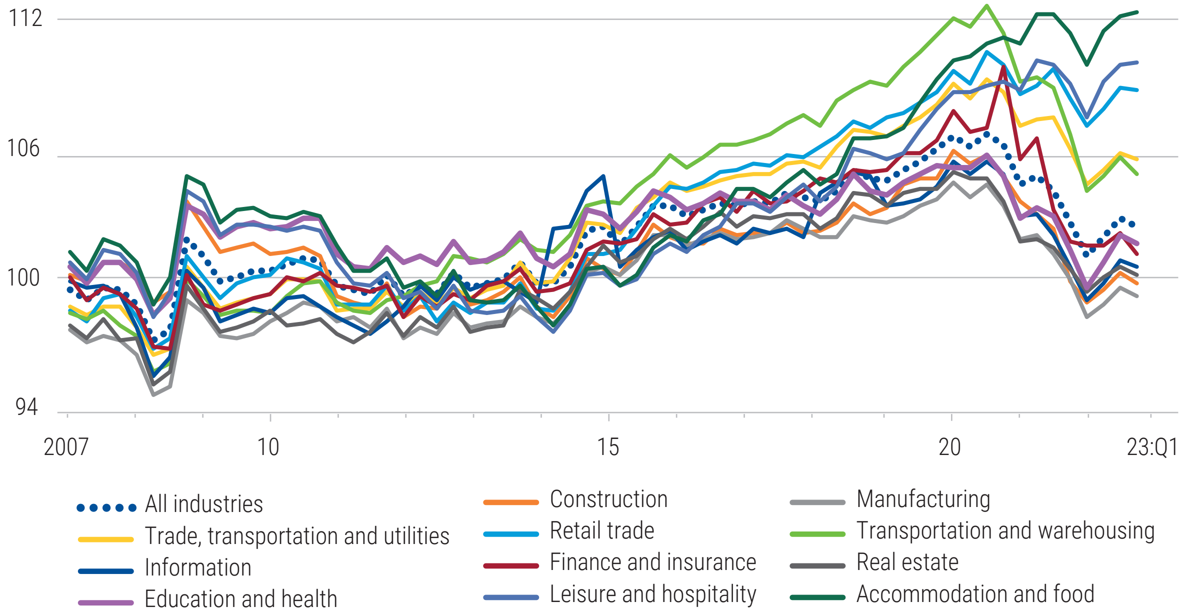
[2] The interpretation of inflationary pressures as a manifestation of cost-push inflation, driven by energy commodities and imports in general, which then was amplified by firms' price setting behaviour was advanced by a number of scholars (Bivens, 2022; Konczal and Lusiani, 2022; Storm, 2022; Schnabel, 2022; Hayes and Jung, 2022; Weber and Wasner, 2023) as well as TDR 2021 and 2022, but was originally opposed by many commentators. Today, it is widely acknowledged, including by the Federal Reserve and the ECB, that rising average markups, which account for the largest part of profit share increases, contribute to the price dynamics.

[3] See the 2022 Annual Report (Relazione Annuale) of the Bank of Italy for a detailed account of different collective bargaining practices in the euro area.

Figure I.12 Post-pandemic, real compensation in the United States still has to recover

Quarterly total compensation of workers in the United States, by industry

(Index numbers, average 2006=100)



Source: United States Bureau of Labor Statistics.

Recent debates on inflation should serve as a reminder that inflation in developing countries is generally higher than in developed ones (figure I.8). This often results from the process of structural transformation rather than a destabilizing excess of income, demand or money creation. For example, when new manufacturing sectors emerge, they often offer higher wages to attract workers from established sectors. This spurs the development of new market segments that cater to higher earning consumers. Historically, inflation rates of up to 20–30 per cent have often accompanied steady growth and development (Bruno and Easterly, 1996; Epstein, 2003; Chowdhury and Sundaram, 2023).

For most developing countries, inflationary pressures are not simply the outcome of internal growth dynamics but of their asymmetric and unstable integration in the global economy (Toye and Toye, 2004; Fontaine, 2021). A concern is how to deal with the current domestic economic structure, namely with an inefficient agricultural sector, small markets, a low tax base and inadequate infrastructure. These factors impede the reallocation of resources to the industrial sector and obstruct prospects for more sustained growth. In this regard, the literature has long established the need to look at a series of rigidities and bottlenecks which, combined with distributional conflicts, could trigger inflationary pressures. These rigidities cannot be addressed by a programme of public expenditure cuts, wage repression and market deregulation, as such measures typically bring down inflation at a very high cost in terms of lost output investment and jobs.

The international financial landscape, marked by strong instability and compounded by the problems arising from flexible exchange rates, presents a formidable challenge to low- and middle-income countries. Exposure to boom–bust cycles and to precarious integration into a highly fragmented global value chain with no significant technology transfers and a race to the bottom in wage setting, has been a crucial factor in the ensuing de-industrialization (TDR, 2019; Storm, 2017). The latter has been reinforced by technology-driven transformations of the economy and services, as well as the rise of intangible assets in value chains.

In these circumstances, a spike in inflation can signal a weakness bearing serious consequences, both economic and in terms of the legitimacy of the institutions involved. It may be the result of a drastic deterioration

of the value of a currency, which pushes import prices up, or it reflects volatility in some key input prices, such as energy. These pressures cannot be absorbed by a quick adjustment in production or wage growth.

In such cases, the increase in costs corresponds to a transfer of financial resources from one institutional sector, typically workers, to producers and importers, without a corresponding increase in the quantity supplied. While some of these financial resources may well leak straight abroad, high domestic markups also frequently occur, being both the cause and consequence of rising inflation. In fact, since production takes time, the price of the final product can be higher than it would have been when inputs were purchased. This gap is exacerbated by concentrated corporate control over markets and the lack of appropriate regulations. Chapter II examines this problem in the case of export concentration in developing countries. Workers, on the other hand, end up seeing any contractual adjustment to the cost of living eroded and sometimes surpassed by further rounds of inflation. In contrast with the first example of virtuous inflation, however, this process is not conducive to more production and job opportunities.

This kind of inflation has a clear asymmetric impact on different social groups, as the current inflationary event has shown. When public institutions try to respond without acknowledging this asymmetry, their actions often act to deepen it, provoking a stronger sense of injustice in the majority of the population. Interest rate increases, which are in themselves an aggravation of costs, also apply to those families who do not benefit from inflation. In fact, they apply especially to families, as well as to smaller and younger businesses that lack well-established relations with banks.

Throughout history, significant increases in the cost of living have often triggered protests. In some cases, these led to progress in the organization of labour, production, and society in general. In such instances, a growing government bureaucracy stepped up to guarantee economic stability, monitoring, and then regulating the decisions of companies and even individual managers to enhance stability (Costantini, 2018).

“There is a need to reorganize global value chains to make the economic structure more resilient and governable and reduce its unfair consequences on wage rates and the global South.”

These examples point to the need to reorganize global value chains to make the economic structure more resilient and governable and reduce its unfair consequences on wage rates and the global South. But this also requires sharing technologies to globally coordinate this transition, without wasting resources and with the avoidance of local crises. Price volatility in key commodities needs to be addressed, tackling the opaque financialized system that fuels and feeds off it (chapter III). As seen in recent years, re-shoring attempts (chapter II) and a revival of industrial and protectionist policies in some countries can lead to price frictions and temporary inflationary tensions.

H. CONCLUSION

Since the last Report was published in October 2022, global growth has slowed against a backdrop of price deceleration. Recovery patterns across regions have varied considerably, and the lack of policy action accompanies talk of a “soft landing” for the global economy. A misplaced emphasis on demand-side inflationary pressure has been met with textbook interest rate hikes by central banks. Fiscal and supply-side measures have been more the exception than the rule (e.g., using Strategic Petroleum Reserve in the United States and ensuring food and fertilizer shipments through the Black Sea Initiative). The result has been a slowdown in global growth, persistently lower employment rates in many countries compared to pre-COVID-19 levels, and an exacerbation of income inequality, further shifting from wages to rents and profits, which had already been skewed prior to the pandemic.

Developing countries, and some developed ones are more exposed than ever to financial stress arising from high indebtedness and environmental shocks that are met with an uncoordinated response across the global

economy. With monetary policy geared towards preserving financial market stability, even the possibility of using inflation as an instrument to reduce real debt burdens and redress income and wealth inequalities appears to be off limits.

More generally, lack of policy coordination and weakened multilateral cooperation have betrayed the promise of "building back better", constraining recent policy shifts that hold out the possibility of a more balanced recovery beyond this year (box I.2).

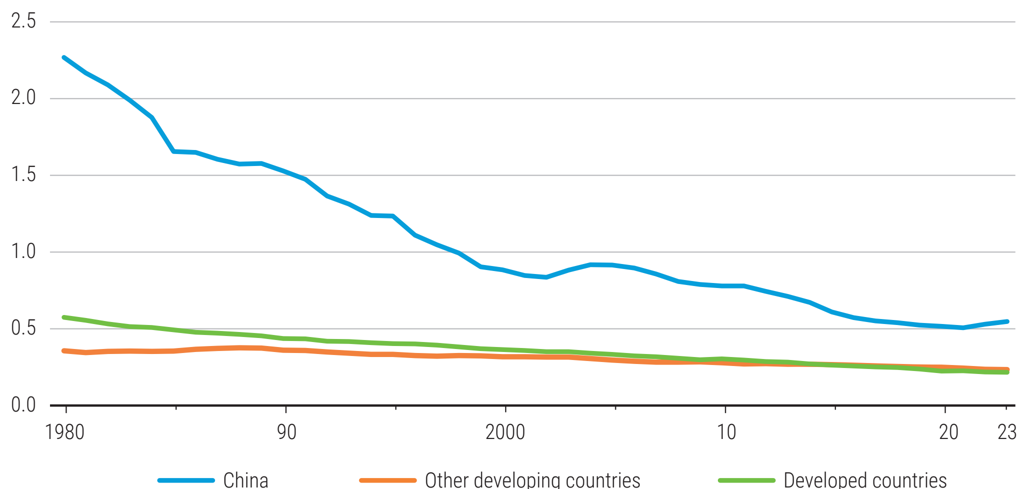
Box I.1 Is a just transition possible in a low growth environment?

With appropriate international policy coordination, a period of low growth in developed countries can be an opportunity. It eases resource pressure, giving developing countries room for the industrial transition needed for a fast decarbonization. This would require fiscal and monetary agreements among the G20, WTO deals for technology transfer and collaboration with IMF and World Bank to provide access to finance. Energy efficiency has lagged in both developed and developing economies, with the latter needing more time due to lower incomes and limited policies. The former need to progress beyond the reliance on market-based mechanisms, as these are insufficient for the scale of the challenge.

Figure I.B1.1 Energy efficiency has increased since 1980 in most economies

Carbon intensity of GDP

(Grams of CO_2 per dollar of GDP)



Source: UNCTAD calculations based on the United Nations Global Policy Model and database.
Note: GDP at constant 2015 prices, PPP.

Market-based emission reduction strategies, such as carbon taxation, aim to promote renewables and fund the transition. However, these plans face practical hurdles. Energy spending, including fuels and power, typically accounts for less than 10 per cent of GDP in most economies (table I.B1.1). This poses challenges for shifting from fossil fuels to renewables. Carbon tax proposals depend on revenue redistribution to households and businesses or investments in the renewable transition. Realistic tax rates, coupled with energy spending below 10 per cent of GDP, result in relatively small transfers compared to other income flows driving demand. This underscores the need for industrial policy and direct interventions to effectively guide energy production.

Table I.B1.1 Spending on energy is a small fraction of total spending in most countries

Spending on primary energy as percentage of GDP, current prices, 2022
(Percentage)

	Primary energy expenditure (Percentage of GDP)
Russian Federation	21.4
Saudi Arabia	13.8
Indonesia	11.8
India	11.4
Australia	7.3
Canada	6.0
Brazil	5.7
Republic of Korea	5.6
Mexico	5.4
Argentina	5.0
Türkiye	4.7
South Africa	3.5
United States	3.4
China	3.3
Japan	3.2
Italy	2.7
France	2.5
Germany	2.4
United Kingdom	1.8

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

1. The effects of anti-inflation policies in advanced economies have been skewed, with the benefits accruing mostly to owners of financial assets and the costs mostly borne by wage earners and recipients of transfers everywhere, especially in developing countries. Aggressive monetary tightening threatens to hold back productive investment and restrain productivity growth for years to come. Moreover, focusing on containing wage growth, a minor player in the recent flare-up of inflation, has effectively put the burden of defending the real value of wealth on working people in both developed and developing countries. The focus on inflation reduction could have been on controlling prices that played a major role, such as energy prices, food and retail prices and exchange rates. The unchecked capacity of large firms to pass higher costs through to higher prices, while discussions on international taxation of profit move slowly, continues to compromise livelihoods worldwide.
2. Prioritizing private returns over social needs was demonstrated during the distribution of vaccines during the pandemic and the related protection of intellectual property rights, even when mass casualties have been the price to pay. This, together with the trade tensions described in chapter II, leads to deferral of critical decisions and commitments by technologically advanced countries, and sets a worrying precedent for the rest of the world as global temperatures and climate shocks intensify.
3. The return of industrial policy, most visibly in a series of legislative initiatives in the United States, while signalling a welcome break with the old Washington Consensus, is being shaped by geopolitical tensions and a retreat from multilateralism.

"Achieving a post-pandemic recovery that reduces inequalities and averts a climate catastrophe, requires substantial changes to rules and practices of the global economy."

There is an urgent need to change course. Real wages need to start growing again in most leading economies and sustain their growth over a long period of time in order to effectively reduce inequality. Doing so will provide an incentive for capital formation and productivity growth. Instead, most leading central banks have continued to raise interest rates throughout 2023, sometimes with the explicit intention of impeding wage growth. An alternative growth trajectory requires employment to expand, which, with the limited time left to respond to the climate challenge, must be efficiently directed to the right sectors and technologies. For developing countries, sufficient policy and fiscal space will be essential to better manage international resources which have been left to market forces.

However, as discussed in Part II of this Report, achieving a post-pandemic recovery that reduces inequalities and averts a climate catastrophe, requires substantial changes to rules and practices of the global economy.

Box I.2 Inflation targeting: the history of the 2-per cent target

Inflation targeting involves announcing inflation targets and a "credible and accountable" strategy to achieve them (Bernanke et al., 1999; Setterfield, 2006). The strategy reaffirms the prominent role of central banks setting interest rates, and on the fiscal authorities' commitment to frugality (avoiding fiscal dominance).

Theoretically, central banks could pick any target inflation rate and adjust the nominal rate accordingly. But in the 1990s, the 2-per cent inflation target – a figure arbitrarily set by the central bank of New Zealand in 1990 – became widely adopted and justified by a series of assumptions about wage rigidity and product differentiation (Akerlof et al., 1996).

The main academic tenets of this approach continue to be put forward to this day, but after the Global Financial Crisis of 2008, the case for a higher inflation target gained force. It was based on the argument that, in a recession, when inflation falls, the nominal interest rate that equals the natural rate that can stimulate the recovery may well fall close to or below the zero lower bound. A higher inflation target in normal times would imply higher average nominal interest rates and provide more room for monetary policy to decrease interest rates when needed (Blanchard, 2022).

"The 2-per cent inflation target – a figure arbitrarily set by the central bank of New Zealand in 1990 – became widely adopted and justified by a series of assumptions about wage rigidity and product differentiation."

To update the theoretical framework, two ideas emerged: first, a Phillips curve with a broad flat section (Yellen, 2019; Seccareccia and Khan, 2019; Ratner and Sim, 2022) suggesting that disinflationary policies have become more costly in terms of employment. Indeed, "among the greatest disappointments for proponents of inflation targeting has been its apparent inability to reduce the so-called sacrifice ratio, the unemployment costs of fighting inflation" (Epstein, 2003: 2), Bernanke and co-authors concluded that the sacrifice ratio is often higher after adoption of an inflation-targeting regime (Bernanke et al., 1999). Second, the concept of a secular fall in the natural interest rate due to aging and automation (Eggertsson et al., 2019) is contradicted by the data (Taylor, 2017).

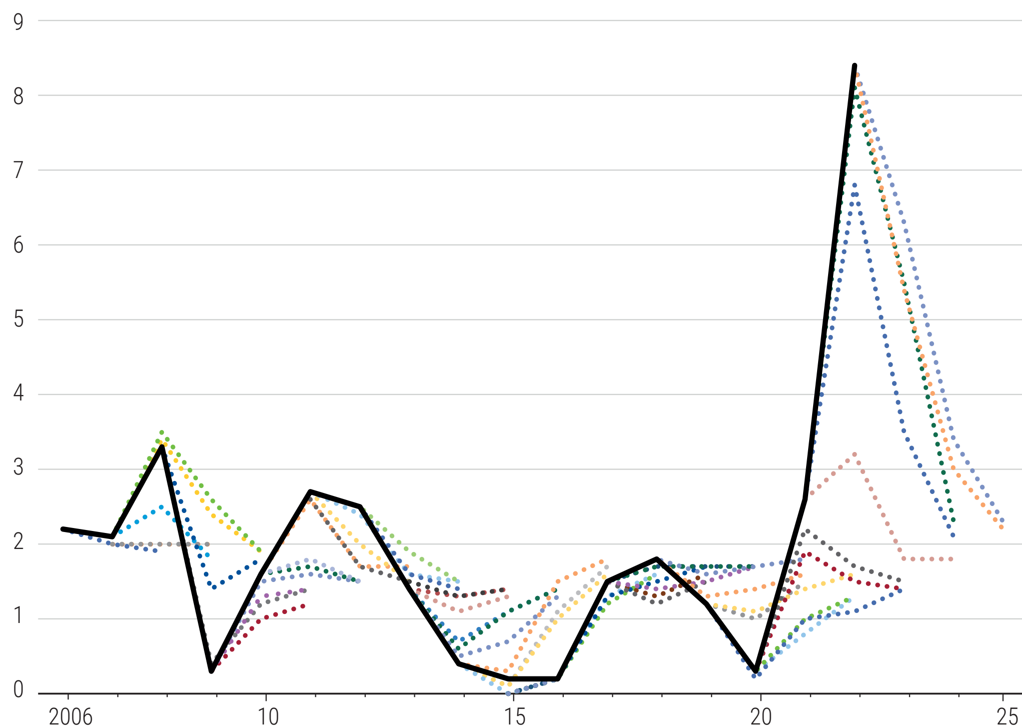
At the end of 2022, there were calls for a new monetary normal around a higher inflation target. Some observers suggested a 3 per cent figure (Blanchard, 2022) while others proposed a more flexible target varying between 2 and 4 per cent (Stiglitz, 2023). But should there be a target at all for monetary policy?

Researchers have found that the policy record experience of the inflation-focused approach has been rather disappointing, even disastrous for many countries (Epstein, 2003; Ball and Sheridan, 2004; Roger and Stone, 2005). "On average, there is no evidence that inflation targeting improves performance as measured by the behaviour of inflation, output or interest rates" (Ball and Sheridan, 2004: 250). Often, the rate of inflation has been decreasing independently of whether these countries adopted an inflation target or not, while employment gains have generally not materialized.

Figure I.B2.1 Inflation targeting is complicated by the difficulty of making correct projections

Projections of the European Central Bank and actual Harmonized Index of Consumer Prices inflation rate

(Percentage)



Source: European Central Bank Macroeconomic Projection Database.

Note: Each coloured dotted line reflects a given projection at a certain moment in time.

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