



World Economic Situation and Prospects

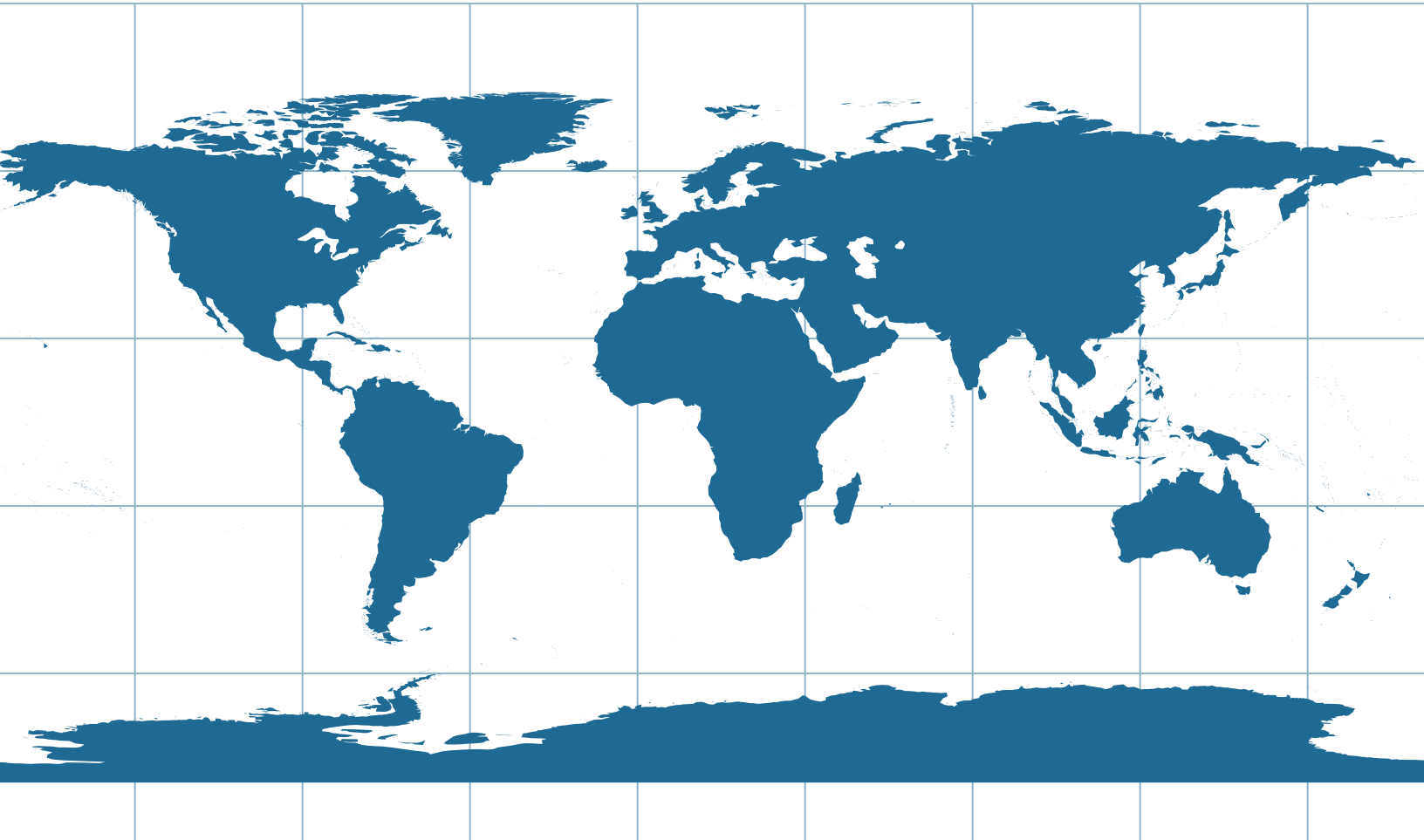


2019



United Nations

World Economic Situation and Prospects 2019



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Chapter I

Global economic outlook

Prospects for the world economy in 2019–2020

Robust global growth masks an increase in risks and vulnerabilities

On the surface, global economic growth appears robust. The world economy is projected to expand at a steady pace of 3 per cent in 2019 and 2020. Growth rates in many developed economies have risen near to what is widely considered their potential, while unemployment rates have fallen towards historical lows. Among the developing economies, the East and South Asia regions remain on a strong growth trajectory, while many commodity-exporting countries are continuing a gradual recovery. However, a closer look below this surface reveals significant shortcomings in the foundations and quality of global economic growth.

Short-term risks are rising, with the potential to severely disrupt economic activity and inflict significant damage on longer-term development prospects. These include escalating trade disputes, financial stress and volatility, and an undercurrent of geopolitical tensions. Amid the significant build-up in global public and private debt, policy space has narrowed considerably across the world, and any negative shock could have severe and long-lasting implications for global growth. Waning support for multilateralism also raises questions around the capacity for collaborative policy action in the event of a widespread global shock.

These short-term risks compound underlying structural vulnerabilities of a longer-term nature. Economic growth is often failing to reach where it is needed most. Per capita incomes are stagnant or declining in several regions, including some with high rates of poverty. With persistently high levels of inequality, the goal of poverty eradication by 2030 is moving increasingly out of reach. In addition, the critical transition towards environmentally sustainable patterns of production and consumption is not happening fast enough. While some progress has been made in reducing the greenhouse gas intensity of production, this progress remains insufficient to reduce aggregate emission levels, given the increased volume of production. The level of carbon emissions continues to rise, accelerating climate change.

Urgent and concrete policy action is needed to change the trajectory of the global economy towards a sustainable path and implement the actions and policy changes needed to deliver the ambitious goals of the 2030 Agenda for Sustainable Development. This includes sound macroeconomic and macroprudential policies, structural and redistributive reforms, and industrial policies, adapted as appropriate to country-specific circumstances. At the international level, progress relies on a cooperative and long-term strategy for global policy in key areas such as climate change, sustainable consumption and responsible finance, supported by declines in income and gender inequality. A withdrawal from multilateralism will pose further setbacks for those already being left behind.

Strong headline figures mask shortcomings in the foundations and quality of global economic growth

Short-term risks compound underlying structural vulnerabilities

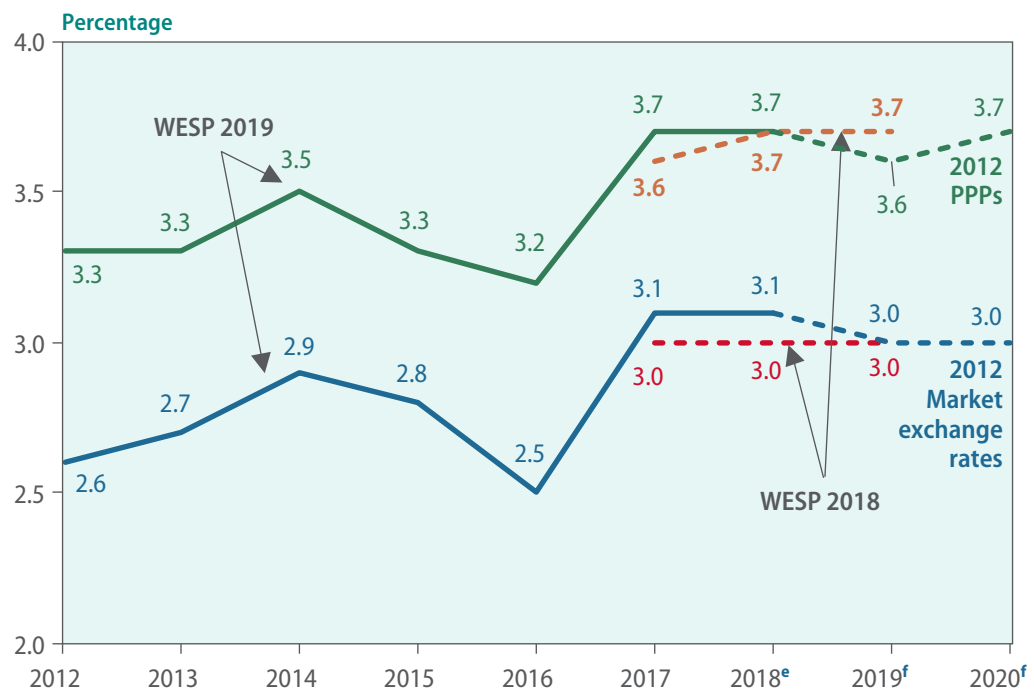
The rest of this chapter focuses on the short-term outlook for the global economy, world trade and international financial flows, and key risks to that outlook. Chapter II considers the implications of this macroeconomic backdrop for the implementation of the 2030 Agenda for Sustainable Development. Policy challenges are discussed, emphasizing the need for multilateral solutions in the areas of international trade, international finance, and climate change. The chapter also discusses important domestic structural challenges, including overcoming excessive commodity dependence and persistently high levels of poverty and inequality. Chapter III looks in more detail at economic prospects in individual regions and country groups.

At the global level, economic growth remains steady, but may have reached a peak

In 2018, global economic growth remained steady at 3.1 per cent when calculated at market exchange rates, or 3.7 per cent when adjusted for purchasing power parities (figure I.1).¹ A fiscally induced acceleration in the United States of America offset slower growth in some other large economies, including Argentina, Canada, China, Japan, Islamic Republic of Iran, Turkey and the European Union (EU) (figure I.2). Despite these slowdowns, economic growth accelerated in more than half of the world's economies in both 2017 and 2018.

There are growing signs that global growth may have reached a peak. Estimates of global industrial production and merchandise trade growth have been tapering since the beginning of 2018, especially in trade-intensive capital and intermediate goods sectors, signalling weaker investment prospects. The annualized expansion of global industrial production slowed to 3.0 per cent in the first 9 months of 2018, compared to 3.5 per cent

Figure I.1
Growth of world gross product, 2012–2020

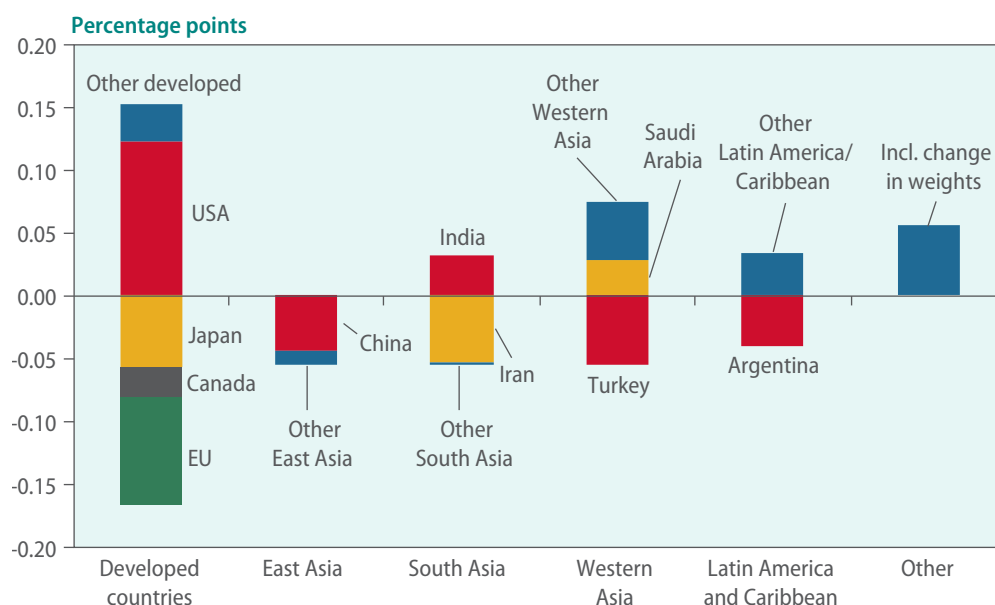


Source: UN/DESA.

Note: e = estimates, f = forecast.

¹ Purchasing power parities (PPPs) adjust for differences in the costs of living across countries. Developing countries get a higher weight in PPP-based aggregations. Since developing countries have been growing significantly faster than developed countries, the level of global growth is higher when using PPP exchange rates.

Figure I.2
Contributions to change in world gross product growth, 2017–2018



Source: UN/DESA.

growth in 2017. World merchandise trade growth averaged 3.7 per cent in the 9 months to September, compared to 4.7 per cent growth in 2017.² At the same time, several developed economies are facing capacity constraints, which may constrain growth in the short term.

Leading indicators point to some softening in economic momentum in many countries in 2019. The Organization for Economic Cooperation and Development (OECD) Composite Leading Indicator for the 36 members of the OECD plus 6 large non-member countries (Brazil, China, India, Indonesia, the Russian Federation and South Africa) has drifted down since the end of 2017. According to Moody's Analytics Survey of Business Confidence, expectations about business conditions and investment intentions over the next six months have weakened. Both the ifo World Economic Survey and Ipsos Global Consumer Confidence Index indicate a moderation of economic activity in the coming months. These expectations are closely associated with heightened uncertainty, both in terms of financial market volatility and global economic policy uncertainty.

At the global level, growth is expected to moderate slightly to 3 per cent in both 2019 and 2020 (table I.1).³ Slower growth in China and the United States will be largely offset by continued recovery in some developing regions and economies in transition that have been hardest hit by the commodity price collapse of 2014/15. Among developed economies, US growth is projected to decelerate notably as the impulse from fiscal stimulus wanes and the effects of higher interest rates are increasingly being felt. While steady growth is projected for the EU, the risks are tilted to the downside, including a potential fallout from Brexit. Among developing and transition economies, the gradual moderation of growth in China is likely to continue, with policy support partly offsetting the negative impact of trade tensions. Several large commodity-exporting countries, such as Brazil, Nigeria and the Russian

Slower growth in China and the United States will be largely offset by mild recovery in large commodity exporters

² Data comes from the CPB Netherlands Bureau for Economic Policy Analysis.

³ Country-level forecasts underlying this summary table are reported in the Statistical annex. Unless otherwise specified, regional aggregations are based on 2012 market exchange rates. Key assumptions underpinning the forecasts are reported in the Appendix to chapter I.

Table I.1

Growth of world output and gross domestic product, 2016–2020

| Annual percentage change | | | | | | Change from WESP 2018 | |
|---|------|------|-------------------|-------------------|-------------------|-----------------------|------|
| | 2016 | 2017 | 2018 ^a | 2019 ^b | 2020 ^b | 2018 | 2019 |
| World | 2.5 | 3.1 | 3.1 | 3.0 | 3.0 | 0.1 | 0.0 |
| Developed economies | 1.7 | 2.2 | 2.2 | 2.1 | 1.9 | 0.2 | 0.2 |
| United States of America | 1.6 | 2.2 | 2.8 | 2.5 | 2.0 | 0.7 | 0.4 |
| Japan | 1.0 | 1.7 | 1.0 | 1.4 | 1.2 | -0.2 | 0.4 |
| European Union | 2.0 | 2.4 | 2.0 | 2.0 | 2.0 | -0.1 | 0.1 |
| EU-15 | 1.9 | 2.2 | 1.8 | 1.8 | 1.8 | -0.1 | 0.0 |
| EU-13 | 3.2 | 4.6 | 4.2 | 3.6 | 3.5 | 0.6 | 0.1 |
| Euro area | 1.9 | 2.4 | 2.0 | 1.9 | 1.9 | 0.0 | 0.0 |
| Other developed countries | 1.9 | 2.4 | 2.5 | 2.3 | 2.2 | 0.1 | 0.1 |
| Economies in transition | 0.4 | 2.0 | 2.1 | 2.0 | 2.6 | -0.2 | -0.4 |
| South-Eastern Europe | 3.1 | 1.9 | 3.9 | 3.7 | 3.7 | 0.7 | 0.4 |
| Commonwealth of Independent States and Georgia | 0.3 | 2.0 | 2.1 | 2.0 | 2.5 | -0.2 | -0.4 |
| Russian Federation | -0.1 | 1.5 | 1.5 | 1.4 | 2.1 | -0.4 | -0.5 |
| Developing economies | 3.9 | 4.5 | 4.4 | 4.3 | 4.6 | -0.2 | -0.4 |
| Africa | 1.6 | 3.4 | 3.2 | 3.4 | 3.7 | -0.3 | -0.3 |
| North Africa | 2.9 | 5.3 | 3.7 | 3.4 | 3.5 | -0.4 | -0.7 |
| East Africa | 5.5 | 6.1 | 6.2 | 6.4 | 6.5 | 0.4 | 0.2 |
| Central Africa | -0.5 | -0.2 | 2.2 | 2.5 | 3.8 | 0.1 | 0.0 |
| West Africa | 0.2 | 2.4 | 3.2 | 3.4 | 3.8 | -0.1 | 0.0 |
| Southern Africa | 0.3 | 1.5 | 1.2 | 2.1 | 2.6 | -1.1 | -0.4 |
| East and South Asia | 6.1 | 6.1 | 5.8 | 5.5 | 5.6 | 0.0 | -0.4 |
| East Asia | 5.7 | 6.1 | 5.8 | 5.6 | 5.5 | 0.1 | 0.0 |
| China | 6.7 | 6.9 | 6.6 | 6.3 | 6.2 | 0.1 | 0.0 |
| South Asia | 8.0 | 6.1 | 5.6 | 5.4 | 5.9 | -0.9 | -1.6 |
| India ^c | 7.1 | 6.7 | 7.4 | 7.6 | 7.4 | 0.2 | 0.2 |
| Western Asia | 3.1 | 2.5 | 3.0 | 2.4 | 3.4 | 0.7 | -0.3 |
| Latin America and the Caribbean | -1.3 | 1.0 | 1.0 | 1.7 | 2.3 | -1.0 | -0.8 |
| South America | -2.9 | 0.5 | 0.4 | 1.4 | 2.3 | -1.4 | -1.0 |
| Brazil | -3.5 | 1.0 | 1.4 | 2.1 | 2.5 | -0.6 | -0.4 |
| Mexico and Central America | 3.1 | 2.4 | 2.4 | 2.5 | 2.3 | -0.2 | -0.1 |
| Caribbean | -0.7 | -0.4 | 1.9 | 2.0 | 2.0 | 0.1 | 0.0 |
| Least developed countries | 3.6 | 4.6 | 5.0 | 5.0 | 5.7 | -0.4 | -0.5 |
| Memorandum items | | | | | | | |
| World trade ^d | 2.5 | 5.3 | 3.8 | 3.7 | 3.9 | 0.3 | 0.1 |
| World output growth with PPP weights ^e | 3.2 | 3.7 | 3.7 | 3.6 | 3.7 | 0.0 | -0.1 |

Source: UN/DESA.

^a Estimated.^b Forecast, based in part on Project LINK.^c Fiscal year basis.^d Includes goods and services.^e Based on 2012 benchmark.

Table I.2

Growth of world output and gross domestic product per capita, 2016–2020

| Annual percentage change | 2016 | 2017 | 2018 ^a | 2019 ^b | 2020 ^b |
|--|------|------|-------------------|-------------------|-------------------|
| World | 1.3 | 2.0 | 2.0 | 1.9 | 2.0 |
| Developed economies | 1.3 | 1.9 | 1.9 | 1.8 | 1.6 |
| United States of America | 0.9 | 1.5 | 2.1 | 1.8 | 1.3 |
| Japan | 1.1 | 1.9 | 1.2 | 1.6 | 1.5 |
| European Union | 1.8 | 2.3 | 1.9 | 1.8 | 1.8 |
| EU-15 | 1.6 | 2.0 | 1.6 | 1.6 | 1.6 |
| EU-13 | 3.4 | 4.9 | 4.4 | 3.9 | 3.8 |
| Euro area | 1.8 | 2.2 | 1.8 | 1.8 | 1.7 |
| Other developed countries | 0.8 | 1.3 | 1.4 | 1.2 | 1.2 |
| Economies in transition | 0.1 | 1.7 | 1.9 | 1.8 | 2.4 |
| South-Eastern Europe | 3.3 | 2.1 | 4.0 | 3.8 | 3.8 |
| Commonwealth of Independent States and Georgia | -0.1 | 1.7 | 1.8 | 1.7 | 2.3 |
| Russian Federation | -0.2 | 1.5 | 1.5 | 1.4 | 2.2 |
| Developing economies | 2.6 | 3.2 | 3.1 | 3.1 | 3.4 |
| Africa^c | -0.9 | 0.5 | 0.6 | 0.9 | 1.2 |
| North Africa ^c | 1.3 | 2.5 | 1.7 | 1.7 | 1.8 |
| East Africa | 2.5 | 3.1 | 3.3 | 3.4 | 3.6 |
| Central Africa | -3.1 | -2.8 | -0.4 | -0.1 | 1.1 |
| West Africa | -2.5 | -0.3 | 0.5 | 0.7 | 1.1 |
| Southern Africa | -2.0 | -0.8 | -1.1 | -0.2 | 0.3 |
| East and South Asia | 5.1 | 5.1 | 4.8 | 4.6 | 4.7 |
| East Asia | 5.0 | 5.4 | 5.2 | 5.0 | 4.9 |
| China | 6.2 | 6.4 | 6.2 | 5.9 | 5.9 |
| South Asia | 6.6 | 4.8 | 4.4 | 4.1 | 4.7 |
| India ^d | 6.7 | 5.1 | 6.2 | 6.5 | 6.4 |
| Western Asia | 1.1 | 0.6 | 1.1 | 0.6 | 1.7 |
| Latin America and the Caribbean | -2.3 | 0.0 | 0.0 | 0.8 | 1.4 |
| South America | -3.8 | -0.4 | -0.5 | 0.5 | 1.4 |
| Brazil | -4.2 | 0.2 | 0.6 | 1.4 | 1.8 |
| Mexico and Central America | 1.8 | 1.1 | 1.2 | 1.3 | 1.2 |
| Caribbean | -1.2 | -0.9 | 1.4 | 1.5 | 1.5 |
| Least developed countries | 1.2 | 2.2 | 2.6 | 2.6 | 3.3 |

Source: UN/DESA.

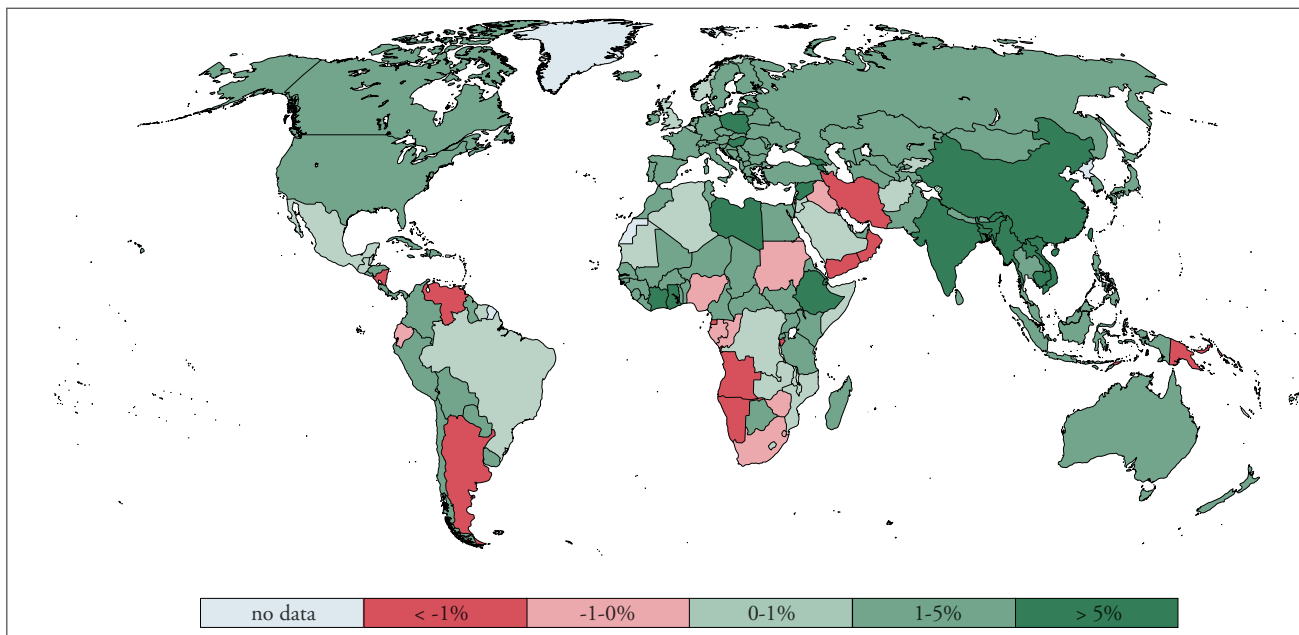
^a Estimated.^b Forecast, based in part on Project LINK.^c Figures for Africa and North Africa exclude Libya.^d Calendar year basis.

Global growth is not reaching areas where it is needed most

Federation, are projected to see a moderate pickup in growth in 2019–2020, albeit from a low base. The prospects for commodity exporters remain clouded by several factors. The price collapse in 2014/15 has left a legacy of higher levels of debt and depleted fiscal buffers, severely constraining policy space. While prices have partly recovered, they remain highly volatile and subject to wide fluctuations, as exemplified by the sharp decline in oil prices in the fourth quarter of 2018.

The robust headline global growth figures conceal an uneven pace of economic progress across the world. While economic prospects at the global level have improved since 2016, several large developing countries have seen per capita income decline in 2018 (figure I.3). Despite a modest improvement, per capita incomes will stagnate or grow only marginally in Central, Southern and West Africa, Western Asia, and Latin America and the Caribbean in 2019 (figure I.4 and table I.2). These regions combined are home to nearly 20 per cent of the global population, and nearly one quarter of those living in extreme poverty. Furthermore, among developing countries where per capita growth is strong, economic activity is often driven by core industrial and urban regions, leaving peripheral and rural areas behind—thereby contributing to increasing internal inequalities.⁴ This pushes the targets of eradicating poverty and creating decent jobs for all, with an adequate level of

Figure I.3
GDP per capita growth, 2018^{a,b}



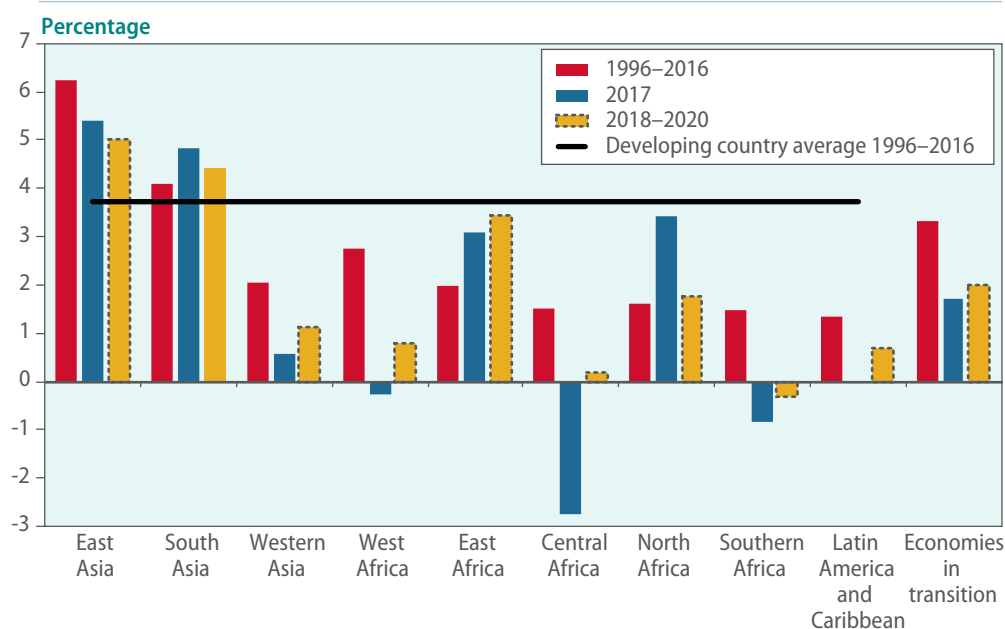
Source: UN/DESA.

^a Disclaimer: The designations employed and the presentation of material on this map do not imply the expression of any opinion whatsoever on the part of the Secretariat 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. Dotted line represents approximately the Line of Control in Jammu and Kashmir agreed upon by India and Pakistan. The final status of Jammu and Kashmir has not yet been agreed upon by the parties. Final boundary between the Republic of Sudan and the Republic of South Sudan has not yet been determined. A dispute exists between the Governments of Argentina and the United Kingdom of Great Britain and Northern Ireland concerning sovereignty over the Falkland Islands (Malvinas).

^b The map represents countries and/or territories or parts thereof for which data is available and/or analysed in *World Economic Situation and Prospects 2019*. The shaded areas therefore do not necessarily overlap entirely with the delimitation of their frontiers or boundaries.

⁴ See, for example, Rodríguez-Pose and Hardy (2015).

Figure I.4
Average annual GDP per capita growth by region



Source: UN/DESA.

social protection, even further from reach. Inadequate income growth, coupled with high levels of inequality, also pose risks to many of the other Sustainable Development Goals (SDGs), as countries strive to alleviate infrastructure bottlenecks, strengthen the business environment, upgrade human capital and broaden opportunities.

GDP growth in the least developed countries (LDCs) is estimated to average 5.0 per cent in 2018 or 2.6 per cent in per capita terms, continuing a steady acceleration since 2015. Three countries—Bhutan, Sao Tome and Principe, and Solomon Islands—were recommended for graduation from the LDC category in 2018 (box I.1). Although most countries have participated in the upturn, which is partly driven by some recovery of commodity prices, almost one third of the LDCs have grown by less in 2018 than in 2017. Some large LDCs are expanding at an average annual rate of 7 per cent or more, including Bangladesh, Bhutan, Burkina Faso, Cambodia, Ethiopia, Lao People's Democratic Republic, Myanmar and Senegal. By contrast, growth in many small island developing States (SIDS) and conflict-affected countries remains well below what is called for in target 8.1 of SDG 8 (promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all). In the majority of LDCs, per capita GDP growth is significantly below levels needed to eradicate extreme poverty. Longer-term growth projections point to nearly 30 per cent of the population in LDCs remaining in extreme poverty by 2030. Changing this outcome would require both double-digit economic growth and a significant reduction in income inequality (see discussion in chap. II). This, in turn, will require a significant rise in well-targeted investment, including rural infrastructure development; well-managed public resources and targeted social protection programmes; and supportive education and employment policies.

Poverty eradication requires double-digit growth and steep reductions in income inequality

Box I.1

Graduation from the United Nations least developed country category

In 2018, Bhutan, Sao Tome and Principe, and Solomon Islands were recommended for graduation from the least developed country (LDC) category, following endorsement by the United Nations Economic and Social Council (ECOSOC) and the United Nations General Assembly. In the three countries, graduation is likely to take place in 2023–2024, giving Governments time to devise and enact smooth transition policies to allow for the phase-out of the benefits associated with LDC status.

This was a historic occasion in the history of the LDC group. Never before had so many countries been identified in a single year. In the 47 years since the start of the category, a total of only five LDCs have graduated from the list. Two more, Vanuatu and Angola, are already scheduled for graduation in 2020 and 2021, respectively.

The recommendations of the Committee for Development Policy (CDP), a subsidiary body of ECOSOC, follow strong growth in the national income, as well as improved education and health. Government development policies have driven progress, as have the commodity boom from about 2000 to 2014 and the coordinated efforts of the international community.

For Bhutan and Sao Tome and Principe, per capita gross national income (GNI) tripled, the under-five mortality rate declined and gross secondary enrolment more than doubled from 2003 to 2018. During that same period, per capita GNI doubled for Solomon Islands while the country's gross secondary enrolment rate almost doubled.

The LDC category is assessed using three criteria: human assets (health and education targets), economic vulnerability and GNI per capita. Countries must meet two of the three criteria at two consecutive triennial reviews of the CDP to be considered for graduation. The CDP sends its recommendations to ECOSOC for endorsement, which then refers its decision to the General Assembly.

Bhutan, Sao Tome and Principe and Solomon Islands each continue to meet the GNI per capita and human assets criteria but not the economic vulnerability criterion.

The CDP found that while Nepal and Timor-Leste also met the criteria for graduation, they were not recommended for graduation at this time owing to economic and political challenges. These countries may again be considered for graduation at the next triennial review of the CDP in 2021 if they still meet the criteria. ECOSOC deferred a decision on Kiribati and Tuvalu, which also meet the criteria, to 2021.

Bangladesh, Lao People's Democratic Republic and Myanmar met the graduation criteria for the first time in 2018, but would need to do so again for a second time at the next triennial review in 2021 to be considered for graduation.

Graduating LDCs stand to lose several benefits delivered exclusively to members of the category—including trade preferences, certain forms of technical and financial support, dedicated climate financing, and other measures such as travel assistance and smaller contributions to the United Nations budget.

Multilateral trade preferences for LDCs, such as duty-free quota-free market access under the European Union's (EU) Everything But Arms (EBA) initiative, are particularly important. Bangladesh, for instance, the biggest LDC and the world's second-largest garment exporter, sends half of its garment exports to the EU and enjoys a tariff preference margin of 9.6 per cent on many of its exports to that market.

The country is unusual in that it has no bilateral trade agreements (although it is a member of regional agreements Bay of Bengal Initiative for Multi-Sectoral, Technical and Economic Cooperation (BIM-STEAC) and South Asian Free Trade Area (SAFTA)). As Bangladesh becomes unable to rely on multilateral preferences, following its probable loss of EBA in 2027, it may consider negotiating free trade agreements (FTAs) or bilateral agreements with a number of major trading partners, such as China. Talks with Sri Lanka have already begun. An FTA with Europe could be an alternative to EBA and the Generalized System of Preferences Plus (GSP+).

For Bangladesh, therefore, the next few years will be crucial, given that any bilateral agreements or FTAs negotiated now are likely to set a precedent for future agreements. The power-based nature of bilateral negotiations, however, makes this a much more challenging environment than the multilateralism that has governed trade up to this point.

An associated trend is the increasing "Africanization" of the LDC group. The next 10 likely graduations, except Angola, are in the Asia-Pacific region. Lao People's Democratic Republic and Myanmar

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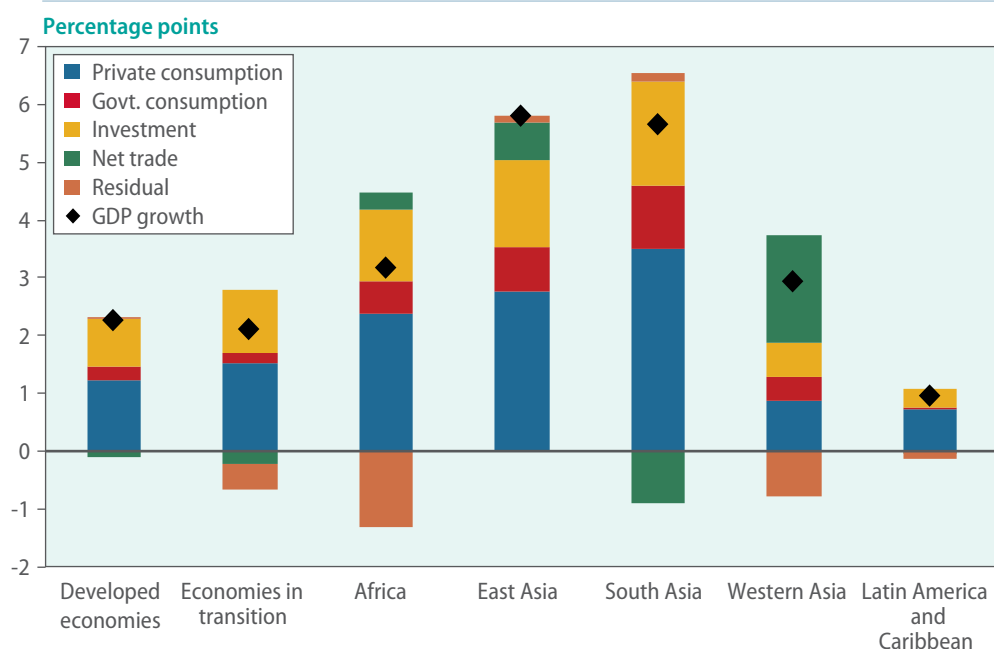
are on track to graduate by the mid-2020s and Cambodia by about 2027. By the end of the decade the LDC group will probably comprise about 30 African countries, plus Afghanistan, Haiti and Yemen. This has implications for the preference schemes of trading partners such as the EU, which has separate Economic Partnership Arrangements with African, Pacific and Caribbean countries. If partner countries and regions, and their companies, wish to keep benefiting from trade preferences with low-wage manufacturing countries, they will have to develop new trade regimes for former LDCs in Asia.

The graduating countries are, in a sense, victims of their own success, and new measures need to be put in place to help them after graduation. Whether or not they maintain current market access arrangements is, to some extent, a test of global attitudes towards multilateralism.

Box I.1 (*continued*)

Author: Daniel Gay
(UN/DESA/EAPD).

Figure I.5
Contribution to GDP growth by expenditure component, 2018



Source: UN/DESA estimates.

Investment is contributing more to growth

A decomposition of economic growth by expenditure reveals some differences in the drivers of GDP growth across regions in 2018 (figure I.5). Private consumption remains the largest contributor to growth in many regions, most notably in Africa, Latin America and the Caribbean, and South Asia. In Western Asia, net trade contributed significantly to growth as higher average oil prices boosted oil-related export revenues in the Cooperation Council for the Arab States of the Gulf (GCC) countries, while Turkey experienced a sharp contraction of imports. Meanwhile, East Asia's broad-based growth during the year was underpinned by robust domestic demand conditions and positive net trade. In both the East and South Asia regions, investment growth has been driven by the implementation of large infrastructure projects in several economies.

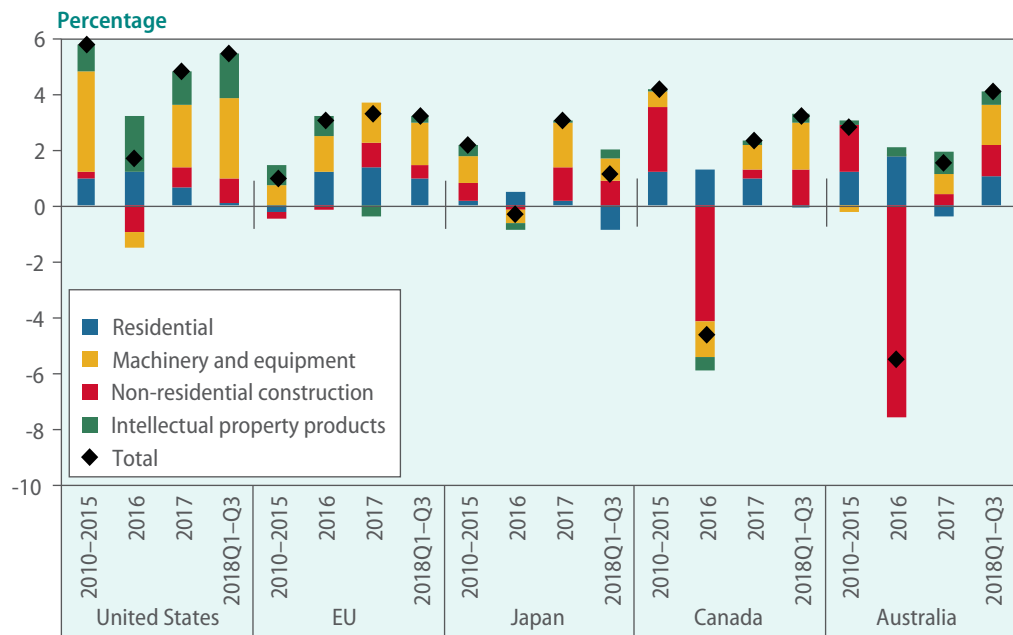
While private consumption continues to be a key driver of overall GDP growth for most regions, investment activity has strengthened in many developed and developing economies over the past two years. In particular, private non-residential investment gained

Private consumption remains the main contributor to growth in most regions

Investment playing a more important role in driving growth

Figure I.6

Annual growth of private investment, decomposed by asset type (constant prices)



momentum in developed countries (figure I.6). Investment in machinery and equipment contributed roughly half of investment growth in Canada, Japan, the United States and the EU in the first 9 months of 2018.

In the United States, business investment strengthened in response to policy changes initiated in 2018, including a sharp reduction in the corporate tax rate. In Europe, investment growth remained solid, while construction activity continued to boom in several countries (for example, Estonia, Hungary, Poland and Slovenia) supported by growing disposable incomes, government measures and continuing accommodative monetary policy. Nevertheless, forward indicators suggest that investment growth may moderate in 2019, amid tightening financial conditions, rising trade tensions, and protracted policy uncertainties.

Investment ratios in developed economies remain low by historical standards

This upturn across developed economies comes after a prolonged period of subdued investment in the aftermath of the global financial crisis. Despite the recent improvement, the average investment-to-GDP ratio remains lower than in the pre-crisis period. Changes in investment ratios may reflect a wide range of factors, including shifts in production structure, price adjustments of capital goods relative to consumer goods, broad changes in savings behaviour, or even the impact of technological changes that are difficult to measure in statistical terms, such as the contribution of the digital economy. A decline in the investment ratio in itself may not necessarily give rise to concern. Concerns are warranted, however, if debt continues to increase unabated, while a smaller share of current income is invested into productive assets that will provide a future flow of income to pay down those debts. Since the 2008/09 crisis, corporate non-financial debt has risen notably in developed economies as interest rates remained ultra low. The International Monetary Fund (IMF) recently highlighted that a significant part of the new loans—particularly in the segment of highly indebted speculative-grade companies—has been used to “fund mergers and acqui-

sitions and leveraged buyouts (LBOs), pay dividends, and buy back shares from investors—in other words, for financial risk-taking rather than plain-vanilla productive investment” (Adrian, Natalucci and Piontek, 2018). This trend is evident in both Europe and the United States, and could pose a risk going forward.

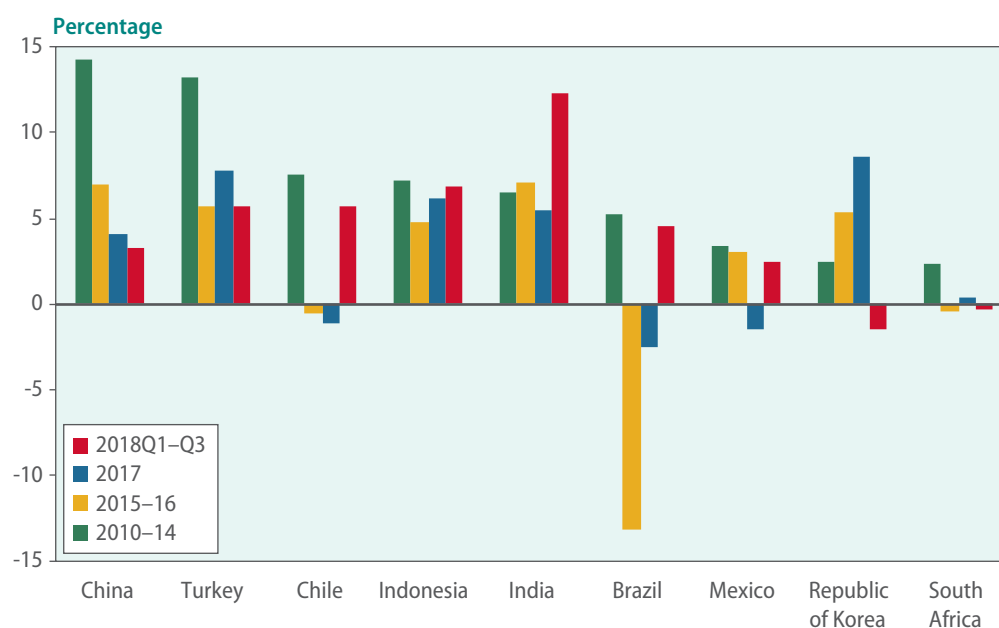
Many of the major developing economies also experienced a pick-up in investment growth in 2018 (figure I.7). Following a protracted downturn, private investment saw some recovery in Brazil, supported in part by accommodative monetary policy. Investment activity in several other commodity exporters, including Chile, Colombia, and Peru, also improved during the year. In Mexico, capital spending benefited from reduced uncertainty as the new trade agreement with the United States and Canada was finalized. In India, the acceleration in investment growth was mainly driven by public infrastructure spending. In China, fixed asset investment remained solid but moderated at a gradual pace, amid efforts to reduce excess capacity in several industrial sectors.

Looking ahead, investment prospects in several large commodity-dependent economies will depend highly on developments in global commodity markets. The high oil price volatility, amid shifting policy stances, has brought about renewed concerns over the growth outlook of these economies. In the Russian Federation, the tightening of economic sanctions is expected to weigh on investment activity in the near term, compounding high business borrowing rates. For several developing economies, elevated corporate debt may constrain the pace of investment growth going forward. In many African economies, investment levels appear insufficient to achieve a more sustained and inclusive growth. More broadly, as in developed economies, the rise in debt in developing economies has generally not been matched by an equivalent expansion of productive assets, but has often been used to finance short-term consumption or has been channelled towards share buy-backs or real estate and financial assets. This raises concerns about the longer-term sustainability

Many developing economies experienced a pick-up in investment growth in 2018

Figure I.7

Annual growth of gross fixed capital formation in selected developing economies



Source: CEIC.

Note: Data for Mexico and Turkey up till 1H 2018. Figures for China are estimated using fixed asset investment data, deflated by the CPI index.

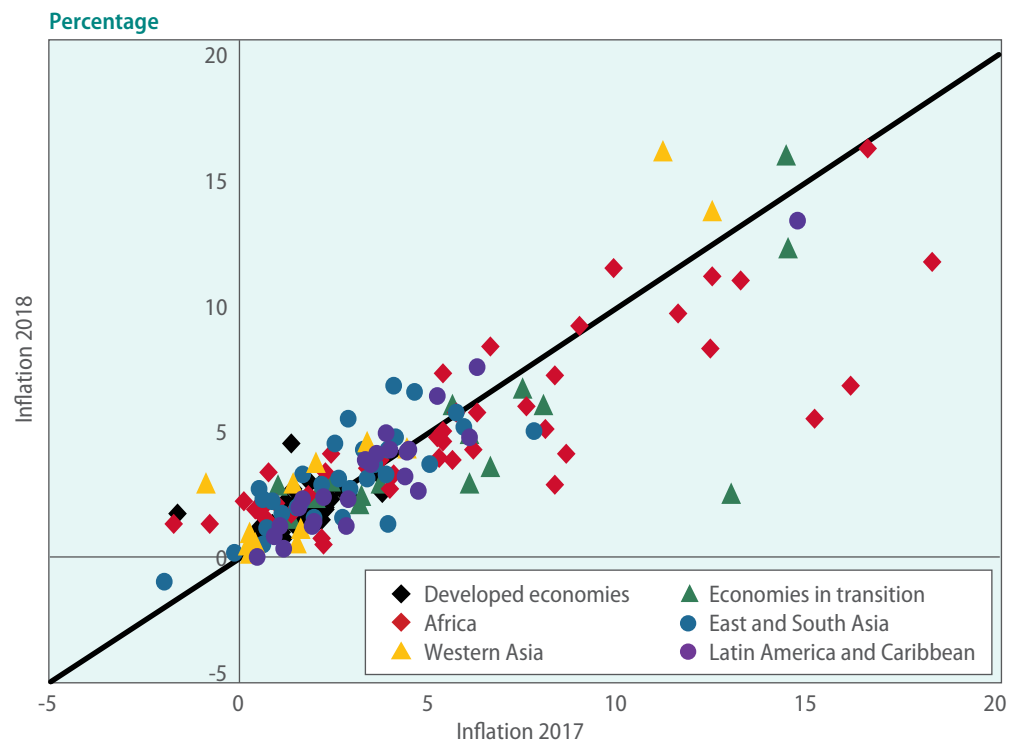
of debt, as well as concerns about productive capacity over the medium term, given large existing infrastructure gaps, degradation of capital and the implications for productivity. Against this backdrop, macroprudential policies, in coordination with monetary, fiscal and foreign-exchange policies, are needed to promote financial stability and contain the build-up of financial vulnerabilities.

An expansion of infrastructure investment is crucial to the success of the SDGs. To meet the challenge of delivering universal electricity, clean water, health care, education and well-diversified economies—and to facilitate the exchange of goods and services between countries—total annual financing needs, according to recent estimates, range between \$4.6 trillion and \$7.9 trillion at the global level. Many states must double current levels of infrastructure investment to meet these needs (UNCTAD, 2018a). Securing the finance for infrastructure investment is only one facet of a well-designed national sustainable development plan. Making the most valuable use of limited resources requires long-term strategic planning, expertise in procurement and contract negotiation, a transparent business environment and the labour force skills needed to deliver the projects. Policymakers need to develop clearly designed development strategies that actively foster the positive feedback loops between infrastructure, productivity and growth (*ibid.*).

Inflationary pressures remain contained

Global inflation remains moderate, but is on an upward trend in the majority of countries (figure I.8). Rising oil prices contributed to additional inflationary pressures in oil-importing countries over the course of most of 2018, while currency depreciation against the US dollar put upward pressure on imported prices in many countries. By contrast, some of the commodity-exporting countries in Africa and the Commonwealth of Independent

Figure I.8
Inflation in 2017 and 2018



Source: UN/DESA.

Note: Countries with inflation above 20 per cent are excluded from the figure for clarity (Angola, Argentina, Egypt, Islamic Republic of Iran, Libya, South Sudan, Sudan and Venezuela).

States (CIS) that experienced sharp currency depreciations in response to the commodity price shocks of 2014/15 have seen inflation recede in 2018, as the exchange-rate shock has been absorbed into the price level. Ongoing trade disputes can be expected to put some upward pressure on inflation in 2019, as the impact of tariffs passes through value chains to consumer prices. In developed economies, rising capacity constraints have put some upward pressure on inflation, and headline inflation generally exceeds central bank targets in Europe and North America.

Employment is rising, but job quality is low

The upturn in the world economy has been associated with a slight rise in global employment, although some caution should be used in interpreting headline figures, which give an incomplete picture of the quality of jobs discussed further below. According to International Labour Organization (ILO) estimates, the global unemployment rate stood at 5.5 per cent in 2017. Developed economies have seen notable gains in recent years, with the average unemployment rate declining from a post-financial crisis high of 8.7 per cent in 2010 to 5.4 per cent in 2018. In several large economies, including Germany, Japan and the United States, unemployment rates are currently at their lowest level in decades (see table A.7 in the Statistical annex for country-level detail and projections). In all three countries, firms have reported a lack of qualified workers as a factor restraining production levels. In the United States, capacity limits in internal delivery transport by rail and trucking have pushed up prices of freight transportation sharply, while firms in Japan cite an extremely high utilization of production equipment.

At the global level, falling unemployment in developed economies has been largely offset by rising unemployment in several large upper-middle-income countries, such as Argentina, Brazil and South Africa, which have been deeply impacted by political and economic crises, inequalities, and continuous socioeconomic imbalances (see table A.8 in the Statistical annex). Worldwide, an estimated 190 million people are currently unemployed. While the global unemployment rate has remained largely stable in recent decades, the total number of unemployed people has increased by approximately 40 per cent since the early 1990s. This means that there is a consistently growing population that is not able to fully participate and benefit from the advances in the global economy.

Reducing unemployment remains a crucial development challenge for policymakers. But equally as important as reaching targets for job creation is strengthening the quality of employment. The 2030 Agenda for Sustainable Development strives to create decent work for all, which requires not just an increase in employment opportunities, but also reductions in informal employment and in labour market inequality (particularly in terms of the gender pay gap), and the provision of safe and secure working environments.

Of those employed in 2017, 300 million workers were nonetheless living in extreme poverty. Progress towards reducing the numbers of the working poor remains slow. Many of the working poor hold informal jobs or are in other vulnerable forms of employment. In developing countries, three out of four workers are in vulnerable forms of employment, which entails lower levels of job stability and limited access to social protection. Over 60 per cent of all workers worldwide are in informal employment (box I.2). Moreover, more than half of the world population has no access to social protection. This tends to perpetuate high levels of subsistence activities, which generally provide very low levels of income.

Tight labour markets and capacity pressures are evident in some developed economies

Unemployment is rising in some large developing countries

Job quality remains low in many parts of the world

Box I.2

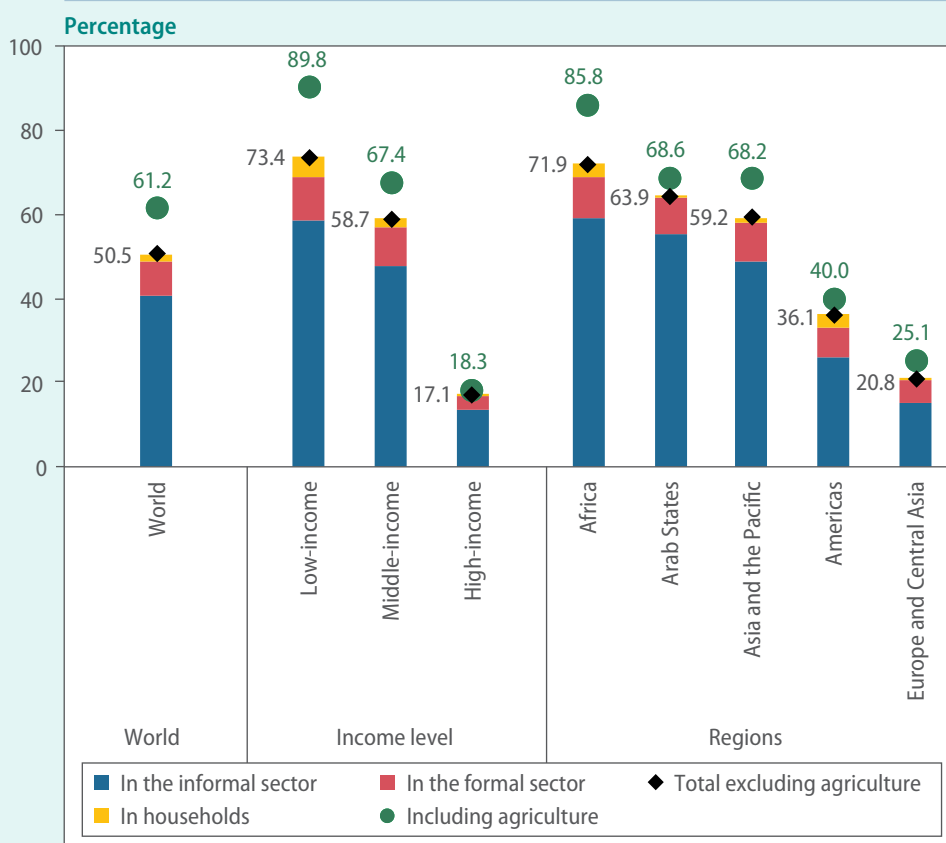
Informal employment around the world: recent data and policies

Today, two billion workers, or 61.2 per cent of all workers worldwide, are in informal employment (ILO, 2018). The informal economy involves all economic activities by workers and economic units that are, either in law or in practice, not covered or insufficiently covered by formal arrangements (ILO, 2015). It is primarily characterized by its high heterogeneity. Informal employment is the reality of more than 85 per cent of own-account workers and one out of two employers. Their economic units are not legally recognized; they face non-compliance with fiscal obligations as well as serious difficulties in engaging in commercial contracts and gaining access to financial resources, markets or property. It is also the reality of 40 per cent of employees whose employment relationship is, in law or in practice, not subject to national labour legislation, income taxation, social protection, or entitlement to certain employment benefits. Informality is, finally, the reality of all contributing family members, who are considered as having informal jobs by definition.

Informality has multiple adverse consequences for individuals, firms and societies. Individuals who work informally are exposed to pervasive decent work deficits and limited access to social protection. Enterprises that operate informally are a source of unfair competition for those enterprises that comply with fiscal and labour laws. In addition, they face high barriers in terms of access to capital, financial resources, public infrastructures and markets, with negative implications for productivity and business sustainability. Finally, for Government and societies, informality means reduced government rev-

Figure I.2.1

Extent and composition of informal employment, 2016



Source: ILO calculations, based on national labour force survey or similar household survey data.

Note: Data represents harmonized definition of informal employment. Global estimates are based on 119 countries representing 90 per cent of total employment.

(continued)

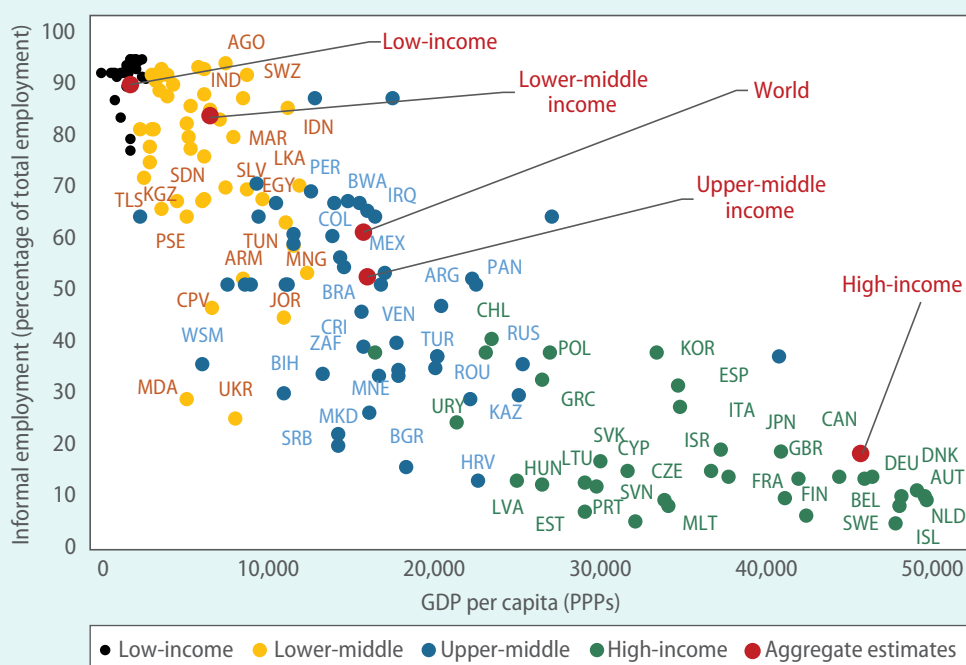
enues. This, in turn, limits the scope of government action and weakens the rule of law, undermining social cohesion and inclusive development.

The level and forms of informality vary depending on the level of economic development. The share of informal employment ranges from 18.3 per cent in high-income countries to 67.4 per cent in middle-income countries and as high as 89.8 per cent in low-income countries (figure I.2.1). Nevertheless, countries with similar levels of GDP per capita show very different levels of informal employment (figure I.2.2). The dispersion reflects cross-country differences, such as the composition of GDP, the institutional setting and also characteristics of workers that may act as barriers to formal employment. Indeed, the poor face higher rates of informal employment, and poverty rates are at least two times higher among workers in informal employment compared to workers in formal employment. The majority of workers with no education (93.8 per cent) are in informal employment compared to 23.8 per cent of workers with a tertiary level of education. More than half of all workers in informal employment have, at best, a primary level of education. Further, more than three quarters of the youth and older workers are in informal employment compared to 57 per cent among those aged 25–64 years old. Finally, the share of informal employment is almost twice as high in rural areas compared to urban areas. This results partially from the higher exposure of agriculture to informal employment compared to industry and services. Rural areas are also impacted by the institutional and economic environment (limited access to public infrastructure and services; differences in the quality of services; local governance), personal and employment characteristics of the rural population (higher incidence of poverty; lower levels of education; over-representation of small economic units), or traditions and rural actors' perception of laws, regulations and social norms.

Firm size is also linked to the prevalence of informality. It is estimated that enterprises of less than 10 workers account for 75 per cent of total informal employment. However, despite the greater ability of large enterprises to cover the cost of formalization, a significant share of wage employment is informal in medium and large enterprises, including in formal enterprises (Bonnet, forthcoming).

Box I.2 (*continued*)

Figure I.2.2
Level of GDP per capita and informal employment share



Sources: ILO and World Bank's World Development Indicators.

Note: Only selected country labels are included for visibility.

(continued)

Box I.2 (continued)

Formalization policies

Recommendation 204 (R204) of the International Labour Organization (ILO) suggests that reducing informal employment must be tackled along three policy channels:

- Formal employment generation (via growth, structural change, etc.);
- Policies for the transition from the informal to the formal economy (tax incentives, social security schemes for specific population groups, etc.);
- Policies to impede the informalization of formal jobs (firm and labour enforcement systems for example).

It is important to take into account that transition to formality will require time and cannot rely on one-time policy interventions. This view is well supported by the example of Latin America in 2005–2015. It is estimated that over this period, the region generated 51 million jobs, and 39 million were formal jobs (Salazar and Chacaltana, 2018). This brought the share of non-agricultural informal employment as a whole down from 52 per cent in 2005 to 47 per cent in 2015. The ILO Regional Programme for the Promotion of Formalization in Latin America and the Caribbean (FORLAC)^a argues that countries in the region embarked on four pathways to formality: productive development, regulation simplification/ improvement, incentives (tax, social protection), and enforcement. In his study, Infante (2018) underscores the relative importance of different drivers of the transition to formality: it is estimated that economic factors, such as growth and structural transformation, that boosted formal employment generation, account for 60 per cent of the reduction in informality in the region, while institutional policies account for the remaining 40 per cent.

Other recent studies on the impact of institutional policies tend to find that specific policies have positive but small effects that are short lived (Salazar and Chacaltana, 2018; Jessen and Kluve, 2018). A key to understanding these results is that impact evaluation studies tend to focus on single interventions in a particular time frame—the time frame usually being soon after the intervention has started. However, the Latin America experience shows that the most impressive results have occurred in those cases where multiple interventions accumulated progressively over time, and where the political will towards formalization was sustained for more than a decade. Informality will persist for a long period, unless an integrated and consistent approach is implemented, as ILO R204 recommends.

^a Available from <https://www.ilo.org/americas/temas/econom%C3%ADa-informal/lang-es/index.htm>.

Authors: Florence Bonnet and Juan Chacaltana (ILO).

At the country level, returns from growth are failing to reach many individuals most in need

Even where income inequality has come down in recent years, wage growth and job creation for those at the lower end of the income scale is not proceeding nearly fast enough to lift the threat of poverty from those being left behind. More rapid progress towards creating decent jobs requires both active labour market and education policies, especially to support youth, women and vulnerable groups, as well as well-managed fiscal frameworks.

While unemployment rates are at historical lows in many developed economies, many individuals, notably those in the bottom 10 per cent of income scales, have seen little or no growth in disposable income for the last decade (figure I.9). Low real wage growth at the bottom end of the wage distribution partly reflects a lack of bargaining power of workers in low-skilled jobs. This may result, for example, from a decline in collective bargaining, more stringent social security conditions, or a lack of labour protection legislation, especially in the case of informal employment. Wages in particular sectors may also be impacted by technological change. For example, structural changes to technology and production over the last two decades have been associated with declining demand for medium-skill workers compared to high- and low-skilled workers. This has been a factor compressing median wage growth. More broadly, the erosion of labour market bargaining power and skills-biased technical change have been factors behind the decline in the labour share of income over the last several decades.

Figure I.9
Real household disposable income, developed economies

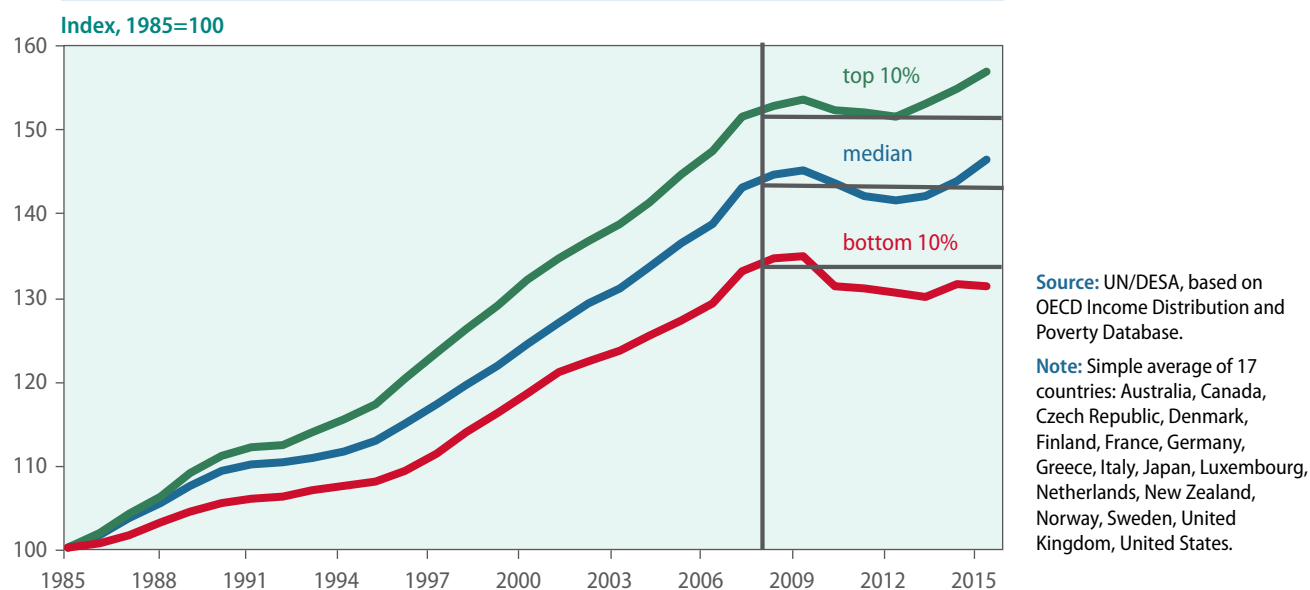
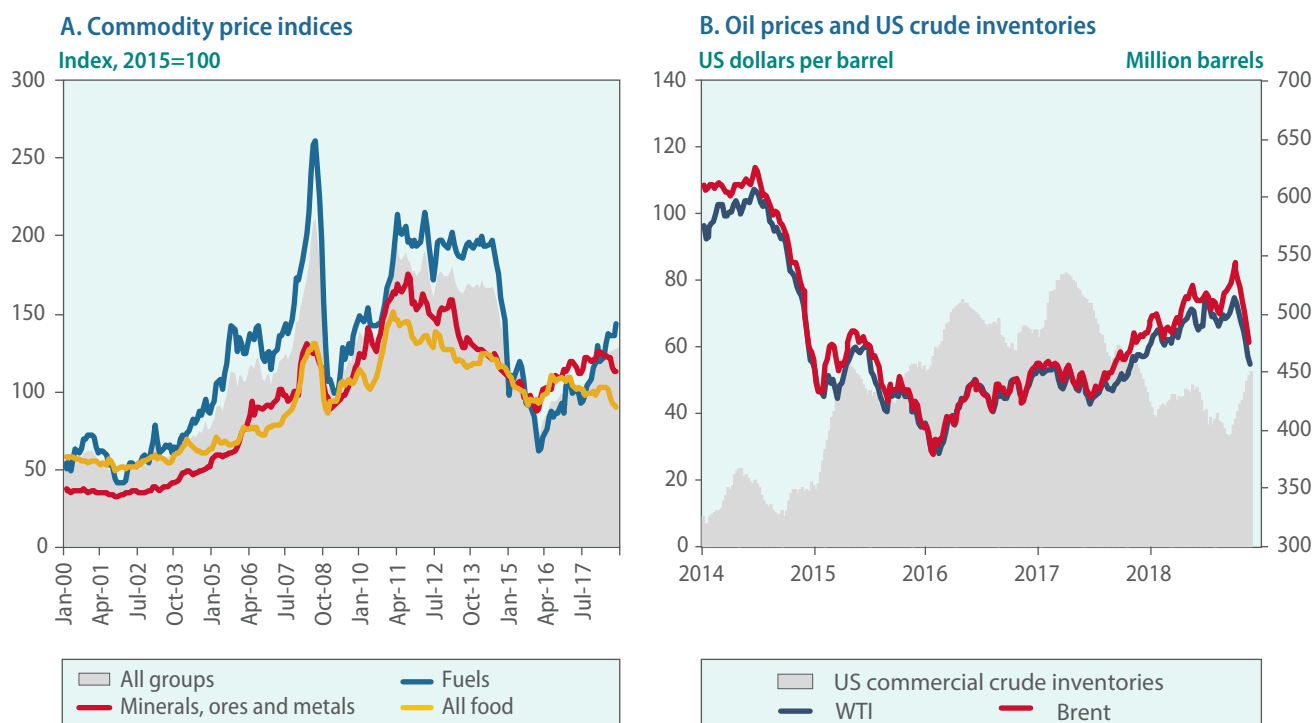


Figure I.10
Major commodity prices



Source: UNCTAD.

Source: Energy Information Administration.

Economic conditions remain challenging for many commodity exporters

Economic conditions remain challenging for many commodity exporters, underscoring the vulnerabilities faced by countries that are overly reliant on natural resources.⁵ The UNCTAD free-market commodity price index (FMCPI)⁶ rose by nearly 20 per cent in the year to September 2018 (figure I.10.A), driven by the price of energy commodities, which has risen well above average levels in 2017. However, the prices of non-fuel commodities have generally declined over this same period, with the FMCPI excluding fuels down by 7.6 per cent. This reflects a 9.1 per cent drop in food prices. This negatively impacts terms of trade of agriculture exporters, but also helps keep food price inflation moderate in net food-importing countries. The sub-index for minerals, ores and metals declined by 7.9 per cent year on year to end-September 2018, due to a combination of strong supply conditions and rising trade tensions, which weigh on demand for base metals. The ongoing expansion of the electric vehicle market (box I.3) is likely to lead to demand growth for metals such as nickel, cobalt and lithium, supporting prices in the medium to long term. Further detail on developments and prospects for individual commodities are reported in the Appendix to this chapter.

Oil prices remain volatile

Over the first three quarters of 2018, oil prices rose steadily, and the Brent spot price recovered to reach \$80 per barrel at the end of September 2018 (figure I.10.B). The rise largely reflected a rebalancing of excess supply. Since 2017, the Organization of the Petroleum Exporting Countries (OPEC), the Russian Federation and some other oil producers have operated under an agreed crude oil production cap, entailing a reduction of 1.8 million barrels per day relative to 2016 levels. The supply cuts have partially offset rapidly increasing crude oil production in the United States. As the expanding world economy has increased oil demand, the level of commercial crude oil stocks has declined from the peak registered in the first quarter of 2017. The level of commercial inventories of crude oil in the United States⁷—which is also a guide to the level of global commercial inventories—declined from the peak of 535 million barrels in March 2017 to 403 million barrels at the end of September 2018 (figure I.10.B).

However, the level of commercial inventories showed a quick rebound in the fourth quarter of 2018. Over the six weeks to mid-November, the US commercial inventory rose by 44 million barrels. Corresponding to the steep inventory increase, the price of Brent crude plunged to \$60 per barrel. The outlook is mixed. Upward pressure on oil prices might come from a significant decline of crude oil supply from the Islamic Republic of Iran, due to the implementation of unilateral economic measures by the United States, while supply from the Bolivarian Republic of Venezuela is already negatively impacted by the oil sector's deteriorating technical capacities. Moreover, the reduction of capital expenditures on exploration activities for the last few years limits the supply capacity, particularly in smaller oil-producing countries. Meanwhile, other factors point to lower prices, based on the stubbornly high level of commercial inventories and an expectation that the rate of growth of

⁵ See discussion in Chapter II on excessive commodity dependence.

⁶ The UNCTADStat database on commodity prices and indices underwent substantial revisions in 2018, including the introduction of a new commodity price index, which includes energy commodities and has 2015 as the base year. The old commodity price index was discontinued as of December 2017.

⁷ See U.S. Energy Information Administration, available from <https://www.eia.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s=WCESTUS1&f=W>.

Box I.3

Impacts of large-scale electric vehicle deployment on battery metals markets

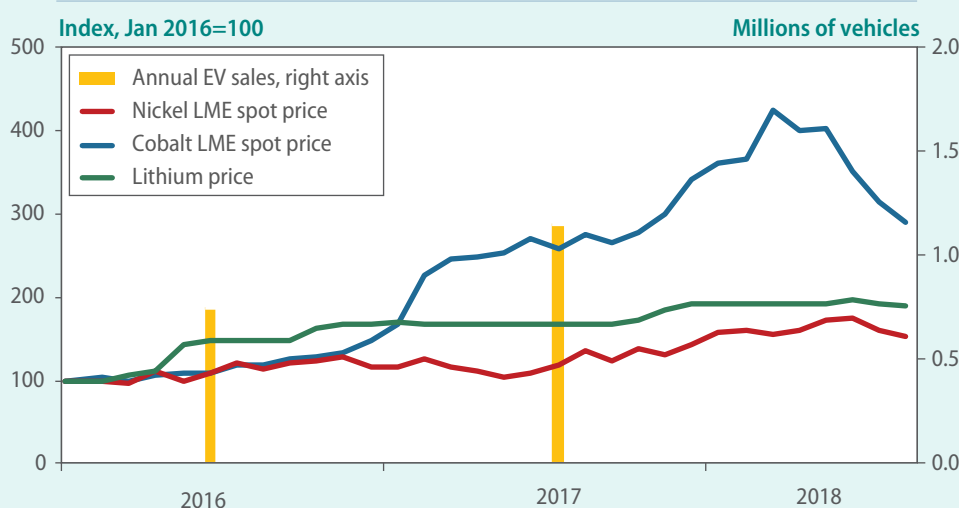
The market for electric vehicles (EV) is expanding at a rapid rate, driven by regulation and a trend towards the reduction of carbon emissions from the transport sector combined with falling costs of EVs relative to vehicles with internal combustion engines. EV sales have increased almost tenfold in the past five years, from 118 thousand vehicles in 2012 to 1.15 million in 2017. Current estimates put EV sales at 11 million in 2025 and 30 million in 2030 (Bloomberg New Energy Finance, 2018).

EVs are powered by lithium-ion batteries, which contain cobalt, lithium and nickel as key components. The massive increase in demand for these battery metals over the coming years poses challenges but also creates opportunities for commodity-dependent developing countries where a large share of these battery metals is mined.

The battery industry is the dominant end-use of cobalt and currently absorbs about half of global production. Since cobalt is almost exclusively mined as a by-product of copper and nickel and given the commodity's low elasticity of supply, price signals do not necessarily trigger a supply response. Furthermore, cobalt mining is highly concentrated in the Democratic Republic of the Congo, which accounted for 58 per cent of global cobalt mine production in 2017 and has the world's largest reserves (U.S. Geological Survey, 2018). These supply-side features, in combination with growing demand from the battery industry, have caused tension in the cobalt market and a dramatic price increase in 2017 (figure I.3.1). While producers are working on formulations that reduce the cobalt content in lithium-ion batteries, the rapid expansion of the EV market is going to drive demand growth and likely create upward pressure on prices, at least over the short to medium term.

Figure I.3.1

Battery metals prices and EV sales



Sources: Quandl, World Bank, Thomson Reuters, International Energy Agency.

Batteries are also the largest end user for lithium, absorbing 46 per cent of lithium used (ibid.). Australia, Chile and Argentina jointly accounted for 89 per cent of global mine production in 2017 (ibid.).^a Since lithium is not a homogenous commodity that is sold on a major exchange, but rather comes in different compounds that are traded between a small number of suppliers and buyers, price data is not readily available. However, existing data suggest that lithium prices have increased significantly in 2016 and 2017. Unlike cobalt, lithium is mined as a primary metal so that price signals have a more immediate effect on supply. Consequently, suppliers have announced the expansion of existing mine production as well as new operations, including in the Argentina-Bolivia-Chile "lithium triangle," which has attenuated

^a Figure excludes mine production in United States.

(continued)

Box I.3 (continued)

the price increase in 2018. Going forward, the surging lithium demand from the EV sector can be expected to lead to an expansion of production rather than supply tensions or steep price increases.

While nickel is an essential component of lithium-ion batteries, the battery industry currently represents only 3 per cent of global nickel consumption.^b However, only class-I nickel, about half of the global production, is suitable for battery production. Hence, at current EV market growth rates, the battery industry could become the dominant end user for class-I nickel within a decade. An additional driver of incremental nickel demand is the anticipated change in battery chemistries towards a higher share of nickel. Given the high capital intensity and long lead times of new nickel mines and increasingly depleted nickel sulphide deposits, the emerging growth in nickel demand is likely to put upward pressure on prices.^c

^b Authors' estimates.

^c See UNCTAD and FAO (2017) for a case study on the Indonesian nickel ore export ban.

The EV revolution is just gathering steam and projected growth rates are enormous. For developing countries that own many of the reserves of battery metals, this increases the urgency to strengthen environmental, social and ethical standards of mining operations and to ensure local value retention in order to support the sustainable development of mining communities. Recent developments in this context include the classification of cobalt as a strategic metal by the Government of the Democratic Republic of the Congo, which allowed it to increase royalties fivefold from 2 per cent to 10 per cent. Other developing countries with significant reserves of battery metals—such as Cuba, Madagascar, the Philippines and Zambia for cobalt, Brazil, Indonesia and the Philippines for nickel and Argentina, Bolivia, China and Chile for lithium—will need to find ways to align potential ramifications of the rapidly emerging global EV market with their national sustainable development efforts.

Authors: Authors: Stefan Csordas and Janvier D. Nkurunziza (UNCTAD/DITC/Special Unit on Commodities)

crude oil demand will moderate. These opposing forces are expected to create large swings in oil prices over the coming year.

International trade

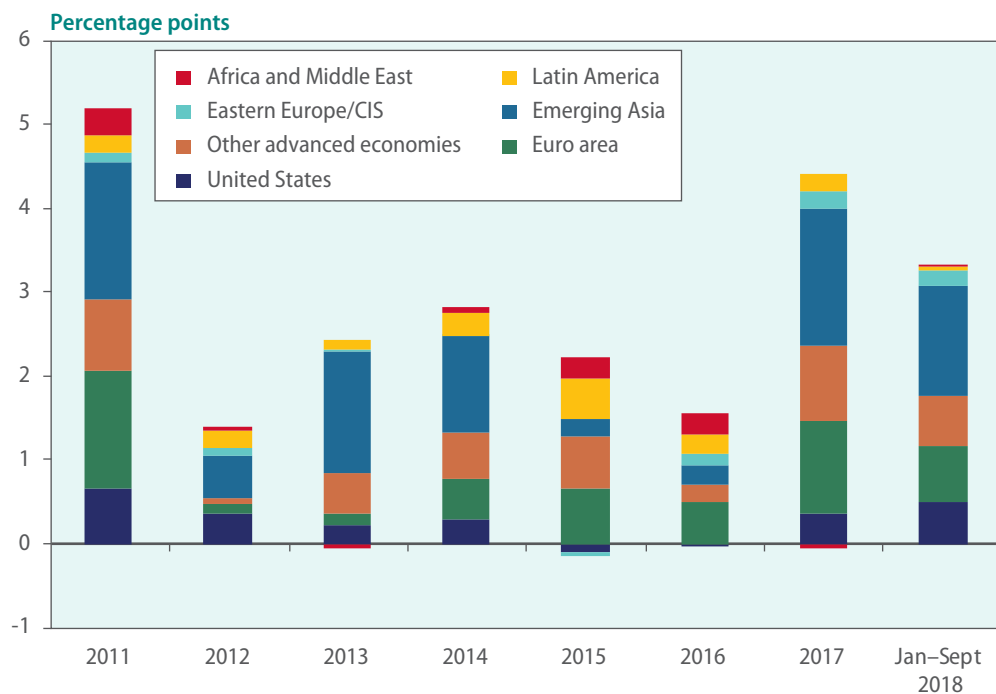
Global trade growth moderates, amid heightened trade tensions

Global trade growth is moderating alongside rising trade tensions among the world's largest economies and tightening monetary conditions that are escalating financial fragilities in some emerging economies. The global trade performance peaked in 2017, expanding by 5.3 per cent in volume terms, which is above the average growth observed in the last half decade. But growth tapered throughout 2018, with an estimated expansion of 3.8 per cent for the year as a whole. The slowdown was mainly driven by a weaker rise in merchandise import demand in most developed countries (figures I.11 and I.12). In Asia, however, trade growth has remained more resilient. East Asia has benefited from strong global demand for electronics, boosting intraregional trade, given the region's deep integration into the industry's global production networks. Meanwhile, global trade in services continued to expand more rapidly than merchandise trade, up by more than 10 per cent in value terms in the first half of 2018. International tourism revenues contribute 30 per cent of global services trade, and tourist arrivals increased by 6.0 per cent in the first half of 2018 (box I.4). Tourism is also closely correlated with market sentiment, suggesting that as of mid-2018 the build-up of economic risks had not materially impacted global sentiment.

In 2018, there was an escalation in trade tensions and a sequence of rising tariffs among the largest world economies, most prominently between China and the United States (see the discussion on escalating trade policy disputes below). While these tensions

So far, trade disputes have affected trade flows only moderately...

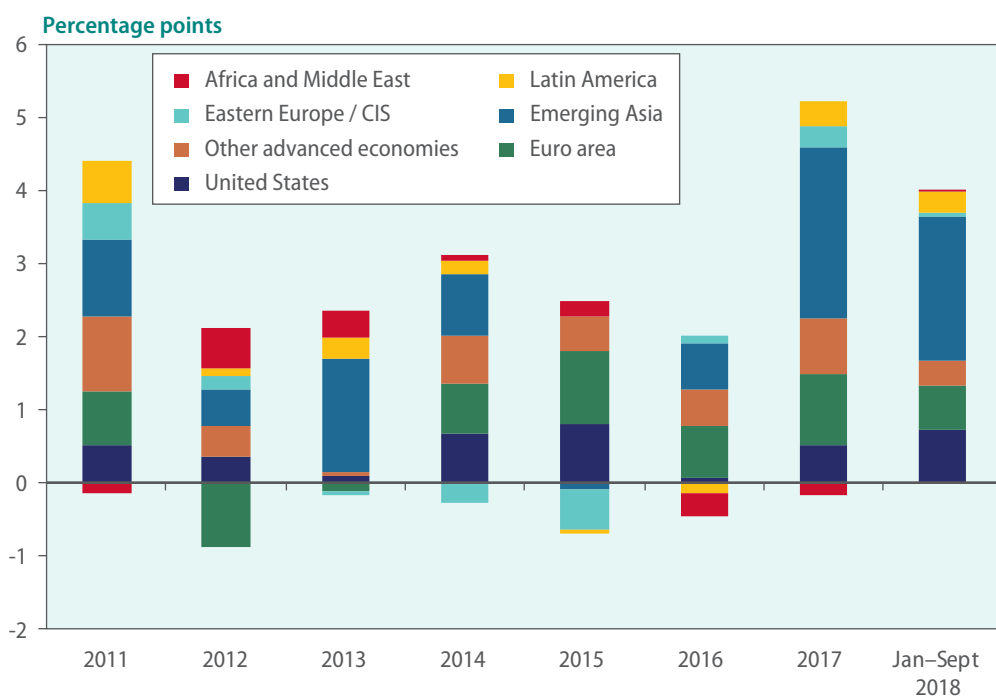
Figure I.11
Contribution to global merchandise export volume growth by region, 2011–2018



Source: UN/DESA, based on data from CPB Netherlands Bureau for Economic Policy Analysis.

Note: Regional groupings are not strictly comparable to those in the WESP, but are illustrative of regional tendencies.

Figure I.12
Contribution to global merchandise import volume growth by region, 2011–2018



Source: UN/DESA, based on data from CPB Netherlands Bureau for Economic Policy Analysis.

Note: Regional groupings are not strictly comparable to those in the WESP, but are illustrative of regional tendencies.

Box I.4

International tourism

Strong demand continues in international travel

International tourist arrivals increased 7 per cent in 2017 to reach 1.3 million worldwide. It was the highest increase since 2010 and the eighth consecutive year of above-average growth. Results were driven by the global economic upswing and solid outbound demand from virtually all source markets, including a strong recovery in the emerging markets of Brazil and the Russian Federation after a few years of decline.

Demand remained robust in the first half of 2018, with arrivals increasing 6 per cent compared to the same period in 2017. By regions of the United Nations World Tourism Organization (UNWTO), growth was highest in Asia and the Pacific and Europe (both by 7 per cent), while the Middle East (5 per cent), Africa (4 per cent) and the Americas (3 per cent) also recorded an increase in arrivals. By subregion, South-East Asia and Southern Mediterranean Europe (both 9 per cent) enjoyed particularly strong results.^a

Tourism: third largest export sector in the world generates \$1.6 trillion

In 2017, total exports from international tourism reached \$1.6 trillion, comprising \$1.3 trillion in international tourism receipts and \$240 billion in international passenger transport services (rendered to non-residents). This represents 7 per cent of the world's exports of goods and services and about 30 per cent of services exports.

International tourism receipts represent the bulk of export revenues from tourism and consist of visitor expenditure on accommodation, food and drink, shopping, and other goods and services purchased in destinations. Global receipts increased by \$95 billion in 2017, or 5 per cent in real terms (accounting for exchange-rate fluctuations and inflation).

Tourism is a crucial source of foreign revenues for both emerging and advanced economies and an essential component of national export strategies. It is the third largest global export category after chemicals and fuels, ahead of automotive products and food. In many developing countries, tourism is the top export category.

Tourism: creating jobs and opportunities on the road to 2030

Tourism accounts for 10 per cent of the world's gross domestic product and has become a major source of job creation at all skill levels. The sector accounts for 1 in 10 jobs worldwide, including direct, indirect and induced jobs (World Travel and Tourism Council, 2018). Globally, tourism is a major employer of women and youth, and offers many opportunities for entrepreneurs. Decent work opportunities and policies that favour the integration of other sectors in the tourism value chain can multiply the socioeconomic impacts of tourism. Tourism features heavily throughout the 17 Sustainable Development Goals (SDGs), and is a tool for development that creates and sustains jobs, has the potential to increase productivity, and reduces poverty.

Partnerships and learning from the many initiatives and success stories around the world is key to advancing these goals. UNWTO launched the Tourism for SDGs Platform, an online co-creation space where all stakeholders can share events, projects, initiatives, research and policies that promote tourism's role in the road towards 2030.^b

Building sustainable, inclusive and resilient cities

The management of tourism in cities is a fundamental issue for the tourism sector and its contribution to sustainable development. Overcrowding in some cities has made headlines in recent times, reflecting challenges in managing growing tourism flows in urban destinations and the impact on its residents.

Long before the emergence of buzzwords such as "overtourism," UNWTO defined tourism's carrying capacity as "the maximum number of people that may visit a tourist destination at the same time, without causing destruction of the physical, economic and sociocultural environment and an unacceptable decrease in the quality of visitors' satisfaction" (UNWTO, 1983).

Tourism will only be sustainable if it is developed and managed considering the experience of both visitors and local communities. It is therefore critical to ensure that tourism development is aligned

^a For the latest tourism data and trends, please refer to the UNWTO World Tourism Barometer, available from mkt.unwto.org/barometer, or the UNWTO Tourism Highlights, available from mkt.unwto.org/highlights.

^b More information about the Tourism for SDGs Platform is available from <http://tourism4sdgs.org/>.

(continued)

with the United Nations New Urban Agenda and the SDGs, namely Goal 11 (make cities and human settlements inclusive, safe, resilient and sustainable).

The UNWTO (2018) report, *Overtourism? Understanding and Managing Urban Tourism Growth Beyond Perceptions*, examines how to manage tourism in urban destinations to the benefit of visitors and residents alike by proposing 11 strategies and 68 measures to better understand and manage visitor growth. These include measures to stimulate community engagement, reduce seasonality, promote less-visited parts of the city, improve infrastructure and develop plans that take into account the destination's capacity.

Examples of successful initiatives to manage urban tourism include Berlin, which has promoted the organization of conferences and seminars in community buildings and schools, preferably those linked to the conference subject. This provides conference organizers with innovative locations, allows for direct financial benefits in a neighbourhood, and stimulates a different form of exchange between residents and visitors. Turismo de Portugal, in collaboration with NOVA School of Business and Economics and NOS (Telecom Company) designed a pilot project to study the various pressures created by tourism in Lisbon and Porto. The project aims to measure and monitor tourism by using telecom traffic (CDR data), social media usage, Airbnb data and arrivals at airports. A second phase of the project will design policy recommendations and concrete actions to be taken by relevant tourism authorities to address the key challenges. Most of these strategies are naturally applicable to other types of tourism destinations, considering they are based on key principles of sustainable tourism such as community engagement, partnerships and coordination of all players, as well as the definition and management of carrying capacity at destinations.

Box I.4 (continued)

Authors: Sandra Carvão, Michel Julian and Javier Ruescas (UNWTO).

have materially impacted some specific sectors, stimulus measures and direct subsidies have so far offset much of the direct negative impacts on China and the United States, and disruption to trade flows at the global level remains moderate. The magnitude of trade flows subject to new tariffs is still limited, even following the decision of the United States to impose tariffs on an additional \$200 billion worth of Chinese goods beginning in mid-September 2018. Although China and the United States are the two biggest traders in the world, bilateral trade between the two countries represents just 3–4 per cent of global merchandise trade, as the bulk of global trade is concentrated in intraregional flows in East Asia, Europe and North America.

Temporary trade barriers act as a supply shock that reduces output and raises inflation. While often introduced to “protect” the domestic economy, trade barriers are generally not effective tools to provide macroeconomic stimulus or to promote rebalancing of external accounts (Barattieri et al., 2018). Directly impacted sectors have already witnessed rising input prices and delayed investment decisions, and these impacts can be expected to spread, especially through production networks. A rise in trade barriers can have large, non-linear effects on trade volumes, and these impacts tend to increase with deeper vertical specialization along the value chain (Goldberg and Pavnick, 2016).

...but the economic impacts may build

Impact of tariff hikes is heterogeneous across sectors and firms

Recent tariff hikes and counter measures, if prolonged, are expected to increasingly reduce and divert trade, disrupt cross-border operation of global value chains (GVCs), and entail costs for consumers, producers and workers in China, the United States and elsewhere. The firm-level impacts depend critically on their position in the production networks of the impacted sectors. For example, industries in the United States that use steel as a major production input, such as construction and transport equipment, have faced higher production costs since US steel tariffs were announced in early 2018. The after-tax price of steel in the

United States has risen by nearly 30 per cent relative to world export prices since the beginning of 2018 (figure I.13). While the direct impact of steel tariffs may preserve or create jobs within the steel industry, the indirect effects in the much larger steel consuming industries will squeeze corporate profits and potentially reduce employment and wages (Afonso and Holland, 2018).

The agricultural sector in the United States is also under stress given the retaliatory tariffs implemented by China on products such as soybeans and corn. Meanwhile, US automobile producers with operations in China are facing higher costs from new tariffs implemented by both countries (AmCham China, 2018). The export exposure of Chinese firms to the United States is also a major factor in spreading economic and financial effects in the corporate sector in China—for example, in the machinery and electronic sectors (Huang et al., 2018).

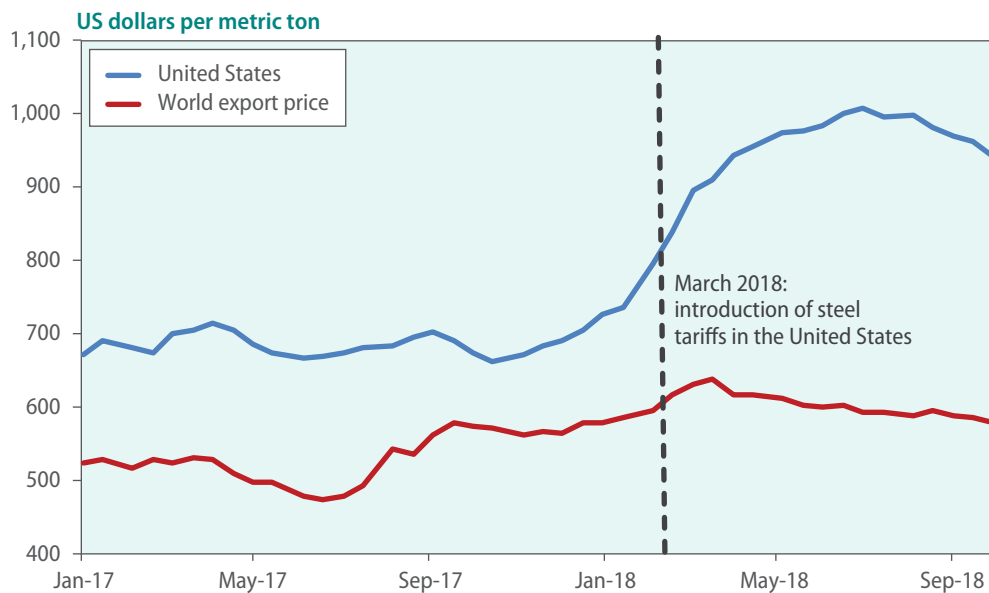
The high import content of Chinese exports suggests that developing countries integrated into these supply chains will also be impacted. For those products where China or the United States have market power, for example, cascading effects could be felt through downward pressure in international prices, with adverse implications for suppliers in other developing countries. In addition, if business performance and confidence deteriorate from the ongoing trade disputes, then changes on investment plans might become more widespread, including not only lower capital expenditures but also production and employment reallocations across countries. Some Chinese manufacturers might consider shifting their production to other countries that are not affected by tariffs, such as Mexico or Viet Nam.

At the country level, vulnerabilities to the negative fallout from global trade disputes differ substantially. Trade openness and the composition of trade flows, together with exchange-rate regimes, are crucial determinants of the degree of exposure to trade shocks and of how they are absorbed in different economies. Macroeconomic policy space also plays an important role in counteracting, or deepening, potential negative effects. For instance, China is considering the implementation of a tax cut to boost consumption, while at the same time implementing several policy measures to inject liquidity into commercial

Countries' sensitivity to trade shocks depends on their trade openness, exchange-rate regimes and diversification across markets and products

Figure I.13

Steel prices in the United States and world, January 2017–October 2018



Source: UN/DESA, based on data from SteelBenchmarker™ Data.

Note: Prices correspond to hot-rolled band (HRB) steel prices.

banks, offsetting much of the direct impact of ongoing trade disputes on the domestic economy. In addition, targeted subsidies and support can temporarily offset the direct impact of tariffs on specific industries. For example, the United States is implementing an emergency bailout plan worth \$12 billion to support corn and soybean farmers.

At a more disaggregated level, exporters' product and market diversification helps them to navigate adverse trade shocks. This provides exporters with some flexibility to confront higher trade costs. More generally, technological capabilities shape how countries integrate into foreign markets. For example, even comparing only developing countries, those economies with higher technological capabilities have more exporters, and their exporting firms are larger, more diversified and charge higher prices for their products, suggesting a higher product quality (box I.5) (Vergara, 2018).

Manufacturing output surveys in the euro area and some economies in the Association of Southeast Asian Nations (ASEAN) point towards a further slowdown in trade activity in the near term. Given the current prospects for the world economy and the height-

Global trade growth is projected to remain below 4 per cent in 2019–2020

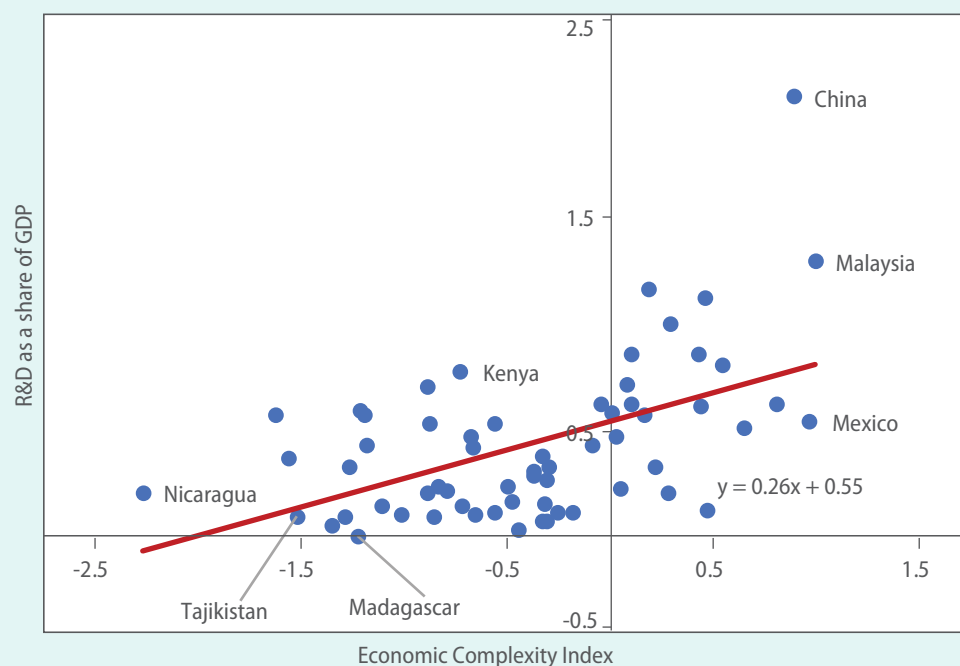
Box I.5

Technological capabilities and export dynamics in developing countries

An engine of export growth, economic growth and development, technological capabilities have long played a central role in economic literature. Early contributions on development theory emphasized that technological progress was a critical factor in upgrading production structures and shaping the patterns of international specialization. Also, while Schumpeterian ideas emphasized the importance of research and development (R&D) investment and innovation in shaping market dynamics, modern growth theories highlighted the role of human capital, R&D and, more broadly, knowledge as major drivers of growth. Despite these long-standing contributions, many open questions remain regarding how technological capabilities shape export dynamics at the microeconomic level, especially in developing countries.

Figure I.5.1

Economic complexity and R&D investments, 2015



Source: Author's own elaboration, based on data from World Bank's World Development Indicators and the MIT's Observatory of Economic Complexity <https://atlas.media.mit.edu/en/>.

(continued)

Box I.5 (continued)

There are several different measures that capture aspects of an economy's technological capabilities. In recent years, one measure that has gained prominence is the Economic Complexity Index (ECI).^a The ECI measures the multiplicity of productive knowledge in an economy by combining information on the diversity of a country's exports (based on the number of its export products) and the ubiquity of its products (based on the number of countries that export the same products). Another traditional variable to measure capabilities is R&D investment, which reflects the level of effort that countries spend to foster knowledge creation and absorption. In fact, a firm's R&D activities not only encourage product and process innovation, but also enhance its absorptive capacity to assimilate external knowledge.

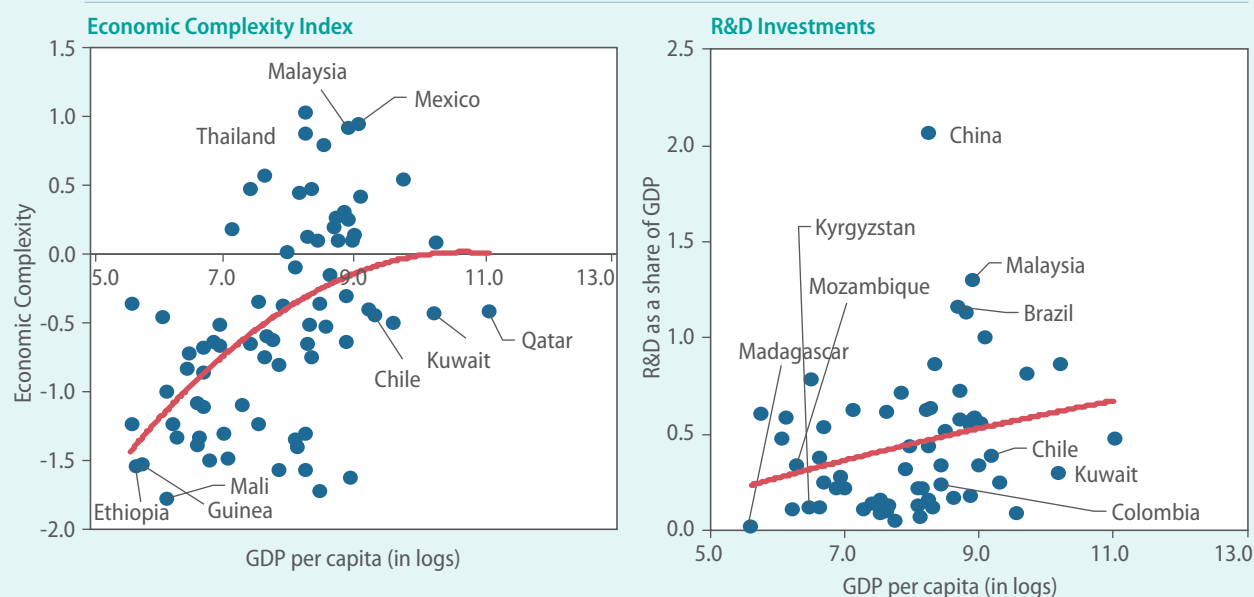
Figure I.5.1 displays the levels of ECI and R&D investment for selected developing countries. As expected, there is a positive correlation, but the dispersion of observations also underscores that ECI and R&D investment reflects distinctive aspects of technical capabilities. For example, Mexico displays a relatively high ECI as its export structure is diversified, with a relatively large share of medium-high and high technology products because of the significant presence of transnational firms. However, technological efforts in the Mexican economy are limited, with relatively low levels of R&D investment—only 0.55 per cent of GDP—illustrating the weaknesses of its national innovation system. By contrast, Kenya exhibits a relatively low level of ECI, as its export structure is highly concentrated in a few vegetable products and textiles. Nevertheless, Kenya has strengthened its efforts to visibly increase R&D investment in recent years—to about 0.8 per cent of GDP, a relatively high figure for a developing country. This should have some effect on the diversification and technology upgrading of its exports in the medium term. Meanwhile, figure I.5.2 displays the plots for ECI and R&D against the level of development, using GDP per capita as a proxy. As expected, both variables are positively correlated with the level of development, but the relationship differs significantly across countries. For example, some heavily commodity-dependent countries in Western Asia and Latin America exhibit relatively low levels of capabilities and high GDP per capita compared to other developing countries.

^a See <https://atlas.media.mit.edu/en/rankings/country/eci/>.

^b For details about the database, see <http://www.worldbank.org/en/research/brief/exporter-dynamics-database>.

In analyzing the role of technological capabilities on a country's export dynamics, Vergara (2018) used a range of export indicators from the World Bank's Exporter Dynamics Database.^b This database compiles export information from national sources exporter-level customs data for 40 developing countries between 2002 and 2012. It comprises statistical information at the sectoral level (two digits of the HS 2002 Classification) for the number of exporters (total and per product), average value of exports

Figure I.5.2
Technological capabilities and GDP per capita, 2015



Source: Author's own elaboration, based on data from World Bank's World Development Indicators and the MIT's Observatory of Economic Complexity <https://atlas.media.mit.edu/en/>.

(continued)

per exporter and per new exporter, average unit prices per exporter, average number of products per exporter, and the average number of destinations per exporter. In particular, the analysis tackles the following questions: Do countries with more technological capabilities have more and larger exporters? Do exporters from countries with more capabilities receive higher unit prices for their products? Are exporters from countries with more capabilities more diversified by product and destination? In doing so, the empirical approach controls for other country dimensions that are relevant for export dynamics, such as the size of the economy, level of development, trade openness, size of manufacturing sector, and commodity dependency.

The empirical analysis provides several interesting outcomes.^c First, the results show that, within sectors, countries with higher technological capabilities have more exporters (total and per product) and the exporters are larger and charge higher prices for their products, suggesting a higher quality of their products. Second, the results confirm a positive and strong relationship between technological capabilities and diversification: within sectors, exporters in countries with more capabilities tend to export a higher number of products and to more destination markets. Moreover, technological capabilities seem to play a crucial role in promoting market diversification in high technology exporters.

Thus, even comparing exporters' behaviour only among the developing countries, stronger technological capabilities are significantly related to the "extensive" and "intensive" margin of exports, diversification across products and destinations, and product quality—all of which are relevant aspects of developing countries' insertion in global trade markets. Importantly, these features should make countries with stronger technological capabilities more resilient to trade shocks, while also helping their medium-term growth and development prospects. These findings reinforce the importance of economic diversification, a policy environment that supports innovation and technological progress, and investment in workforce skills to accelerated development prospects.

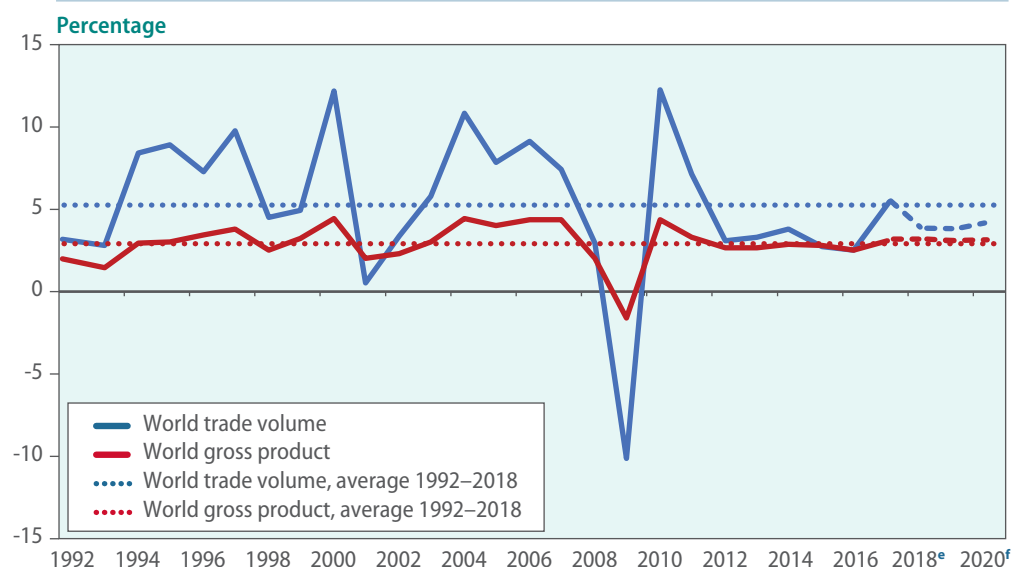
Box I.5 (continued)

^c For full details of the empirical approach—definition of variables, econometric specification, estimation methodologies and robustness checks—see Vergara (2018).

Author: Sebastian Vergara (UN/DESA/EAPD).

ened trade disputes, global trade growth is expected to remain below 4 per cent per year in 2019–2020, well below the average trade growth observed in previous decades (figure I.14). This trend also reflects the diminishing effects of structural factors that boosted trade in previous decades, such as the rapid expansion of GVCs and the information and communications technology revolution. Global trade in services is expected to continue to show greater resilience than merchandise trade. Service sectors offer significant opportunities for

Figure I.14
Growth of world trade and world gross product, 1992–2020



Source: UN/DESA.

Note: e = estimates, f = forecast.

Box I.6

Trade in services as a driver of development in times of tension: inclusiveness, resilience and diversification

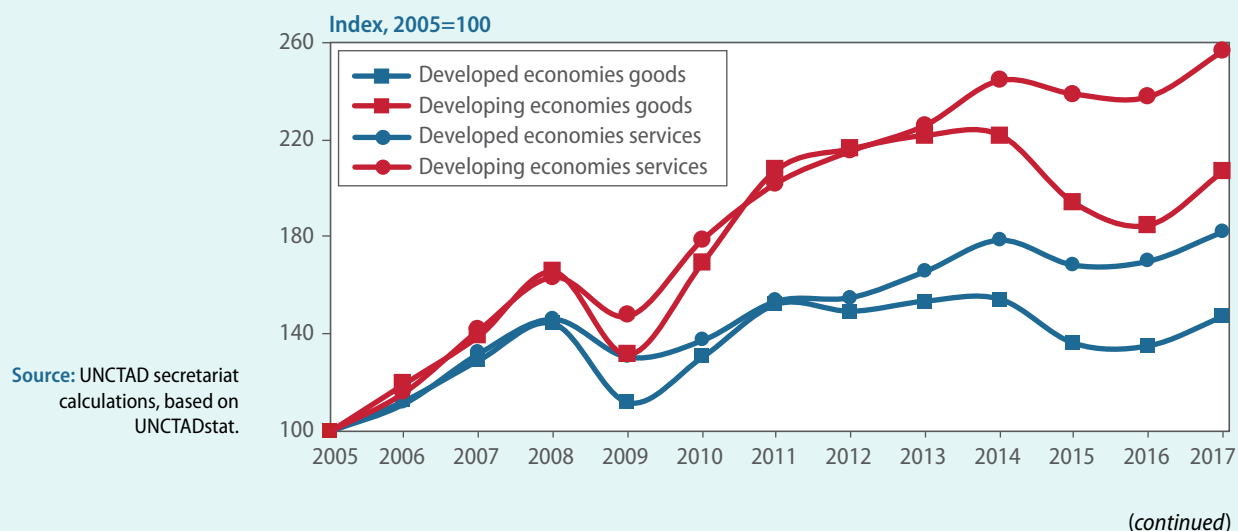
Following the trend of recent years, trade in services has continued to expand at a relatively fast pace—about 7 per cent in 2017. This trend seems to hold in 2018 with year-over-year growth of 15.0 and 9.6 per cent in the first two quarters, respectively. In developing countries, relatively fast growth of services exports has allowed their share in global services exports to rise from 23 to 30 per cent between 2005 and 2017. In this period, developing Asia registered the fastest growth in trade in services, about 9 per cent per year on average. Africa showed the weakest performance, but nevertheless recorded an average annual expansion of 5 per cent. Least developed countries (LDCs) also saw significant growth in services exports but have started from a low base and still account for less than 1 per cent of global services exports. Still, services account for 19 per cent of total exports in LDCs, underscoring the importance of the contribution of services for the achievement of target 17.11 of the Sustainable Development Goals (SDGs), which calls for a significant increase in exports from developing countries and LDCs (see box II.1).

Despite this expansion, restrictions to services trade in the world economy remain noteworthy. They are particularly acute in trade in services through the temporary movement of people, where restrictions related to quotas, labour market tests, durations of stay (IMF, World Bank and WTO, 2017), visa and work permit rules, and the recognition of qualifications and licences persist. Trade policy needs to pay attention to addressing the restrictions to services trade, as the costs are high and restrictions are declining more sluggishly than for goods.

Services trade is not a direct target of recent tariff hikes. However, in times of trade tensions, tightening visa requirements and other measures restricting foreign visitors may also affect service categories such as education and tourism. Tension-related tariff hikes will also disrupt global value chains (GVCs), impacting their services components. Nonetheless, in the current international trade environment, the heightened trade tensions with a focus on tariffs may increase the relevance of services in pro-development trade strategies.

Data on services exports also point to the important role of services in contributing to inclusiveness, resilience and diversification. In addition to growing more in developing countries than in developed countries, services exports are also more dynamic than goods exports in both country groups (figure I.6.1). Thus, services' contribution to total exports has increased, from 24 to 28 per cent in devel-

Figure I.6.1

Services and goods exports (value), 2005–2017

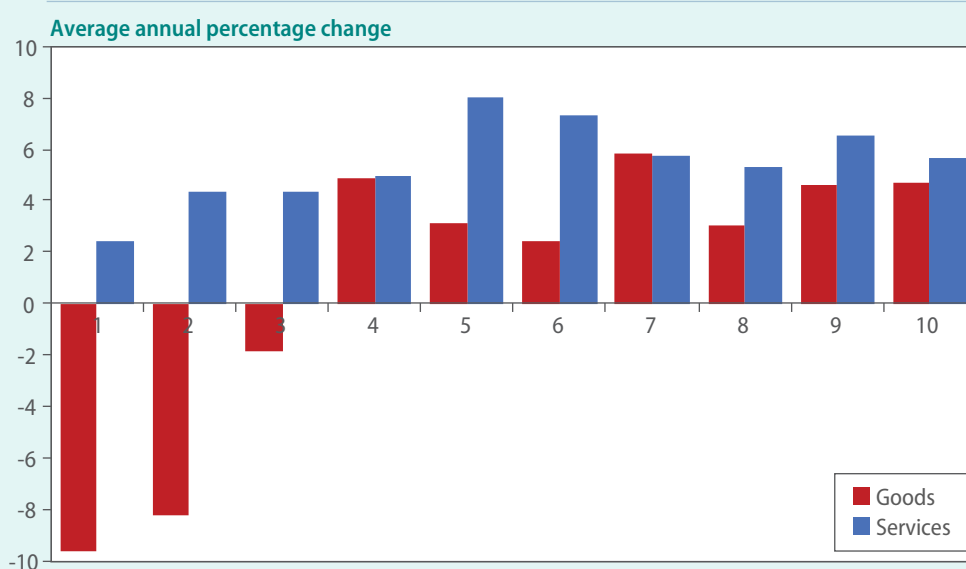
oped economies and from 14 to 17 per cent in developing economies since 2005. Services exports have also been more resilient, as shown by the much lower declines in services trade compared to goods trade, both during the global financial crisis and during the trade downturn in 2015 and 2016.

The inclusive potential of services is also revealed by figure I.6.2, which illustrates the annual growth rate in exports between 2005 and 2017 in small and large exporters. The figure groups countries according to the value of their global exports, with the first decile representing small exporters—that is, the 10 per cent of countries that account for the smallest global export revenue. The tenth decile represents the top 10 per cent of global exporters. In goods, exports have declined in countries with the smaller export revenue, increasing their distance from other countries. In services, although exports have grown less in countries with smaller export revenue, growth has nonetheless been positive since 2005. Moreover, services exports grew more in countries with medium export revenue (deciles 5 and 6), pointing to some reduction of the gap with large services exporters.

Box I.6 (continued)

Figure I.6.2

Exports value growth by deciles of export revenue, 2005–2017



Source: UNCTAD secretariat calculations, based on UNCTADstat.

Importantly, trade in services plays a vital role in promoting horizontal and vertical diversification in most economic sectors. This role is reflected in the substantial value added component of services in goods exports, in intermediate inputs and in services bundled with goods, for example distribution services provided by manufacturing companies. While direct exports of services in 2011 accounted for 25 and 14 per cent of total exports in developed and developing economies, respectively, services represented much higher shares of 44 and 32 per cent of the value added in total exports in developed and developing economies, respectively. In addition, while directly exported value added has increased in recent years, close to two thirds of the growth of services value added in exports is due to an increase in services embodied in exports of other sectors (UNCTAD, 2017a). The export of this services' value added within products in all economic sectors, referred to as the mode 5 of services trade, is the reflection of the "servicification" in international trade. Global gross domestic product gains from the multilateral liberalization of mode 5 of services trade could reach €300 billion by 2025 and global trade could increase by over €500 billion (Antimiani and Cernat, 2017).

Author: Bruno Antunes (UNCTAD/DITC).

both developed and developing countries in the medium term, even more so in the current context of heightened barriers for trade in goods (box I.6).

International financial flows

Financial market volatility has increased

Financial market volatility rose in 2018, particularly in the emerging economies

Rising policy uncertainties in the global economy and deepening country-specific vulnerabilities generated bouts of heightened financial market volatility in 2018, particularly in the emerging economies. Alongside the escalation in trade tensions, investor sentiments were also affected by high levels of debt, elevated geopolitical risks, oil market developments, and shifting expectations over the monetary policy path of the United States. Against this backdrop, global financial conditions experienced some tightening during the year, albeit at an uneven pace across regions and countries. Notably, while liquidity remained high in most of the developed world, many emerging economies experienced a sharp tightening in financial conditions. The shift in investor preferences, particularly between the United States and the emerging markets, is in part evidenced by the divergence in stock market trends in 2018 (figure I.15).

Despite periodic spikes in volatility, financial conditions in the developed countries remain generally benign

As inflation rises closer to central bank targets, monetary policy normalization is proceeding at a measured pace in the developed economies. In the United States, the Fed is lifting interest rates at a slightly faster pace than earlier anticipated in response to buoyant growth and labour market conditions. The European Central Bank has announced that it will cease asset purchases by end-2018. Meanwhile, despite high uncertainty surrounding the impact of Brexit, the Bank of England raised its key policy rate by 25 basis points in August 2018 to contain inflation.⁸

Despite the gradual tightening of monetary policy stances, however, financial conditions in most of the developed countries remained generally benign. From a historical perspective, long-term sovereign bond yields are still subdued, corporate spreads remain rel-

Figure I.15

Stock market performance in the United States and the emerging economies



⁸ Additional information on monetary and fiscal policy assumptions underpinning the forecast is reported in the Appendix to this chapter.

atively low, and equity market valuations are still high. Notably, in the United States, financial conditions remained loose during the first three quarters of 2018 (figure I.16). While long-term Treasury yields have recently risen considerably, they remain well below pre-crisis averages. However, the Chicago Board Options Exchange Volatility Index (CBOE VIX), which measures expected equity market volatility in the United States, saw sharp spikes, particularly in the early months of the year and in October (figure I.17). Notwithstanding periodic bouts of volatility, equity markets in the United States recorded new highs in 2018, reinforcing concerns over excessive valuations and an underpricing of risk.

Figure I.16

Chicago Fed National Financial Conditions Index

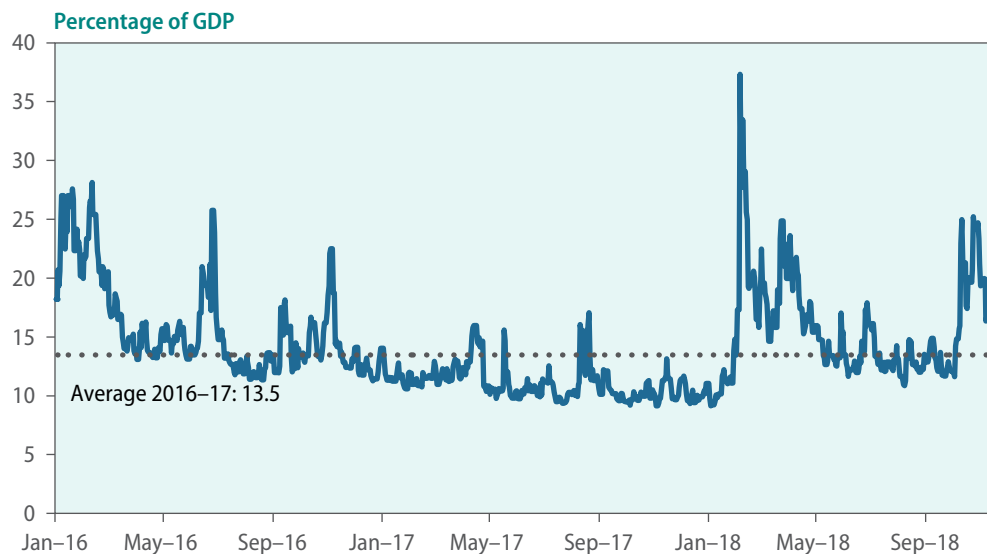


Source: Federal Reserve Bank of Chicago.

Note: Positive values of the NFCI indicate financial conditions that are tighter than average, while negative values indicate financial conditions are looser than average.

Figure I.17

CBOE equity volatility index (VIX)



Source: CBOE Global Markets.

Emerging economies experienced a sharper increase in financial market pressures, due to both external and domestic factors

External factors expose domestic vulnerabilities

Financial markets in Argentina and Turkey came under significant stress

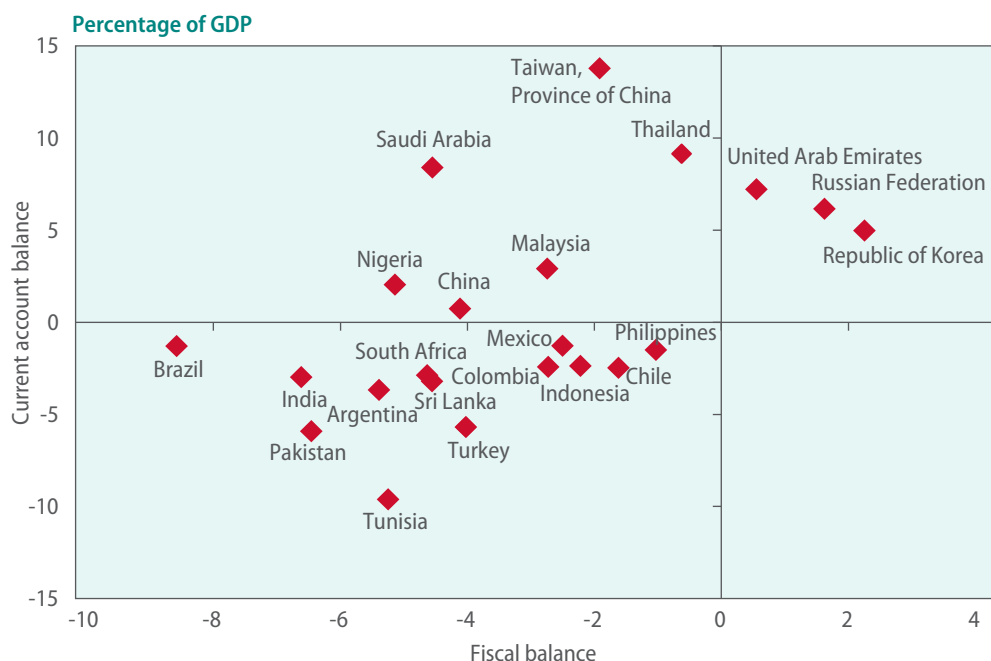
In contrast, the emerging economies experienced a sharp increase in financial market pressures, which intensified in the second half of 2018. The reduced demand for emerging market assets was driven by a confluence of both external and domestic factors. On the external front, the escalation in trade disputes, heightened oil price volatility, and rising interest rates in the United States, were the main factors driving the increase in risk aversion. This was reflected in a broad-based strengthening of the dollar—signalling increased demand for “safe” assets—and a decline in short-term capital flows into the emerging economies.

For several emerging economies, financial markets were subjected to stronger pressures as the impact of external headwinds was compounded by the presence of significant domestic vulnerabilities. As the global environment became more challenging, investors began to increasingly scrutinize the strength of fundamentals in each country. This resulted in a marked differentiation in the performance of financial market indicators between the emerging economies. Countries deemed vulnerable were those facing large macroeconomic imbalances, particularly high current account and fiscal deficits, high external debt, and elevated inflation, as well as those with limited policy buffers, such as foreign-exchange reserves (figure I.18). These countries were more susceptible to capital outflows, currency depreciations and increased spreads.

Notably, financial markets in Argentina and Turkey came under significant stress during the year. The peso and lira weakened by between 40–50 per cent between January and September 2018 (figure I.19), amid a spike in credit default swap and bond spreads. In both countries, the strengthening dollar triggered concerns over rising rollover and default risk, given high gross external financing needs and exposure to dollar-denominated debt. For Argentina, foreign currency debt exposure is mainly in the public sector, while in Turkey, it is mainly held by corporates.

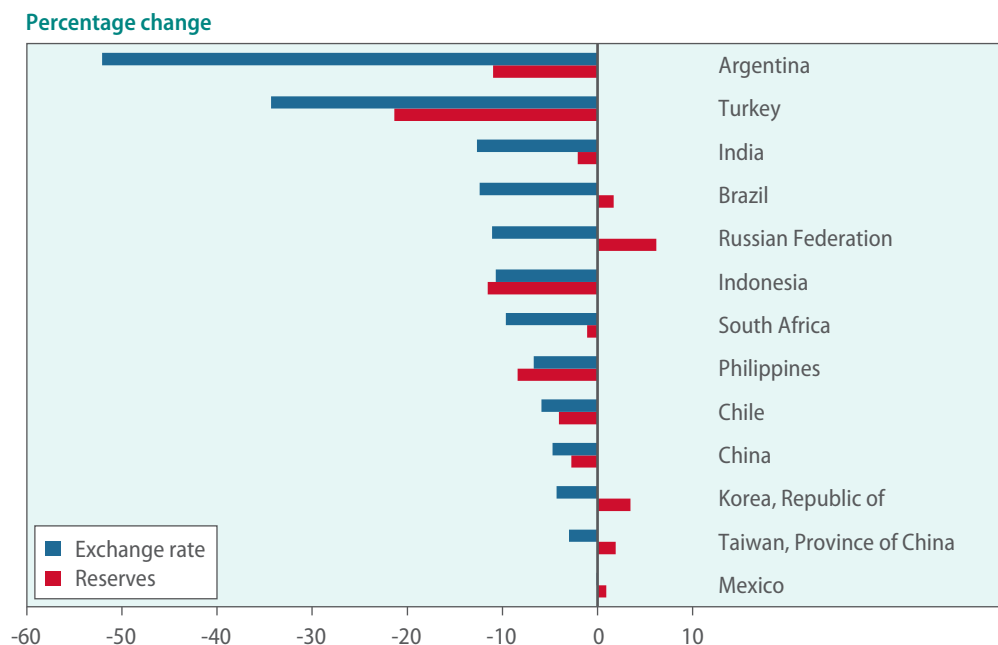
Figure I.18

Current account vs fiscal balance in selected emerging economies



Source: IMF World Economic Outlook October 2018 database.

Figure I.19
US dollar exchange rates and foreign reserves of selected emerging economies,
January–October 2018



Source: CEIC.

Note: Reserves data for Argentina, India, and Turkey are for end-September 2018.

The loss in investor confidence in Argentina and Turkey was also exacerbated by country-specific weaknesses. In Argentina, large fiscal and current account deficits, combined with the Government's inability to rein in inflation, led to growing pessimism over the economy's prospects. Emergency measures, such as raising the key policy rate to 60 per cent and agreeing on a large Stand-by Arrangement with the IMF, have temporarily calmed the markets. However, with the economy entering recession amid severe fiscal austerity measures, the outlook is highly uncertain. Meanwhile, in Turkey, strong growth over the past few years has been accompanied by large current account deficits and a rapid increase in private sector indebtedness, fuelling concerns of overheating in the economy. Furthermore, elevated policy uncertainty impacted by unilateral trade measures as well as rising geopolitical tensions also contributed to a deterioration in investor's sentiments.

Several large emerging economies, including Brazil, India, Indonesia, and the Russian Federation, also experienced considerable declines in equity markets and depreciation of domestic currencies. In Brazil and South Africa, the deterioration in investor perception reflected a weaker growth outlook and persistent macroeconomic imbalances, exacerbated by high political uncertainty, while in the Russian Federation, financial markets were affected by the imposition of new sanctions. The sharp reversal of foreign portfolio flows from these countries drove overall portfolio investment trends in their respective regions during the year.

In response to the increase in financial market turbulence, many central banks in the emerging and developing economies tightened monetary policy or reduced their degree of monetary accommodation in 2018. As risks to financial stability increased, central banks in several large economies, including Argentina, India, Indonesia and Mexico, raised interest

Financial market conditions also deteriorated in several large emerging economies, as investor sentiments weakened

An increase in financial market turbulence prompted several central banks to raise interest rates

rates to stem outflows and support domestic currencies. This in turn contributed to even tighter domestic financing conditions, weighing on the short-term growth outlook.

Notwithstanding the increase in global financial market volatility, the emerging economies on aggregate continued to receive sizeable capital inflows in 2018, supported by sustained foreign direct investment (FDI) flows. The Institute of International Finance estimated that total non-resident capital inflows into the emerging economies amounted to \$1.14 trillion in 2018, a moderate decline from \$1.26 trillion in 2017. Nevertheless, there was a marked divergence in the behaviour of flows, across the different types of capital and across the emerging regions.

Portfolio inflows slowed, reflecting a decline in investors' risk appetite

Non-resident portfolio flows into the emerging economies slowed in 2018, driven mainly by a decrease in risk appetite and lower uptake of emerging market bonds by foreign investors (figure I.20.A). In addition, international issuances of sovereign and corporate debt also fell during the year, with the decline more pronounced in the low-income and frontier market countries (IMF, 2018a).

Among the major emerging regions, both the Emerging Europe and Latin America regions experienced a massive decline in foreign portfolio investment flows (figure I.20.B). Total portfolio inflows also fell in Africa and Western Asia, but the magnitude was less severe, given relatively steady inflows in a few large economies, such as Egypt, Nigeria and Saudi Arabia.

In contrast, portfolio flows into the Asia Pacific region increased, as stronger flows into China and the Republic of Korea more than offset a decline in flows into other countries, particularly India, Indonesia, Malaysia and Thailand. Despite a noticeable weakening in the Chinese stock market and a depreciation of the domestic currency, China experienced a rapid increase in foreign portfolio inflows in 2018. This was largely attributed to the decision of Morgan Stanley Capital International (MSCI) to include Chinese stocks in its benchmark index as well as the Chinese Government's announcement of measures to further liberalize domestic bond markets (Institute of International Finance, 2018).

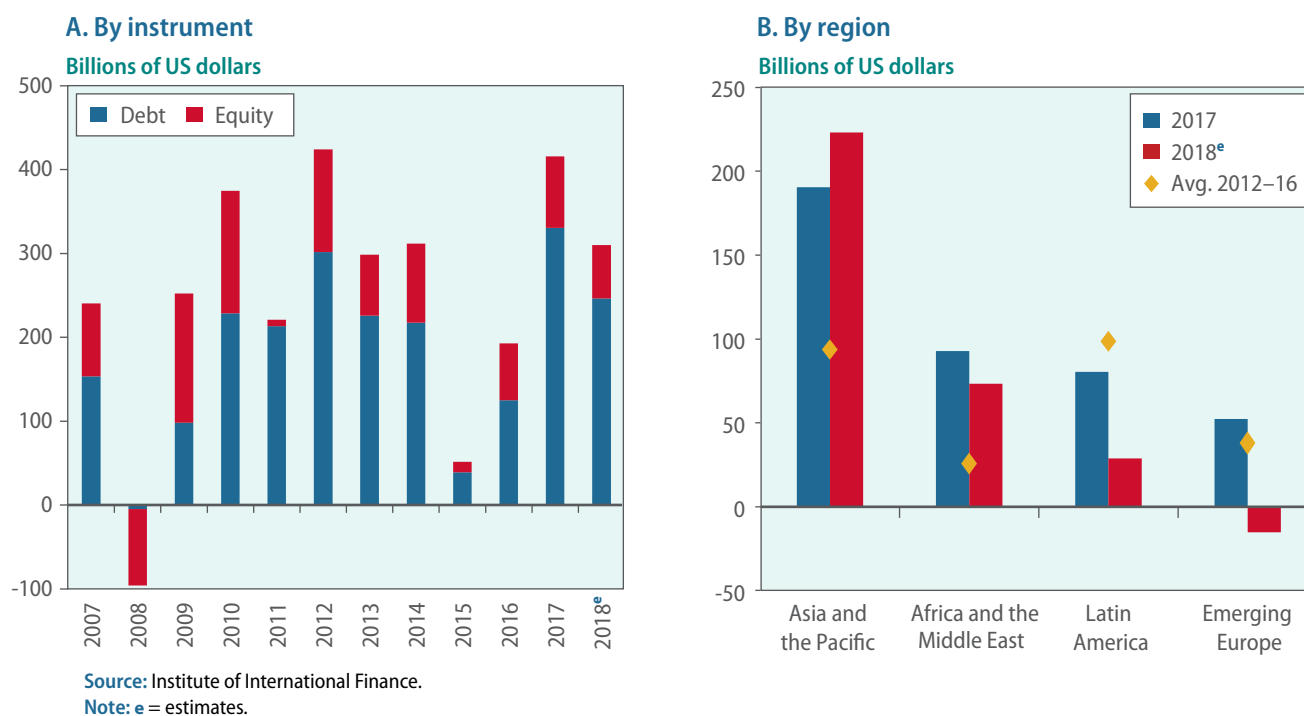
Growth in cross-border bank lending to the developing economies continued to lose momentum

Bank for International Settlements (BIS) data showed a slowdown in overall international banking activity in the second quarter of 2018, but with some variation in trends across regions. Compared to the same period last year, cross-border claims on the United States slowed considerably, but continued to grow at a rapid pace for Japan. At the same time, cross-border claims on the euro area continued to contract on an annual basis, weighed down mainly by a decline in credit to non-bank financial institutions (Bank for International Settlements, 2018).

For the emerging market and developing economies, growth in cross-border bank lending has been slowing since the end of 2017. In the second quarter of 2018, several large emerging countries, including Brazil, India, and Mexico, experienced a contraction in cross-border credit compared to the previous quarter (*ibid.*). While this may reduce risks associated with rising foreign currency debt, it may also constrain available finance for investment.

In recent years, banks have continued to strengthen their balance sheets, as reflected by higher capital and liquidity buffers. Nevertheless, several fragilities remain in the global banking system, which could weigh on international banking flows. Notably, banks in several countries have a large share of borrowers with stretched debt-service ratios, which could in turn lead to an increase in non-performing loans in the event of an income shock or steep rise in interest rates (IMF, 2018a). Meanwhile, tighter global liquidity conditions and the

Figure I.20
Non-resident portfolio inflows to the emerging economies



projected moderation in global trade are also factors that are likely to constrain growth in cross-border banking activity.

Despite higher external uncertainty, FDI flows have remained relatively stable across the developing regions. In its recent report, the United Nations Conference on Trade and Development (UNCTAD) estimated that total FDI inflows to the developing economies stood at \$310 billion in the first half of 2018, a modest 4 per cent lower than the first half of 2017. Developing Asia remained the largest host region, with China emerging as the largest global recipient of FDI during this period (UNCTAD, 2018b). For the developing Asia economies, FDI prospects are supported by relatively robust and stable growth prospects. Furthermore, several countries in the region, including Cambodia, China, and Viet Nam, have recently outlined a range of policy initiatives to attract more foreign investment and to improve the business environment.

In the Latin America region, FDI inflows to the commodity exporters, including Chile, Colombia and Peru, were buoyed by the moderate recovery in global oil and metal prices. In Brazil, however, high political uncertainty weighed on investor confidence. From a medium-term perspective, FDI into the region is gradually shifting away from natural resources, and increasingly into the manufacturing and services industries, particularly renewable energy and telecommunications (ECLAC, 2018a).

In Africa, the partial recovery in global commodity prices has yet to translate into a recovery in FDI flows in the large commodity-dependent economies, including Algeria, Angola and Nigeria. For the region as a whole, weakness in FDI inflows seen in 2017 extended into the first half of 2018. Looking ahead, the implementation of the African Continental Free Trade Area agreement may increase attractiveness of the region for FDI in

FDI flows remain relatively stable across the developing regions

the outlook period (UNCTAD, 2018c). The high concentration of Africa's FDI in natural resources, however, is a cause for concern, particularly given limited productivity gains and positive spillovers to the broader economy.

The FDI outlook for the developing economies is clouded by several risks. In the first half of 2018, FDI flows into Europe declined drastically, as tax reforms drove US multinational firms in the region to repatriate their foreign earnings (ibid.). Although shifting production location is costly, there is a high risk that United States companies located in developing regions will follow suit. Potentially stricter policy restrictions may weigh on outbound investment by Chinese firms, with implications for FDI growth of several developing countries, notably in Africa and Latin America. In 2017, China's outbound direct investment contracted for the first time in more than a decade, partly as a result of tighter capital outflows restrictions. Meanwhile, persistent uncertainty over trade policies and the impact of tariff measures may prompt investors to delay new investment projects. For several countries, high political uncertainty and geopolitical risks continue to pose significant headwinds to FDI prospects.

International financial markets are likely to remain highly volatile, given elevated policy uncertainty

Looking ahead, elevated policy uncertainty is likely to continue driving high volatility in the international financial markets in 2019. Any unexpected policy decisions by the major economies may trigger a major shock to confidence, potentially resulting in a sharp tightening of global financial conditions. This constitutes a significant risk for the emerging economies with high indebtedness as well as limited policy space (see discussion on risks of an abrupt tightening of global financial conditions below).

Official development assistance declined in 2017

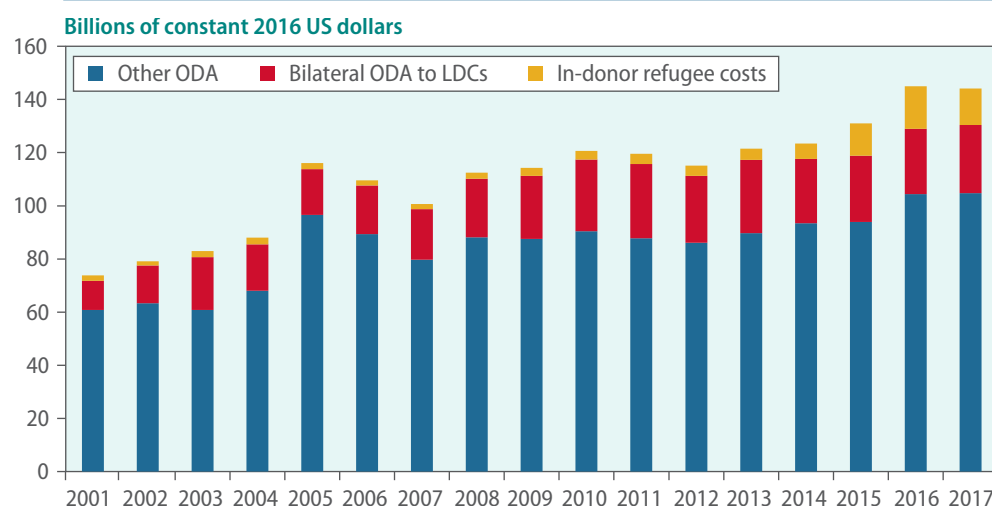
ODA flows declined marginally in 2017, but assistance to LDCs rose

Net official development assistance (ODA) flows from members of the OECD Development Assistance Committee (DAC) amounted to \$146.6 billion in 2017, representing a marginal decline of 0.6 per cent in real terms compared to 2016 (figure I.21). These flows constituted 0.31 per cent of DAC combined gross national income, which remains well below the United Nations target of 0.7 per cent. The decline in aggregate ODA flows in 2017 was mainly due to lower spending on in-donor refugee costs. Excluding these expenditures, ODA grew at a modest pace of 1.1 per cent in real terms compared to the previous year.

In 2017, bilateral aid to the LDCs increased by 4 per cent in real terms, in part reversing the weakness in flows to these countries that has been observed in the past few years. ODA flows account for more than two thirds of external finance for the LDCs, and donor countries are pushing for ODA to be better utilized towards generating private investment and domestic tax revenue (OECD, 2018). Bilateral aid flows to sub-Saharan Africa also saw a turnaround in 2017, expanding by 3 per cent, in contrast to a cumulative contraction of 13 per cent seen between 2011 and 2016. In addition, the total volume of development finance globally is increasingly being supported by providers of aid beyond the DAC members, including countries such as Turkey, the United Arab Emirates, and South-South cooperation providers (ibid.).

Nevertheless, several recent developments could be a cause for concern. While most ODA remains in the form of grants, the volume of loans to developing countries has been on the rise, growing by 13 per cent in real terms in 2017 (ibid.). While this expands available finance, it also increases the risk of currency mismatches for loans in foreign currency (United Nations, 2018a). Meanwhile, although urgently needed, the increase in the share of ODA

Figure I.21

Net official development assistance, by main expenditure component

Source: OECD (2018),
DAC statistics.

flows channelled towards humanitarian aid may have an impact on the resources available for long-term development projects, including to address critical infrastructure gaps.

Risks to the outlook

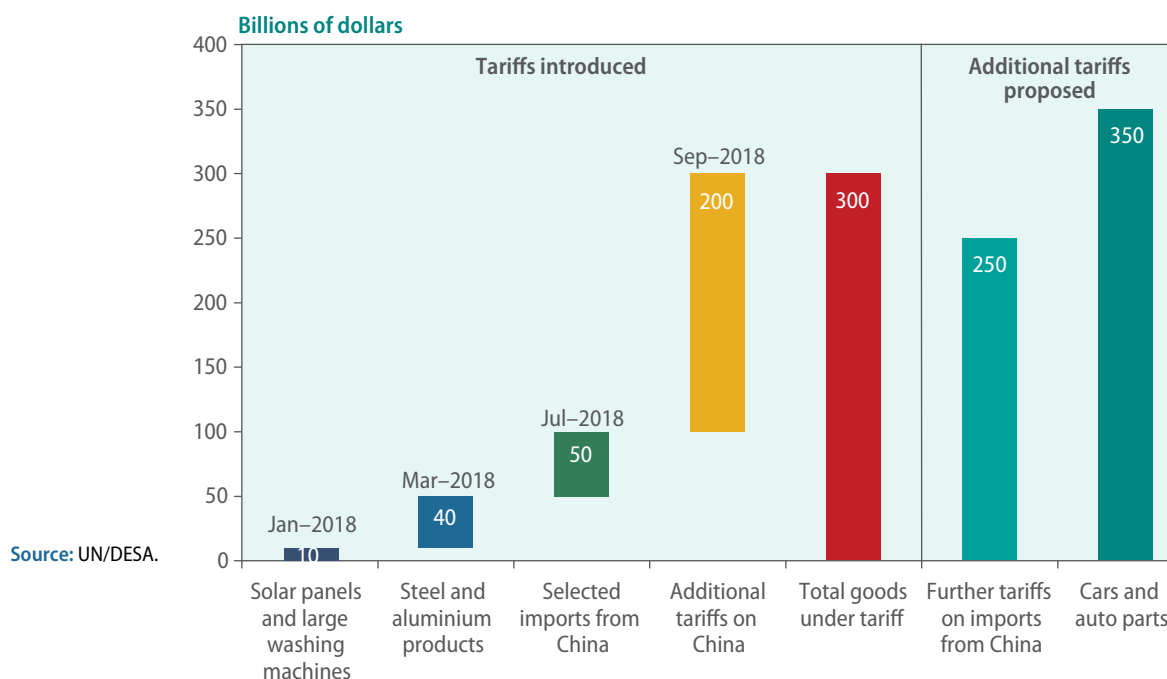
The steady pace of global economic growth masks the build-up of several short-term risks with the potential to severely disrupt economic activity and inflict significant damage on longer-term development prospects. Countries with significant vulnerabilities, such as large macroeconomic imbalances, limited policy buffers and high levels of external debt, are particularly susceptible to such disruptions. A prolonged escalation of trade tensions and an abrupt tightening of global financial conditions pose the main economic risks and are discussed further below. Geopolitical tensions in several regions also present potential threats to the global economic outlook. Meanwhile, climate risks to economic prospects are also intensifying. Over the past decades, the world has observed an increasing number of extreme weather events, of which more than half in the last six years have been attributed to climate change. The human cost of disasters falls overwhelmingly on low- and lower-middle-income countries, putting large communities at risk of displacement and causing severe damage to vital infrastructure. Many SIDS in the Caribbean, Indian and Pacific Oceans are particularly exposed to climate risks.

Escalating trade policy disputes

A prolonged escalation of trade disputes among the world largest economies poses a significant risk to the global trade outlook, with potentially large consequences for the short- and medium-term prospects for the world economy. While this section discusses the trade risks for the global economy in the short term, the uncertainties that this trend imposes on the evolution of the international trading system are discussed in chapter II.

Rising trade disputes pose a significant risk to economic prospects

Figure I.22
United States: tariffs introduced and proposed, 2018



Rising tariffs have been met by retaliations and counter-retaliations

New tariffs were imposed on solar panels and large washing machines in January 2018, as safeguard measures, affecting imports worth \$10 billion. In March of 2018, the United States introduced a global tariff of 25 per cent and 10 per cent, respectively, on steel and aluminium products, covering an estimated \$40 billion imports (figure I.22). The tariff measures were matched with retaliatory tariff increases on United States exports by several countries—including by Canada and China as well as the EU, who have all raised disputes at the WTO to contest the compatibility of the unilateral measures with WTO rules. By mid-2018, the United States introduced new additional tariffs of 25 per cent on more than 1300 products imported from China, worth \$50 billion, to counter what the United States considers “unfair” policies and practices in China regarding technology transfer, intellectual property and innovation. Tariff measures are being complemented with tightening restrictions on foreign investment and visa regimes. China brought the case to the WTO Dispute Settlement Mechanism and reciprocated by introducing equivalent levels of tariffs on some 100 products covering \$45 billion worth of imports from the United States, including soybeans, its major bilateral import item.

While some bilateral trade disputes were negotiated throughout 2018...

Some of the bilateral trade disputes among large economies were negotiated throughout 2018. For example, in July the United States and the EU agreed to negotiate a reduction in tariffs and other trade barriers, defusing for the moment the risk that the introduction of steel and aluminium tariffs could potentially escalate to automobiles. Nonetheless, the United States is continuing to examine the possibility of a global tariff on cars and automotive parts of 25 per cent, justifying such a move on national security grounds under Section 232 of the Trade Expansion Act of 1962. If introduced, the tariffs could affect an estimated \$350 billion of automotive imports (cars, truck and parts) from major trading partners.

In October 2018, the new United States-Mexico-Canada Agreement (USMCA) was announced, which will replace the North American Free Trade Agreement (NAFTA). The automotive sector was a focus of NAFTA renegotiations, as well as renegotiations of the South Korea-United States Free Trade Agreement (KORUS-FTA). USMCA raises the local value added requirement of automobiles for tariff-free access from 62.5 per cent to 75.0 per cent and requires that a certain proportion of the final assembly be done by workers earning a wage of at least \$16 per hour. Under KORUS-FTA, the Republic of Korea has accepted a quota on its auto exports to the United States. These measures have been introduced in an effort to support the automobile sector in the United States.

By contrast, the dispute between China and the United States continued to gain momentum throughout 2018. In September, the United States imposed a new tariff of 10 per cent on an additional \$200 billion worth of Chinese imports as a counter-retaliation against tariffs imposed by China. Together with the initial tariffs, the new tariffs are set to cover about half of the United States bilateral imports from China, which totalled about \$500 billion in 2017. To counter the counter-retaliation, China imposed tariffs on an additional \$60 billion worth of US products. While threats of a further increase in tariffs on US imports from China loom in 2019, an agreement reached between China and the United States at the Group of Twenty meeting in Buenos Aires in early December has temporarily de-escalated tensions. According to the official declaration from the United States, the deal postponed a further increase of import tariffs and specified a 90-day window to negotiate a more comprehensive agreement over technology transfer, intellectual property rights, non-tariff barriers and cyber theft, among others.

There remain significant risks that the global trade tensions may persist for an extended period. The impact of a spiral of additional tariffs and retaliations could be significant, causing a slowdown in investment, higher consumer prices and a decline in business confidence. While the magnitudes of such impacts are difficult to project and depend on the extent and depth of the trade disputes (Bollen and Rojas-Romagosa, 2018), higher trade barriers can be expected to have negative consequences for domestic and global growth, with limited impacts on addressing external imbalances.

In addition, this would imply much wider disruption to GVCs, particularly exporters in East Asian economies that heavily rely on Chinese exports to the United States. Economies that seem to be more exposed to the trade dispute between China and the United States include Hong Kong SAR, Malaysia, Republic of Korea, Singapore and Taiwan Province of China, and especially in sectors such as electrical and optical equipment and transport equipment (Saxena, 2018). In addition, slower growth in China and the United States could also reduce the demand for commodities, affecting commodity exporters from Africa and Latin America.

Importantly, there is a risk that the trade disputes could become intertwined with the financial fragilities and elevated levels of debt in the corporate sector, especially in some emerging economies. For example, exporters facing rising trade costs can be further affected by tighter financial conditions and higher debt-servicing costs. As a result, the deterioration in the earning and profit outlooks could cause significant corporate distress in certain industries, such as automobiles, machinery and electronics.

This channel could be especially relevant if economic and financial distress affects large global firms, which dominate many industries and participate in the world economy along multiple margins with interconnected trade, investments and innovation decisions across countries. Recent research emphasizes the role of these firms in spreading trade

...the trade disputes between China and the United States gained further momentum

A full-blown trade war between China and the United States would have severe economic effects...

... with significant disruptions to GVCs

Higher trade costs, coupled with elevated levels of debt, could become a significant risk in the corporate sector

shocks and other shocks across countries, as a rise in individual tariffs can lead to a broad reorganization of the complete global value chain (Bernard et al., 2018). In addition, higher trade costs due to higher tariffs can also generate changes in firm productivity, magnifying the potential impacts on trade flows as firms respond by adjusting export and import products and markets.

From a medium-term perspective, subdued trade will act as a drag on productivity growth

A protracted period of subdued trade growth also imposes a constraint on productivity growth in the medium term, and hence longer-term growth prospects. Trade supports productivity growth via economies of scale, access to inputs, and the acquisition of knowledge of new production techniques and product designs from international contacts. These channels are strongly intertwined with investment decisions, as firms take decisions regarding entering or expanding operations in foreign markets, together with investment, technology adoption, product mix and innovation decisions. Thus, revitalizing trade growth and promoting developing countries participation in GVCs, especially from regions that so far have limited participation such as South Asia and Africa, could become a powerful engine to encourage productivity gains, economic growth and sustainable development.

Abrupt tightening of global financial conditions

Overstretched asset valuations remain a concern in global financial markets

Despite some recent corrections, overstretched asset valuations and high-risk behaviour remain concerns in global financial markets. The protracted period of abundant global liquidity and low interest rates fuelled an increase in investor risk appetite and an intensified search for yield, resulting in the build-up of financial imbalances across both the developed and developing economies.

Notably, the global stock of high yield bonds and leveraged loans has doubled in size since the global financial crisis (Goel, 2018), driven by low borrowing costs, high risk appetite, and looser lending standards. Instead of being channelled towards productive investment, a large share of the capital raised through leveraged financing has been used to fund share buy-backs and mergers and acquisitions. This has contributed to elevated valuations across several financial asset classes, most evidently in the United States. Despite high economic policy uncertainty, cyclically adjusted price-earnings ratios of listed companies in the United States remain well above long-term averages (figure I.23). In addition, corporate bond spreads, particularly those of high-yield bonds, appear very low after accounting for expected default rates (IMF, 2018a), suggesting a certain degree of underpricing of risk.

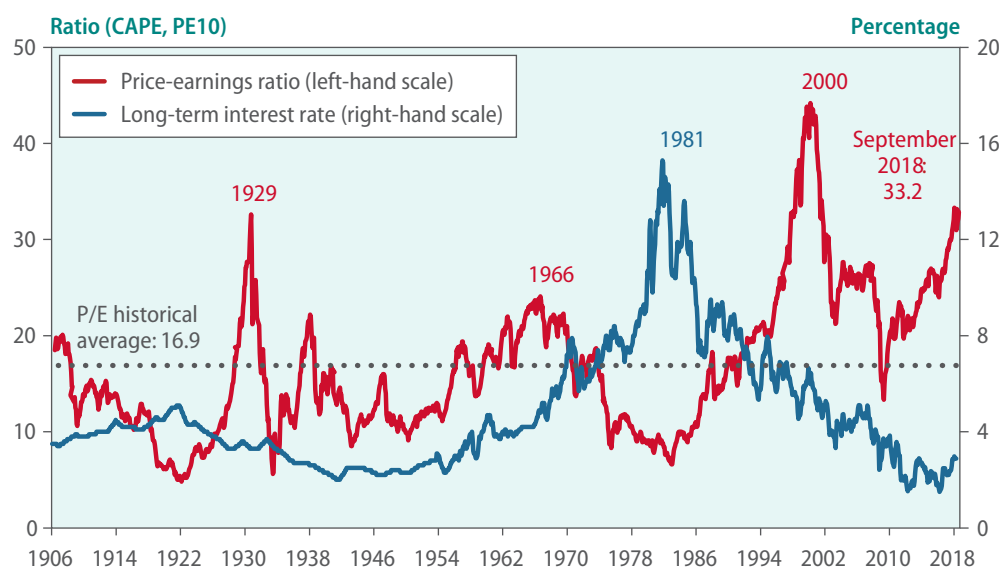
In the current highly uncertain environment, particularly with shifting global financial conditions and rising trade tensions between China and the United States, investor behaviour remains highly sensitive to major data releases and policy announcements. Any unexpected developments could induce a sudden reversal of the risk-taking cycle, triggering sharp market corrections and a disorderly deleveraging process.

The Fed's monetary policy normalization process could trigger a sharp tightening of global liquidity conditions

High uncertainty surrounding the monetary policy adjustment process in the developed economies, particularly the United States, is a potential trigger of a sharp tightening of global liquidity conditions. While inflation so far remains contained, there is a risk that the highly procyclical fiscal expansion and increase in import tariffs could spark a strong rise in inflationary pressures, prompting the Fed to raise interest rates at a pace much faster than expected. The rise in interest rates would reduce equity valuations and impact other financial assets, which could reverberate through the global financial system. This is likely to generate adverse spillover effects on the rest of the world, particularly the emerging economies.

Figure I.23

Price-earnings ratio of S&P 500 index vs long-term interest rates



Source: Online data Robert Shiller, available from www.econ.yale.edu/~shiller/data.htm.

Note: CAPE, PE10 refers to the cyclically adjusted price-earnings ratio applied to the S&P 500 Index. It uses 10 years of real earnings to smooth income fluctuations arising from business cycles. Long-term interest rates refer to 10-year US Treasury rates.

There are several transmission channels through which monetary policy changes made by the Fed can significantly affect the emerging economies. First, a US monetary policy shock can generate large global spillovers through changes in cross-border bank lending to the private sector (Buch et al., 2018). Second, higher interest rates in the United States affect emerging bond markets through an increase in term premiums, and this transmission channel appears to have become more prominent in the post-crisis period (Albagli et al., 2018). Furthermore, as rising US interest rates exert upward pressure on the dollar, countries with a high exposure to dollar-denominated debt face greater refinancing and currency mismatch risks. Koepke (2016) found that the emerging economies face a substantially higher probability of a banking, currency or sovereign debt crisis when the Fed is tightening monetary policy.

The possible failure of policymakers to finalize post-Brexit legal and regulatory arrangements in a timely manner poses additional risks to financial stability, given the massive cross-border financial linkages between the United Kingdom of Great Britain and Northern Ireland and the EU. For instance, the Bank of England recently reported that firms based in the EU hold derivatives contracts with a notional value of £69 trillion at United Kingdom clearing houses, of which £41 trillion are due to mature after March 2019. In the absence of new legal and operational guidelines, EU corporates and banks could lose market access to cleared derivatives, potentially disrupting cross-border financial services. This could constitute a major shock to financial systems in the EU, with contagion effects on other regions, given the prominence of European banks in driving global cross-border financial flows. Shim and Shin (2018) showed that financial stress in developed-country banks is a key driver of capital outflows from the emerging economies, regardless of the strength of the economy's macroeconomic fundamentals.

A further risk stems from the state of fiscal accounts in the EU. Italy, which already has an elevated level of public debt, has openly stated its intention for increased fiscal spending. This creates the potential for an open clash between the limits and guidelines on

Brexit poses considerable risks to financial stability

Domestic financial turmoil in several countries could lead to more widespread contagion to other emerging economies

High indebtedness is a cause for concern in the current environment of rising interest rates

fiscal policy set by the EU and national fiscal policy stances. As a consequence, the EU may face a renewed need to refine and strengthen its fiscal policy framework.

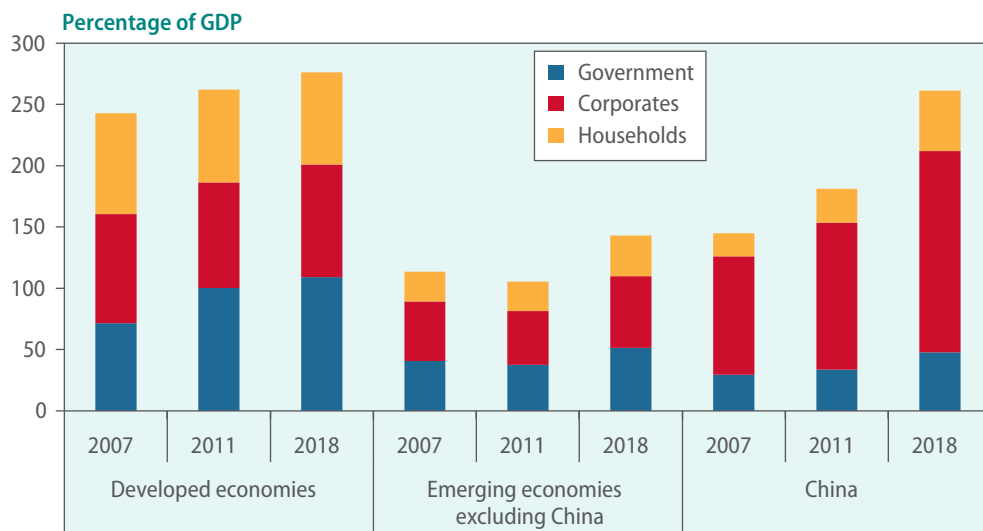
While the turmoil in Argentina and Turkey is mostly due to idiosyncratic issues, concerns over contagion effects to other economies persist. During the year, the sharp depreciation in the Turkish lira had a knock-on effect on European financial markets, contributing to higher currency and equity volatility. Based on BIS data, Spanish banks have the largest exposure to Turkish borrowers, amounting to over 6 per cent of GDP. Banking sector exposure of other European countries is relatively limited, thus exemplifying the importance of investor confidence, regardless of fundamentals, in influencing financial market movements. Importantly, while financial market pressures were most severe in Argentina and Turkey, several large emerging economies, including Brazil, Indonesia, and South Africa, also experienced considerable financial market turbulence during the year. For these economies, the deterioration in growth prospects, large macroeconomic imbalances and high external financing needs contributed to the sharp deterioration in investor risk appetite. With rising interest rates and a strengthening dollar, an abrupt tightening of global financial conditions could exacerbate domestic fragilities and financial difficulties in some countries, potentially leading to higher risk of sovereign and corporate distress. Furthermore, the risk of a “sudden stop” in capital flows has increased, particularly for emerging economies with weak macroeconomic fundamentals, large external imbalances and low policy buffers.

High indebtedness has become a prominent feature of the global economy. Across many developed and developing economies, public and private debt levels have risen to historical highs in the post-crisis period (figure I.24). In the current environment of rising interest rates, high leverage in an economy is a cause for concern, as increasing debt service costs pose a risk to debt sustainability and financial stability.

In the emerging economies, BIS figures show that non-financial corporate debt continued to rise in the first quarter of 2018, amounting to 107.7 per cent of GDP. While the recent increase in corporate debt has been the most evident in China, other large emerging economies, including Brazil, Chile and Turkey, have also experienced a visible rise in cor-

Figure I.24

Breakdown of non-financial sector debt of developed and emerging economies



Source: Bank for International Settlements, Total Credit Statistics.

Note: 2018 refers to outstanding debt data as of 1Q 2018.

porate debt levels. In many of these countries, the prolonged period of excess of liquidity contributed to the “financialization” of the corporate sector to exploit carry trade opportunities, with a large part of corporate debt channelled neither to productive investments nor to high-productivity sectors.

In addition, the escalation in trade disputes adds to risks to corporate balance sheets, particularly those of export-oriented firms. The increase in tariffs are likely to result in a rise in input costs and lower product demand, eroding profits and potentially inducing a higher rate of corporate defaults or bankruptcies.

The fragility of corporate and government balance sheets in several emerging economies has also been exacerbated by the rise in dollar-denominated debt, particularly in the post-crisis period (figure I.25). The Fed’s continued tightening of monetary policy and elevated global risk aversion are factors that are likely to support a further strengthening of the dollar. In this aspect, countries with a substantial amount of dollar-denominated debt are particularly vulnerable to rising interest rates and an appreciation of the dollar, given their high exposure to refinancing and currency mismatch risks.

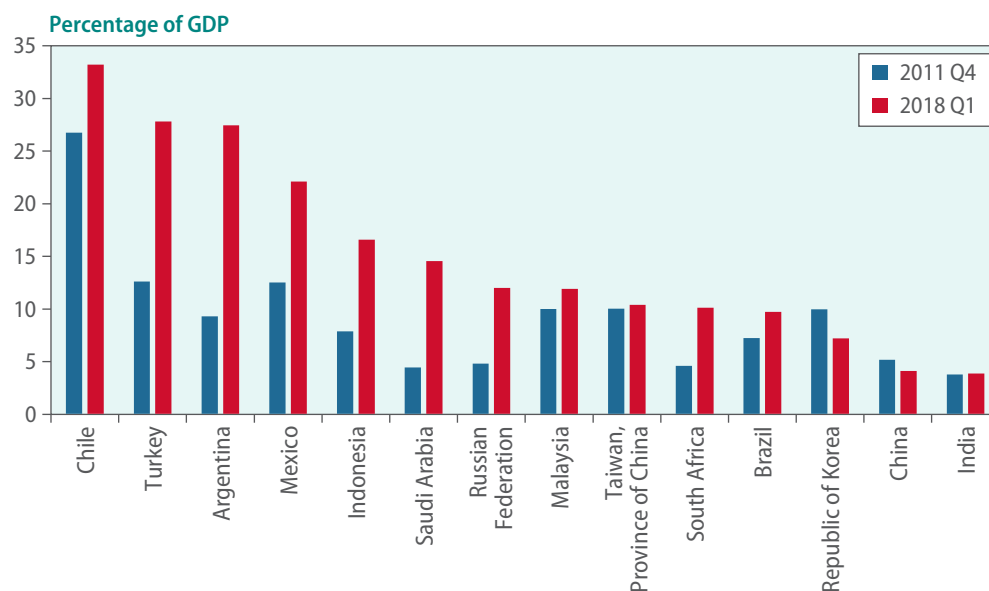
In many developing countries, rising public debt and government interest burdens represent a growing source of risk to financial stability. In 2018, rising fiscal sustainability concerns prompted several governments—including Argentina, Barbados, Pakistan, and Sri Lanka—to seek financial assistance from the IMF. For the commodity-dependent countries, particularly in Africa, Latin America and Western Asia, public finances have deteriorated rapidly over the past few years, due mainly to the collapse in commodity-related revenue. Consequently, many Governments in these regions have made cuts in social spending and SDG-related investment or resorted to ramping up borrowing in order to finance significant budget shortfalls.

Moreover, the extended period of low global interest rates has enabled Governments to increase debt levels with only a limited impact on debt-servicing costs. Several countries have even seen a decline in government interest burdens over the past decade despite ris-

Countries with large external and foreign currency debt are more vulnerable to rising interest rates and a stronger dollar

Rising public debt and government interest burdens are a growing source of risk to financial stability for many developing countries

Figure I.25
Dollar-denominated credit to non-bank borrowers in selected emerging economies



Sources: Bank for International Settlements, Total Credit Statistics.

Note: 2018 refers to outstanding debt data as of 1Q 2018.

ing debt levels, as maturing debt was reissued at a lower rate of interest. As the period of extremely loose global financial conditions draws to a close, debt-servicing costs are also likely to rise, potentially posing a threat to fiscal sustainability. The speed at which higher interest rates will feed into debt-servicing costs depends on the term structure of existing debt and related refinancing needs.

In several countries, high debt-service obligations already constitute a heavy burden on government finances. In 2017, interest payments alone exceeded 20 per cent of government revenue in several countries in Africa, Latin America and South Asia (figure I.26). A number of LDCs and heavily indebted poor countries are identified as being particularly vulnerable to financial shocks. The IMF recently warned that many low-income countries have experienced a substantial rise in both fiscal and interest burdens in recent years, placing them at high risk of debt distress (IMF, 2018b).

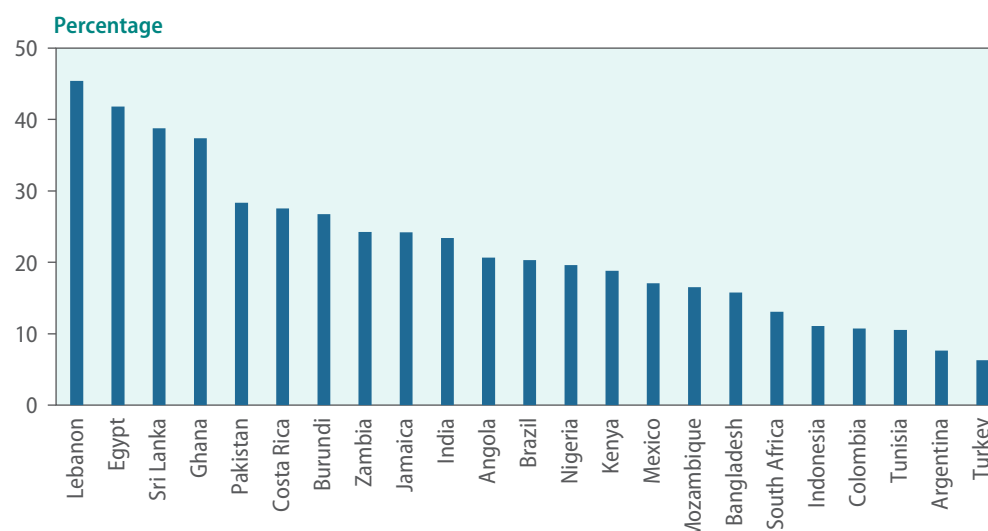
Policymakers are faced with the challenge of containing financial risks while supporting short-term growth

Policymakers in the developing economies are faced with the challenge of containing the build-up of financial risks while supporting short-term growth prospects. Deleveraging policies that are too aggressive could cause major disruptions to economic activity, while a focus on promoting growth, including through maintaining easy financial conditions, would induce further debt accumulation. A stronger policy focus on improving the composition and quality of investment is also important, given that raising investment in productivity-enhancing activities is key to improving the sustainability of growth prospects over the medium term.

Given the changing global financial environment, there is a need for many countries to enhance the resilience of the domestic financial system to external shocks, and to reduce the probability of the occurrence of a financial crisis. Crisis probabilities are influenced by many variables, including the availability of policy buffers and the strength of financial institutions. Barrell et al. (2018) shows that capital and liquidity buffers not only lower the probability of a crisis, but also limit the costs if a crisis occurs.

Figure I.26

Government interest payments as a share of general government revenue, 2018



Source: UN/DESA, based on estimates from the IMF's World Economic Outlook October 2018 database.

Sound and prudent macroeconomic policies are needed to ensure sustained, inclusive and sustainable growth trajectories and to contain financial risks and vulnerabilities. Many policymakers are increasingly taking a proactive role in managing risks associated with debt and capital flows, through a wide range of policy tools. This includes monetary, fiscal, exchange rate, macroprudential policies and capital flow management measures. There is a need to ensure policy consistency when utilizing the various instruments, as well as to clearly communicate policy strategies, in order to sustain confidence. In addition, policymakers should also be cognizant of the significant trade-offs that could exist. For example, Ayyagari, et al. (2017) found that small firms were disproportionately affected by macroprudential policies given that they have limited access to non-bank financing, thus illustrating the trade-off between the objectives of preserving financial stability and promoting greater financial deepening.

Appendix

Baseline forecast assumptions

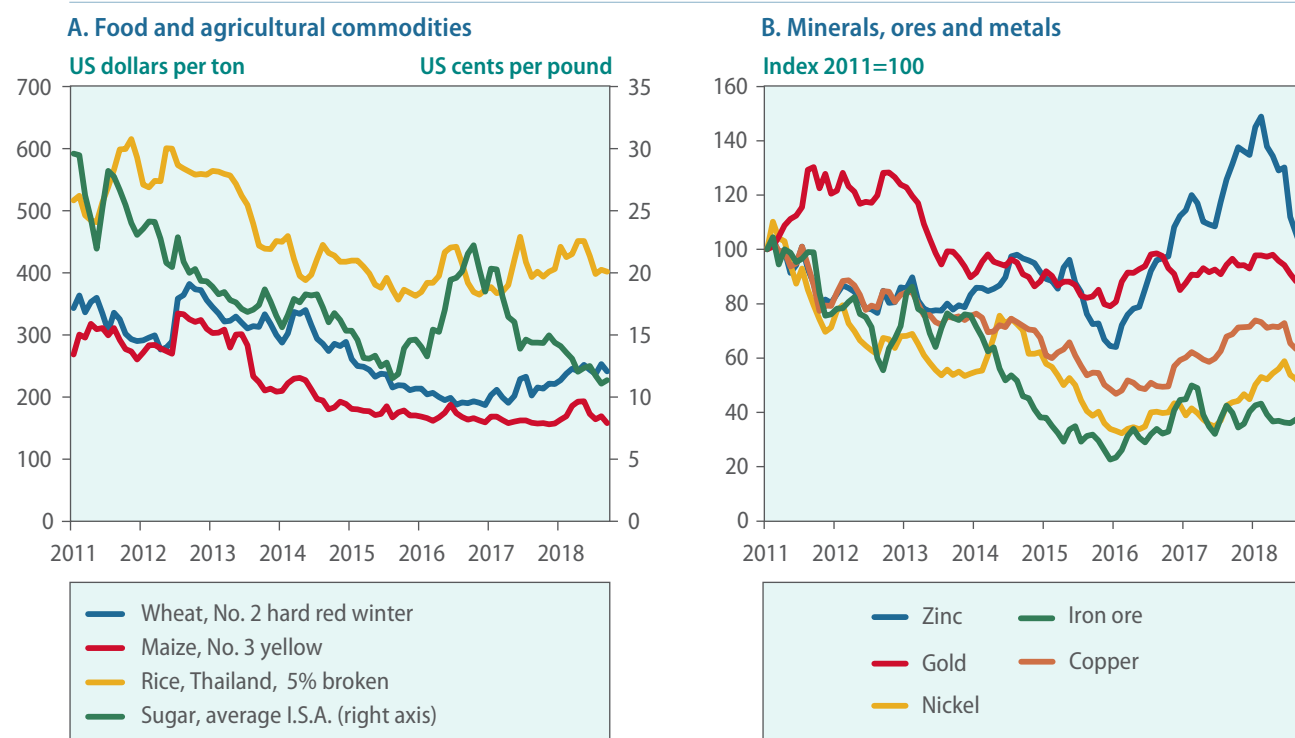
This appendix summarizes the key assumptions underlying the baseline forecast, including recent and expected developments in major commodity prices, the monetary and fiscal policy stance for major economies, and exchange rates for major currencies.

Commodity prices

Recent developments and the short-term outlook for key commodities are reported in table I.A.1. With the exception of crude oil, commodity prices generally weakened in the first three quarters of 2018. In particular, a strong US dollar and rising global trade tensions have weighed on demand for base metals and other commodities. Some individual commodities have seen price increases driven by fundamentals. For example, wheat prices rose in 2018, mainly driven by unfavourable weather conditions in the Russian Federation and some other producer countries. The price of cocoa beans has also risen, after falling to the lowest level in a decade in December 2017. Further upward cocoa price pressures remain weak, as a healthy crop in the primary producer, Cote d'Ivoire, is expected. Overall, commodity prices remain significantly below their 2011 peak levels (figure I.A.1).

Figure I.A.1

Selected commodity prices, January 2011–September 2018



Source: UNCTADstat.

Source: World Bank Pink Sheet.

In the outlook, high inventories and supply prospects are likely to keep prices in check for commodities such as sugar, coffee, cocoa beans, and copper. Strong demand and lower supply levels are expected to exert upward pressure on wheat, maize and cotton prices. Rubber supply is likely to be restricted by unfavourable weather conditions in India, Malaysia, Sri Lanka and Viet Nam. The metals markets remain sensitive to global trade tensions and demand. In particular, the price of iron ore may decline if a slowdown of Chinese steel demand materializes. The ongoing expansion of the electric vehicle market (see box I.3) may add upward pressure to nickel prices in the medium to long term, although supply increases from Indonesia, which has eased its export ban on nickel, will exert an attenuating effect on prices. The price of Brent crude is assumed to average \$71.9 per barrel in 2019 and \$74.6 in 2020, but is expected to exhibit significant volatility.

Table I.A.1

Key commodity prices

| | Unit | 2016 | 2017 | Sep 2018 | Jan–Sep 2018 (% change) | Outlook | Key influencing factors |
|---|------------|--------|--------|----------|----------------------------|---------|---|
| Sugar, average I.S.A. daily prices | ¢/lb | 18.06 | 16.02 | 11.37 | -19.3 | ⇒ | High inventories and supply surplus |
| Rice, Thailand, white milled, 5% broken | \$/mt | 386.17 | 398.92 | 402.00 | -9.0 | ↑ | Stock level decline |
| Wheat, Hard Red Winter No. 2 | \$/mt | 196.42 | 211.84 | 241.01 | 6.0 | ↑ | Strong demand and lower supply |
| Maize, Yellow Maize No. 3 | \$/mt | 168.21 | 160.81 | 157.8 | -3.4 | ↑ | Strong demand and lower supply |
| Coffee, International Coffee Organization composite indicator | ¢/lb | 127 | 127 | 98 | -15.1 | ⇒ | Supply surplus |
| Tea, Mombasa/Nairobi auctions, African origin | ¢/kg | 242 | 245 | 241 | -18.3 | ⇒ | Subject to weather risks |
| Cocoa beans, average daily prices, New York/London | ¢/lb | 131.2 | 92.0 | 99.6 | 12.4 | ⇒ | Supply surplus |
| Rubber, RSS 3, Singapore | ¢/kg | 160.5 | 199.5 | 144.2 | -16.3 | ↑ | Low production due to weather |
| Cotton, Cotlook Index A | \$/kg | 1.64 | 1.84 | 1.99 | -0.8 | ↑ | Strong demand |
| Nickel, London Metal Exchange | \$/mt | 9595 | 10410 | 12510 | -2.8 | ↑ | Strong demand may be offset by increased supply |
| Iron ore, China import, fines 62% Fe, spot, CFR Tianjin port | \$/dry ton | 58.48 | 71.76 | 68.44 | -10.3 | ↓ | Demand slowdown |
| Copper, London Metal Exchange | \$/mt | 4867.9 | 6169.9 | 6050.8 | -14.4 | ⇒ | Strong supply |
| Zinc, London Metal Exchange | \$/mt | 2090.0 | 2890.9 | 2434.7 | -29.3 | ↓ | Supply growth |
| Gold | \$/troy oz | 1249.0 | 1257.6 | 1198.4 | -10.0 | ⇒ | Strong dollar |
| Crude oil, UK Brent | \$/bbl | 44.05 | 54.39 | 78.86 | 14.3 | ↗ | Volatility likely |
| Natural gas, United States | \$/mmbtu | 2.49 | 2.96 | 2.99 | -22.9 | ⇒ | Stable as market rebalance |
| Coal, Australian | \$/mt | 66.12 | 88.52 | 114.16 | 7.2 | ↑ | Declining supply |

Sources: UNCTADstat, International Coffee Organization, World Bank Pink Sheet, UNCTAD and UN/DESA assessments.

Figure I.A.2
Price of Brent crude: recent trends and assumptions

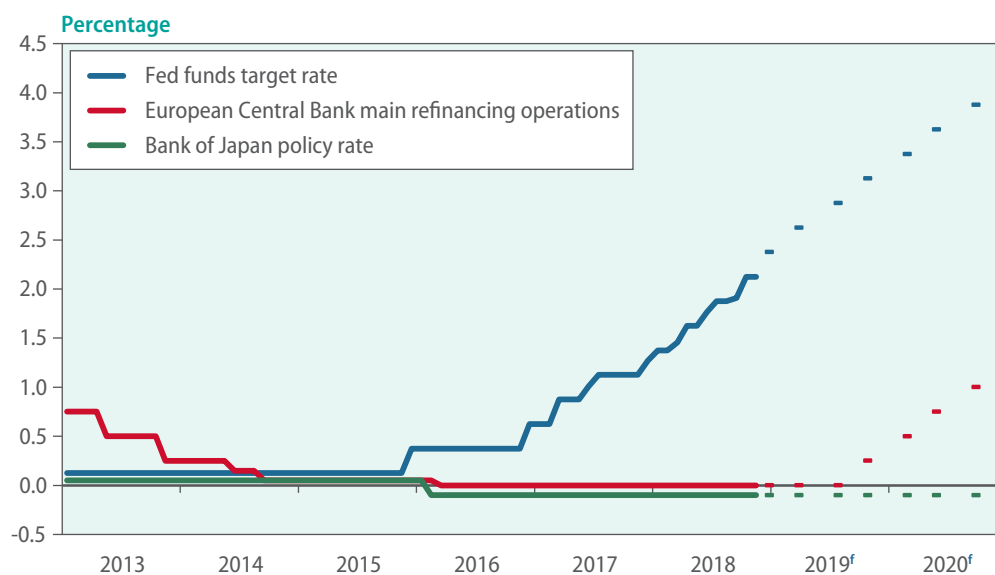


Sources: Energy Information Administration and UN/DESA forecast assumptions.

Monetary policy

In the developed economies, the monetary policy normalization process is expected to continue at a measured pace, as inflation rises closer to central bank targets. Interest rates will continue to diverge between the United States of America, Japan, and the euro area (figure I.A.3), reflecting differences in the timing and pace of withdrawal.

Figure I.A.3
Key central bank policy rates: recent trends and assumptions



Sources: National central banks and UN/DESA forecast assumptions.

Note: f = forecast.

North America: The United States Federal Reserve (Fed) is embarking on a slightly faster pace of monetary adjustment than earlier expected. The Fed raised the target range for the federal funds rate by 25 basis points four times over the course of 2018 and three rate hikes are expected in 2019. Balance sheet adjustment is expected to continue at a measured pace over the course of the forecast horizon (figure I.A.4). The Bank of Canada is expected to roughly track the interest rate increases in the United States in 2019–2020.

Japan: The Bank of Japan (BoJ) is expected to maintain a set of unconventional monetary easing measures known as Quantitative and Qualitative Monetary Easing (QQE) in 2019. While maintaining a negative interest rate on commercial banks' excess reserves at -0.1 per cent, the BoJ is expected to widen the guiding band for the yield on 10-year Japanese Government Bonds.

Australia and New Zealand: Both the Reserve Bank of Australia (RBA) and the Reserve Bank of New Zealand (RBNZ) are expected to tighten their monetary stances moderately in 2019 to fend off inflationary pressures from exchange-rate pass-through.

European Union: The European Central Bank (ECB) will cease asset purchases at the end of 2018, but signalled that interest rates will remain at current near-zero rates at least through September 2019. Despite high uncertainty surrounding the impact of Brexit, the Bank of England raised its key policy rate by 25 basis points to 0.75 per cent in August to contain inflation. Rates are expected to remain on hold until the central bank can assess the impact of Brexit after March 2019.

A growing number of countries tightened monetary policy or reduced the degree of monetary accommodation in 2018 (figure I.A.5). Many developing economies and economies in transition have increased rates alongside the Fed to stem capital outflows. By contrast, in response to escalating trade tensions and volatile commodity prices, several central banks have loosened or maintained accommodative monetary policy stances.

CIS and Georgia: In the Commonwealth of Independent States (CIS), amid rising inflationary expectations and increased uncertainty, monetary accommodation has started to

Figure I.A.4

Total assets of major central banks, January 2007–December 2020

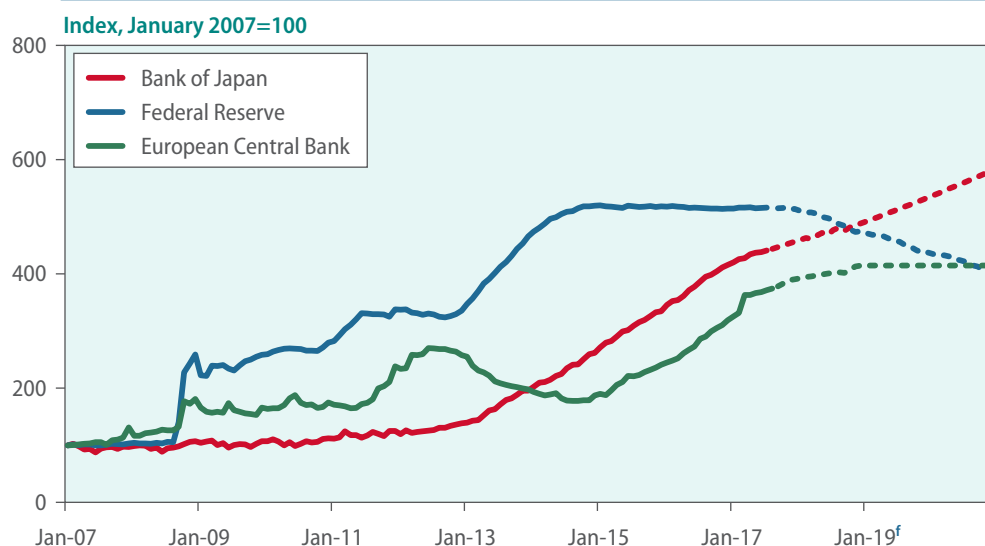
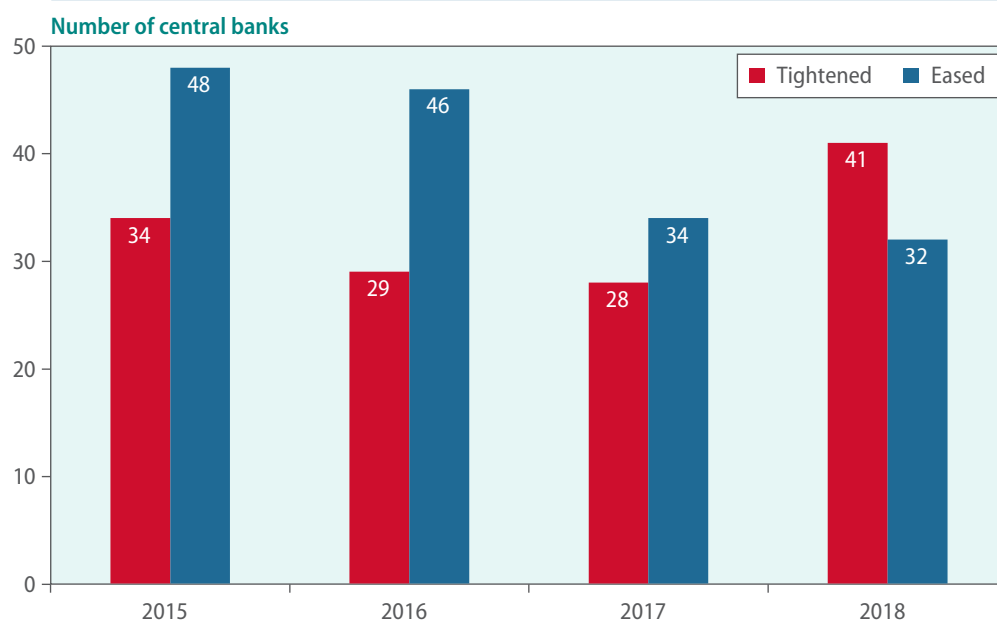


Figure I.A.5
Monetary policy stances



Source: Central Bank News.

Note: As of 30 November 2018. Sample covers 95 central banks across developed and developing economies, as well as the economies in transition.

be withdrawn. In the Russian Federation, depreciation of the rouble and increasing uncertainty led to the first rate hike since 2014 in September. In Ukraine, monetary authorities delivered a number of interest rate increases, prompted by rising inflation expectations—as labour shortages caused strong wage growth—and increases in economic uncertainties. Monetary policy was also tightened in Kazakhstan and Uzbekistan, due to rising inflationary risks and currency pressures. By contrast, in Azerbaijan, rapid disinflation allowed for a series of rate cuts, and the National Bank of Georgia marginally reduced its policy rate in August. Overall, policies remain relatively tight, with high real interest rates limiting the growth of private credit.

South-Eastern Europe: In South-Eastern Europe, monetary policy remains accommodative, despite the modest acceleration in inflation. Albania saw rapid appreciation of the currency in the first two quarters of 2018, which, according to the central bank, steered the exchange rate away from its long-term equilibrium, and undermined export competitiveness. In response, the central bank in June lowered its policy rate to a historically low level of 1 per cent. The National Bank of Serbia also cut its policy rate to a record-low level of 3 per cent in April 2018.

East Asia: Given moderate inflationary pressures and rising downside risks to growth, monetary policy is expected to remain accommodative in most East Asian economies. However, as the developed countries normalize monetary policy, central banks are faced with the risk of managing stronger capital outflow pressures. In China, rising trade tensions in 2018 prompted the People's Bank of China (PBoC) to announce several easing measures during the year. In the outlook period, the PBoC is expected to continuously fine-tune its policy mix in order to support short-term growth, while containing domestic financial vulnerabilities.

South Asia: After several years of accommodative monetary policy, South Asia has gradually moved into a more neutral stance. Some countries have even implemented a more aggressive tightening, amid financial and economic turbulences. In the current conditions, monetary decisions must strike a balance between containing moderately higher inflationary pressures, maintaining growth momentum and facilitating the domestic adjustments to lower global liquidity.

Western Asia: Central banks in Bahrain, Jordan, Kuwait, Qatar, Saudi Arabia and the United Arab Emirates are expected to raise the respective policy interest rates in line with the expected policy interest hikes by the Fed. The Central Bank of the Republic of Turkey is expected to maintain its tight policy stance to stabilize the exchange rate and inflation. The Central Bank of Israel is projected to keep its policy rate at 0.25 per cent.

Latin America and the Caribbean: Monetary policy has remained accommodative in most countries as inflation stayed within the target range of central banks. Many central banks left their benchmark interest rates unchanged for most of 2018. Rising global interest rates and increased inflationary pressures are likely to lead to some monetary tightening in 2019, including in Brazil, Chile, Colombia, the Dominican Republic and Peru. In Argentina, monetary policy has become strongly contractionary. In response to a rapidly depreciating peso and soaring inflation, the central bank lifted its benchmark rate to a record high of 60 per cent. While interest rates in Argentina are expected to gradually trend down in 2019–2020, monetary policy will remain contractionary. In Mexico, the tightening cycle that began in 2016 continues, and the policy rate reached the highest level since 2008. With upside and downside risks to both inflation and growth, there is a high degree of uncertainty over the direction of Mexico's monetary policy during the forecast period.

In countries that are fully dollarized (Ecuador, El Salvador and Panama) or operate a peg to the dollar (e.g., Antigua and Barbuda, Dominica, Bahamas and Barbados), local interest rates are projected to rise in line with those of the Fed.

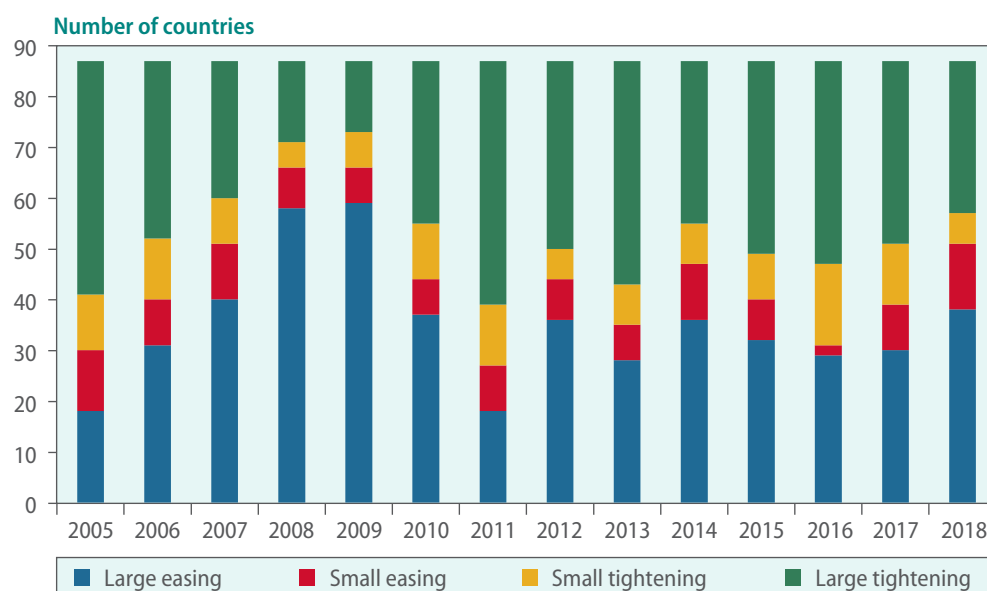
Africa: In many parts of Africa, monetary policy remains tight, given weakened exchange rates and elevated inflation rates. However, as inflationary pressures have eased, several countries, including Angola, Gambia, Ghana, Kenya, Mozambique and Zambia, lowered interest rates in 2018 to support the economy. For 2019, monetary policy is expected to remain tight in several countries, including Egypt, Sudan and Tunisia, aiming to stabilize foreign exchange and inflation. In Algeria, Libya, Morocco and Mauritania, monetary policy stances are expected to stay neutral.

Fiscal policy

Most developed-country Governments have adopted a broadly neutral or mildly expansionary fiscal policy stance for 2018–2020. The main exception is the United States, which has introduced a major fiscal stimulus programme, adding at least 0.5 percentage points to gross domestic product (GDP) growth in 2018. Fiscal deficits are expected to remain sizeable in most commodity-dependent economies, with public debt-to-GDP ratios expected to rise further in the outlook period. Globally, the fiscal stance is easing in the most number of countries since 2009 (figure I.A.6).

United States: The United States is following a highly expansionary fiscal programme, with steep cuts in both household and corporate taxes, and increases in expenditure. The debt ceiling is suspended until March 2019, after which the budgets for the fiscal years

Figure I.A.6
Fiscal policy stances



Source: IMF Fiscal Monitor Database.

Note: Small easing/tightening defined as a change in the cyclically adjusted fiscal balance of less than 0.5 per cent of GDP. Large easing/tightening is greater than 0.5 per cent of GDP.

2019/20 and 2020/21 are likely to be neutral to mildly contractionary, to stem the ongoing rise in debt.

Japan: The fiscal policy will likely be tightened slightly over the 2018 and 2019 fiscal years. While health- and social-welfare-related expenditures are expected to increase moderately, other current expenditures are subject to fiscal consolidation. The consumption tax rate is planned to be raised from 8 per cent to 10 per cent on October 2019 with an introduction of the invoice method.

Australia and New Zealand: The fiscal deficit is projected to narrow moderately over 2019 and 2020 in Australia despite planned personal income tax cuts. New Zealand is forecast to maintain a fiscal surplus with prudent management on expenditures.

European Union: Fiscal policy in the European Union is expected to have a neutral impact on growth in 2018–2019, with many countries shifting away from austerity in recent years. Across the region, stronger GDP growth and significant labour market gains have driven cyclical improvements in budget balances, by boosting tax revenues and reducing welfare expenditures. While almost all European countries are projected to record a primary balance surplus in 2019, the region's aggregate public debt-to-GDP ratio remains high and is expected to decline only slowly.

CIS and Georgia: A higher oil price has eased budget constraints for CIS energy exporters. Some countries have also benefited from privatization proceeds. Nevertheless, fiscal policy remains moderately conservative. In the Russian Federation, public spending is constrained by a fiscal rule, aimed at reducing the sensitivity to oil price fluctuations and building net sovereign assets. The planned budget for 2019–2021 maintains a fiscal surplus and increases non-hydrocarbon revenues, including a rise in the value added tax rate in 2019 and an increase in the pension age. The net effect of fiscal measures on growth in 2019 is expected to be negative; later, higher spending to meet recently adopted social and economic devel-

opment targets may add to growth. In Kazakhstan, significant funds were used in 2017 to bail out the banking sector; stronger economic activity in 2018 helped to consolidate the budget and a fiscal rule has been introduced. Fiscal spending was increased in Azerbaijan in mid-2018 on the basis of stronger export revenues. However, later in the year the country adopted a fiscal rule restricting spending growth and aiming to reduce the public debt. In Turkmenistan, numerous state subsidies were removed in 2017 and free utilities for households will be discontinued in 2019; the budget is being consolidated after earlier massive infrastructure spending. A more supportive fiscal stance is expected in Uzbekistan, utilizing the accumulated wealth fund.

Among the energy importers, conditionality of International Monetary Fund (IMF) programmes places restrictions on fiscal policy in Ukraine and in a number of other countries. Fiscal space is also constrained by external debt repayments, in particular in Belarus. In Georgia, deficit reduction is projected to be accompanied by significant capital expenditure increases. In Tajikistan, further support to the banking sector may be needed.

South-Eastern Europe: In South-Eastern Europe, moderate fiscal consolidation efforts to address the public debt level are expected to continue in 2019–2020. Albania and Serbia have undergone tangible fiscal adjustment. Nevertheless, in the former Yugoslav Republic of Macedonia and Montenegro, significant public spending on infrastructure projects is expected to continue in the near term.

East Asia: As monetary policy space narrows, most East Asian economies are likely to maintain expansionary fiscal stances to support domestic demand. The Republic of Korea plans to increase fiscal spending significantly in 2019, with a focus on job creation and expanding social welfare. China has also introduced several pro-growth fiscal measures such as lowering personal income taxes and accelerating infrastructure investment. Several other economies, including the Philippines and Thailand, will also continue to embark on large infrastructure projects.

South Asia: South Asia's fiscal policies have gradually moved to a moderate expansionary stance. Thus, fiscal deficits are projected to remain elevated. To avert sustainability concerns, some countries will need medium-term consolidation plans, especially those with a fragile tax base and elevated levels of debt.

Western Asia: Due to the recent recovery in oil prices, fiscal stances in Cooperation Council for the Arab States of the Gulf (GCC) economies are expected to be more accommodative. Following Saudi Arabia and the United Arab Emirates, other GCC economies are expected to introduce the value added tax over 2018 and 2019. Iraq is expected to increase fiscal expenditures for public investment projects and public service provisions. Further fiscal consolidation measures are expected to be taken in Jordan, Lebanon and Turkey. The fiscal policy stance is forecast to be accommodative in Israel, given its strong fiscal position.

Latin America and Caribbean: Many Governments will face significant fiscal adjustment pressures during the outlook period. Despite some improvements in 2018, primary fiscal deficits often exceeded debt-stabilizing levels. Government debt-to-GDP ratios are high in several countries, especially in South America (Argentina, Brazil, Uruguay) and the Caribbean (Barbados, Jamaica). Rising global interest rates, a strong dollar and capital flow volatility add to pressures for fiscal consolidation. Most Governments will continue to pursue a gradual approach to minimize the negative impact on economic activity. In Argentina,

fiscal policy will remain strongly contractionary in 2019–2020, with both large spending cuts and tax increases in efforts to eliminate the primary deficit by 2019. In Brazil, the new Government faces strong pressures to consolidate public finances, including comprehensive reform of the pension system. In 2018, Brazil's deficit in the general government overall balance is estimated to have risen to about 8.5 per cent of GDP and general government gross debt to 88 per cent of GDP.

Africa: In aggregate, fiscal deficits narrowed slightly in Africa in 2018, reflecting ongoing fiscal consolidation efforts in many countries that nonetheless allow for higher levels of investment in infrastructure. However, in East Africa, deficits have continued to widen, as domestic resource mobilization remains insufficient to finance expenditure needs. In aggregate, the fiscal position in Africa is forecast to remain stable in 2019, supported by rising export revenues, particularly from natural resources. Under the IMF Extended Fund Facility arrangement, Egypt and Tunisia are projected to implement further measures to reduce budget deficits.

Exchange rates

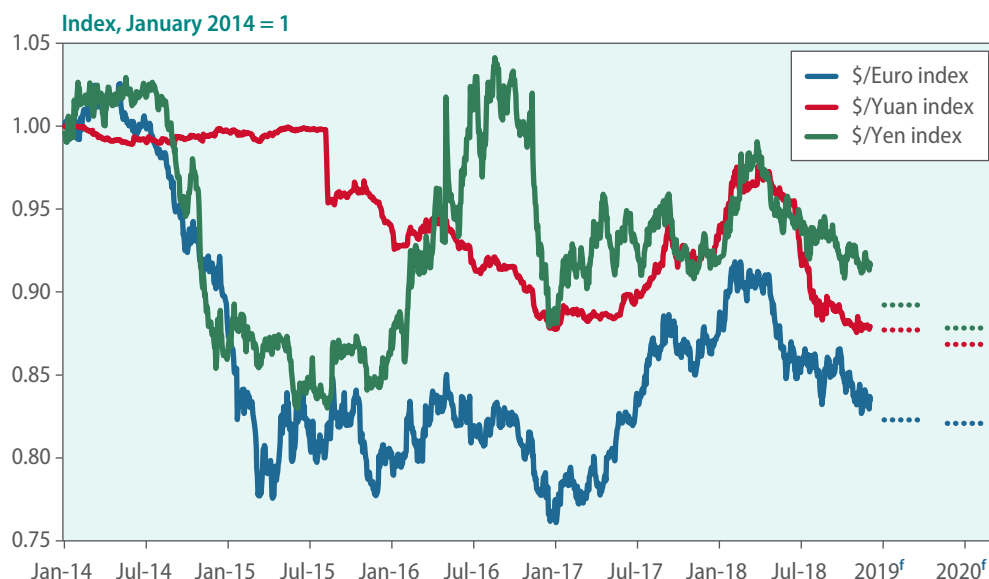
The dollar/euro exchange rate is assumed to average 1.183 in 2018, and to depreciate marginally in line with the widening differential between ECB and Fed interest rates to 1.120 in 2019 and 1.117 in 2020 (figure I.A.7).

The yen/dollar exchange rate is assumed to average 110.41 in 2018, 116.55 in 2019 and 118.4 in 2020.

The renminbi/dollar exchange rate is assumed to average 6.61 CNY/dollar in 2018 and 6.96 in 2019 and 7.03 in 2020.

Figure I.A.7

Major currency exchange rates: recent trends and assumptions



Sources: IMF Exchange Rate Query Tool and UN/DESA forecast assumptions.

Note: f = forecast, A rise indicates an appreciation.

