Financing for Sustainable Development Report 2022

Inter-agency Task Force on Financing for Development

Bridging the Finance Divide

United Nations

Report of the Inter-agency Task Force on Financing for Development

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The online annex of the Task Force (http://developmentfinance.un.org) provides additional data and analysis on progress in implementation of the Financing for Development outcomes, including the Addis Ababa Action Agenda and relevant means of implementation targets of the Sustainable Development Goals.

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The global economic context and its implications for sustainable development

Chapter I

The global economic context and its implications for sustainable development[1]

1. Introduction

The global economic outlook remains highly fragile and uncertain, clouded by the war in Ukraine and continued pandemic risks. Beyond the worsening humanitarian crisis, the economic effects from the war in Ukraine are reverberating across the world. In many countries, the war has exacerbated supply bottlenecks and further fuelled inflationary pressures, leading to rising risks of stagflation. A possible pandemic resurgence also remains a significant threat to the growth outlook of many countries.

Monetary authorities are facing difficult policy choices amid a challenging environment. Even before the latest sharp increase in global oil and food prices driven by geopolitical events, rising inflationary pressures had prompted many central banks to tighten monetary policy stances despite the highly uncertain economic recovery. However, a further tightening of global financial conditions—which might be compounded by a renewed "flight to safety"—could trigger sharp market corrections, leading to large capital outflows from developing countries and a surge in debt servicing costs. This would likely increase debt sustainability concerns and debt distress risks, and could prompt Governments to further tighten fiscal policies, which would further derail growth.[2]

Growing headwinds to the global economy are compounding the risk of a lost decade for sustainable development highlighted in last year's report. Compared to developed economies, the recovery from the pandemic has been weaker in developing economies, as reflected in larger output losses compared to pre-pandemic projections. Slower vaccination progress, a sluggish labour market recovery, limited fiscal space and tightening monetary conditions are among the key factors weighing on growth in developing countries. More subdued global growth may further dampen the recovery outlook for developing countries hit hard by the pandemic and exacerbate inequalities, posing an even larger threat to sustainable development and the achievement of the Sustainable Development Goals (SDGs). For many developing economies, the pandemic had already worsened pre-existing macroeconomic and structural vulnerabilities, including weak labour markets, elevated debt and subdued investment growth.

In many of the world's poorest countries, the pandemic has reversed several years of income gains. The number of extreme poor is expected to remain above pre-pandemic levels over the outlook period. Many countries are at risk of sinking deeper into a cycle of unsustainable debt and austerity while incidents of poverty and hunger are on the rise. This increasingly challenging environment for policymakers is compounded by growing interlinkages between economic, social and environmental factors. The increased frequency and intensity of climate-related shocks is disproportionately affecting some of the world's most vulnerable economies, leaving them further behind. Ongoing structural shifts in the global landscape, in particular the accelerated pace of automation and digitalization and the changing nature of jobs, could also disproportionately harm certain segments of the population, exacerbating inequalities.

Most developing countries are constrained in their ability to utilize fiscal policies to support the recovery and to return to the path of sustainable development. While some countries have been able to take advantage of the low interest rate environment to finance the pandemic response and invest in sustainable development, the cost of financing for many countries remains elevated and is expected to rise, amid a tightening of global financial conditions and heightened geopolitical risks. Given elevated debt vulnerabilities, many countries are unable to sustain the fiscal stimulus needed to fully recover from the pandemic, with support measures already being withdrawn in a large number of countries.

Macroeconomic and financing policies can play a more effective role in promoting a more resilient, inclusive and sustainable recovery. Sustainable development considerations, including the impact of climate change, should be integrated into fiscal, monetary and financial policy frameworks. Decisive support from the international community is also needed in order to create the necessary fiscal space for countries to get back on track to achieve the SDGs, as well as to share the burden of tackling climate change and other common challenges.

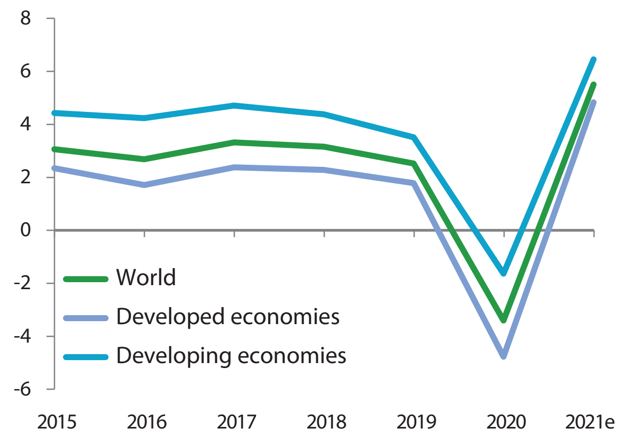
2. Outlook and risks for the global economy

2.1 Global and regional growth trends and outlook

Global output expanded by 5.5 per cent in 2021, buoyed by a low base, marking the strongest growth in almost 50 years. The easing of mobility restrictions across countries supported the release of pent-up demand and a resumption of economic activity, following the sharp recession in 2020 (figure I.1). For many developing countries, however, the economic recovery was more subdued, due mainly to slower vaccination progress, more limited policy support and deeper pandemic-induced scarring effects, including on labour markets. Global inflation rose significantly to 5.2 per cent in 2021, fuelled by a combination of supply chain disruptions, a rebound in global demand and higher commodity prices. Looking ahead, the war in Ukraine and heightened geopolitical tensions could compound global inflationary pressures and exacerbate supply disruptions and volatility in commodity prices (see box I.1). Although the recovery remains fragile, the increase in inflationary pressures has prompted many central banks to begin unwinding their accommodative monetary policies. The United States Federal Reserve's signal of a faster-than-expected pace of monetary tightening also weighed on investor sentiments in late 2021, contributing to bouts of capital outflows from emerging economies. According to data from the Institute of International Finance (IIF), non-resident portfolio flows to emerging economies excluding China turned negative in the last quarter of 2021. The global growth momentum slowed towards the latter part of 2021 and into 2022 amid the rapid spread of the Omicron variant and the waning effects of policy stimulus.

Global growth is expected to slow going forward amid increased uncertainties and downside risks. Despite the growth rebound in 2021 and a projected gradual recovery in the near term, output losses for many developing countries are expected to remain substantial compared to pre-pandemic trajectories. In nearly one fifth of developing countries, output was still expected to be below 2019 levels by the end of 2023, even before accounting for the fallout from the war in Ukraine. In Eastern Asia and South-Eastern Asia, economic activity will continue to be supported by accommodative policies in many economies, although these regions face headwinds from slowing external demand and higher energy prices. For the tourism-reliant economies, including many small island developing States (SIDS), recovery prospects will be underpinned by an upturn in tourism activity, although the pace of recovery in international travel is

Figure I.1
Growth of world gross product
(Percentage)



Source: UN/DESA
Note: e = estimates.

likely to remain uneven amid varying degrees of traveller confidence and vaccination rates.[3] Elevated commodity prices would lend some support to the economic recovery of commodity exporters, including in the Africa, Western Asia and Latin America and the Caribbean regions. For many countries in these regions, however, inflation and monetary tightening will weigh on domestic demand.

The protracted impact of the pandemic and risks of renewed flareups continue to weigh on the economic outlook. For many developing economies, particularly least developed countries (LDCs), low vaccination coverage due to acute vaccine shortages and logistical issues poses a challenge to their recovery prospects. These countries remain highly vulnerable to renewed waves of infection which could lead to prolonged disruptions to economic activity. As of end 2021, the number of vaccine doses per 100 people in LDCs stood at just 23.9, against 147.4 in developed countries. Due to an increase in pandemic-related spending needs and a collapse in revenues, many vulnerable developing countries also face significant fiscal constraints and debt sustainability risks, hindering their ability to support a stronger recovery.

The pandemic shock has significantly increased poverty and inequality globally, leading to a substantial reversal in progress towards sustainable development. Compared to 2019, an estimated 77 million more people were living in extreme poverty in 2021, setting back the fight against poverty by nearly a decade. There is a high risk that this number will increase going forward as the war in Ukraine and soaring food prices inflict further damage on the livelihoods of many. The pandemic has also further exacerbated inequalities—both between and within countries. Even before the pandemic, inequalities were high and rising in most countries. The richest 10 per cent of the global population account for 52 per cent of global income, whereas the poorest half of the population account for 8 per cent.[4] The highly uneven pace of recovery is reflected in the larger downgrade of gross domestic product (GDP) per capita forecasts in developing countries. While the projected output loss in per capita terms of developed economies is expected to narrow substantially over the outlook period, output losses of developing countries are

Box I.1
Ukraine conflict: Implications for the global economic context

The war in Ukraine has caused the loss of thousands of civilian lives and displaced millions from their homes. Beyond the countries directly affected, the conflict's economic and financial impacts are reverberating around the world. Rising commodity prices and trade disruptions are exacerbating inflationary pressures and dampened growth expectations are weighing on the recovery from COVID-19, with severe implications for some of the poorest and most vulnerable countries. Higher food prices, in particular, risk pushing millions more into poverty. Policy actions to secure short-term fuel supplies could prolong the dependency on fossil fuels but could also be an opportunity to accelerate the sustainable energy transition needed to achieve climate goals. The conflict and its cascading impacts are threatening the return to a path towards achieving the SDGs and are increasing risks of instability and unrest around the world. At the same time, the war poses risks of increasing fragmentation of the international system, hampering a united global response.

As the conflict continues to unfold, the scale and scope of its global economic impacts are uncertain and will depend on its projected duration and severity. According to an early scenario analysis that assumes initial commodity and financial market shocks last for at least one year, global growth could be reduced by over 1 percentage point in 2022, with an increase of 2.5 percentage points in inflation.[a] The impact will, however, likely vary among countries. Net commodity importers and countries with stronger trade ties with Ukraine and the Russian Federation will be hit harder. Different response capacities will also affect outcomes, as countries with more fiscal space will be in a better position to shield consumers and firms from commodity price increases.

A review of ***global transmission channels*** can shed more light on the potential economic and financial implications for different countries:

1. Sharp increases in ***global commodity prices*** are further fuelling already high inflationary pressures across the world, eroding real incomes and weighing on demand. Amid a highly uncertain economic outlook, central banks are facing a worsening monetary policy dilemma as they attempt to balance between supporting growth and containing domestic price pressures.

With the Russian Federation being one of the world's largest fossil fuel exporters, sanctions and concerns over supply disruptions have exerted upward pressure on global prices of ***crude oil and natural gas***. While persistently higher oil prices would benefit oil-exporting countries, they would be detrimental for oil-importing countries, and increased import costs could cause a deterioration in their balance-of-payments.

The conflict is also disrupting agricultural exports and food production, causing ***global food prices*** to increase further from current multi-year highs. The Russian Federation and Ukraine account for close to 30 per cent of global wheat exports, with exports going mainly to developing countries. Surging food inflation would severely impact vulnerable households and worsen food insecurity in many developing countries that are still struggling with economic shocks from the pandemic.

2. The impact of the war on the global economic outlook through the ***trade channel*** will have asymmetric effects on different regions and countries. A steep decline in economic prospects in the Russian Federation and Ukraine will significantly impact countries with deep trade linkages with these countries, notably many in Eastern Europe. Countries that are deeply integrated into global value chains could also be significantly affected as the cross-border flow of goods is disrupted by sanctions, transport bottlenecks and reduced production capacity in certain industries.

3. The war is also impacting growth prospects through the ***confidence channel***. A continued escalation of the conflict could lead to a further collapse in confidence and a tightening of global financial conditions amid higher financial market volatility and risk premia. As geopolitical tensions continue to cast uncertainty over the global outlook, foreign direct investment flows could also slow worldwide. An increase in investor risk aversion could also trigger larger and more abrupt capital outflows from developing countries, posing a risk to growth and financial stability.

4. For many developing countries already at high risk of debt distress, the spillover effects of the war may further worsen ***debt vulnerabilities*** due to the increasing balance-of-payments and fiscal pressures described above.

5. Amid increasing defence expenditure and humanitarian needs, the war could divert resources away from ***longer-term development finance***, setting back progress towards sustainable growth and development.

Policy responses

The ***international community*** has responded quickly to the humanitarian crisis, providing support to over 4 million refugees and mobilizing emergency financing for Ukraine and neighbouring countries, as well as resources for longer-term reconstruction. This includes $2.2 billion from the European Bank for Reconstruction and Development, $2.2 billion from the European Investment Bank, $3 billion from the World Bank, $1.4 billion from the IMF, and emergency grants from the Council of Europe Development Bank.[b]

Beyond assisting the directly affected countries, the international community should stand ready to support countries that suffer from the economic and financial impacts, including through balance of payments support and food assistance, where needed. Rising food prices threaten worsening poverty and inequality in the poorest countries that are unable to provide fiscal support domestically, underscoring the impact of the great finance divide (see chapter II), and highlighting the need for increased development cooperation (see chapter III.C). Some countries may also require additional support for refinancing debt (see chapter III.E).

Additional funding will be needed to ensure that increased spending for humanitarian needs and in-donor refugee expenditures do not crowd out existing resources for development cooperation. Donor countries must scale up and meet their official development assistance (ODA) commitments despite growing fiscal domestic pressures to mitigate the domestic impacts of the war, along with potential budget reallocations towards higher defence spending in some countries.

To coordinate the global response, the United Nations Secretary-General set up a Global Crisis Response Group on Food, Energy and Finance. The group brings together the United Nations system, international financial institutions and other stakeholders to jointly address the interconnected impacts of the war on food security, energy and financing and to propose policy options that can contribute to the achievement of the 2030 Agenda and the SDGs.

At the ***domestic level***, Governments able to do so can introduce ***fiscal support*** measures to alleviate the impact of higher food and fuel prices, targeted towards the vulnerable segments of society, including low-income households and small and medium enterprises. These measures could take the form of income support, targeted subsidies and tax rebates.

Countries should ***avoid export bans*** and other trade-restrictive measures, particularly on food and agricultural products that could add to market distortions and further increase global food prices. Further price increases could worsen widespread food insecurity, disproportionately affecting the most vulnerable.

As many countries strive to ensure energy security, there are two competing trends. On the one hand, short-term energy needs could lead to actions with negative environmental impacts. For example, increasing the use of existing coal-powered plants would cause a significant increase in greenhouse gas (GHG) emissions. In addition, new investments in fossil fuel sources could risk locking in hydrocarbon dependency over the medium term and jeopardizing the necessary reduction of GHG emissions to achieve the Paris Agreement. On the other hand, high global oil and gas prices should provide additional incentives for countries to step up investments in a ***sustainable energy transition***, taking advantage of the comparative cost advantage of modern renewable energy sources and increasing energy efficiency (see chapter III.G), while using targeted support measures to protect vulnerable populations from rising energy prices.

Source: UN/DESA.

a OECD. 2022. *OECD Economic Outlook, Interim Report: Economic and Social Impacts and Policy Implications of the War in Ukraine.* Paris: OECD Publishing. These simulations provide an initial look at the potential impact of the conflict based on the market dislocations observed in the first two weeks of the war. They do not incorporate many factors that could intensify the adverse effects of the conflict such as further sanctions, shipping disruptions, or export bans, among others.

b IMF. 2022. "Joint Statement of Heads of International Financial Institutions with Programs in Ukraine and Neighboring Countries". Press Release, 17 March, 2022.

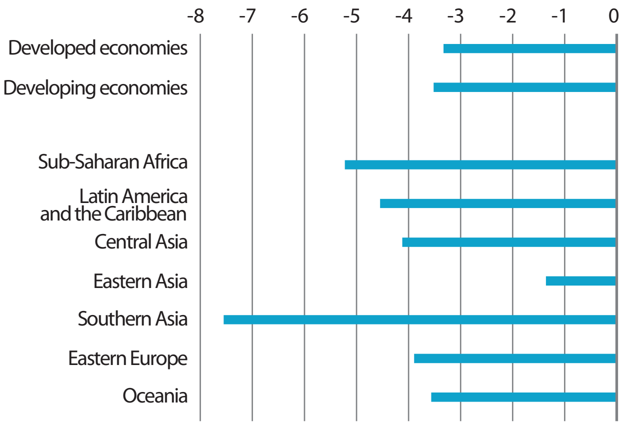
predicted to be much larger. Africa, Latin America and the Caribbean and Southern Asia are expected to experience the largest and most persistent output losses (figure I.2). Many of the poorest countries are not expected to reach pre-pandemic income levels before the middle of the decade, with a likelihood of long-term scarring (i.e., countries remaining below the pre-pandemic output trend).

The asymmetric impacts of the pandemic have exacerbated pre-existing inequalities within countries by disproportionately affecting marginalized or vulnerable groups, including low-skilled and informal workers. People who were already facing disadvantages in the labour market have experienced higher employment losses during the pandemic. These include informal workers, youth, migrant workers, the elderly and women. As women typically earn less and hold less secure jobs, they have been more susceptible to layoffs and have also exhibited a higher tendency to exit the labour force compared to men, due in part to childcare responsibilities. Between 2019 and 2020, women lost 54 million jobs globally, a 4.2 per cent decline in employment (compared to 3.0 per cent for men). By the end of 2021, while it is estimated that men have regained pre-pandemic employment levels, there would still be 13 million fewer women in the labour force. Drawing on data from 45 countries, prime working-age women were more likely than men to report losing their jobs (28 per cent of women versus 24 per cent of men), while partnered women with children in the household were those most likely to lose their jobs (30 per cent of women versus 23 per cent of men) during the pandemic.[5] Gender impacts of the pandemic on labour markets have also varied between developed and developing economies. In developing countries, the pandemic has had visibly stronger negative effects on women's employment and labour force participation relative to men, but this was not the case in developed countries.[6] At the same time, individuals at the very top, in terms of both income and wealth, have seen gains during the pandemic, in part because they benefited from the fiscal and monetary policy responses. In several developed countries, asset purchase programmes are likely to have contributed to the widening of wealth inequality, given that the increase in prices of financial assets disproportionately benefited higher income groups. [7]In 2021, the average income of people in the bottom 40 per cent of the global income distribution was estimated to be 6.7 per cent lower compared to 2019. However, the average income of the top 40 per cent was down by only 2.8 per cent.[8] One calculation showed that the wealth of the world's 10 richest men doubled over the course of the pandemic.[9] Surging food prices, exacerbated by the rise in geopolitical risks, will also hit the poorest segments of the population the hardest, leading to higher food insecurity and exacerbating the pandemic's impact on income inequality. In 2021, food prices rose by 22 per cent, reaching their highest level in a decade.[10]

Significant learning losses will have repercussions on medium-term development prospects. Amid prolonged school closures, the pandemic is translating into significant losses in human capital and a dire education crisis for many developing countries. Despite government efforts to deliver remote learning where possible, learning outcomes have generally been poor (see chapter III.G). The share of 10-year-olds in low- and middle-income countries who cannot read a basic text is estimated to have reached 70 per cent in 2021, an increase of 17 percentage points from 2019.[11] Without a clear strategy to recover these losses, the effects of delayed education will be felt for decades.

The impact of the pandemic on labour markets will continue to be felt through the outlook period, with a high degree of unevenness across countries and sectors. High-income countries have experienced a relatively stronger labour market recovery. Their employment-to-population ratio was just 1.2 percentage points lower in 2021 compared to pre-crisis, although some sectors are facing acute labour shortages which have created logistical bottlenecks. In contrast, the employment-to-population ratio for lower-middle-income and low-income countries in 2021 were both still 2.1 percentage points lower than pre-crisis.[12] For a large number of developing countries, slower

Figure I.2
GDP per capita losses by development status and region, 2021
(Percentage change between current and pre-pandemic forecasts)



Source: UN/DESA estimates.

vaccination progress has made it difficult to ease workplace restrictions[13] and has impaired workers' willingness to return to work in person. Many developing countries also lack the capacity to sustain large-scale fiscal stimulus, including social protection measures, to support workers and livelihoods.[14]

The pandemic is likely to have accelerated several trends that could have significant implications for labour markets. A more rapid pace of digitalization and automation is threatening to make many job losses permanent, while deepening the digital divide (see chapter III.G). In addition, the expansion of the gig economy, where workers are often classified as self-employed rather than employees, has led to a rise in more precarious work conditions. In many countries, social protection, and sometimes healthcare, are tied to employment. This trend could exacerbate inequalities as it precludes more workers from basic benefits such as paid sick leave and access to unemployment insurance.

2.2 Deterioration in public finances

Shrinking fiscal space and rising debt sustainability risks in many parts of the world will prompt the withdrawal of needed fiscal support. Despite facing multiple downside risks and a highly uncertain economic recovery, fiscal support in most developing economies is expected to be largely unwound by 2023. For a number of countries, the withdrawal of fiscal stimulus has been faster than expected, with many measures having expired by late 2021. Furthermore, as global financial conditions tighten, pressures for fiscal consolidation are intensifying for many developing economies.

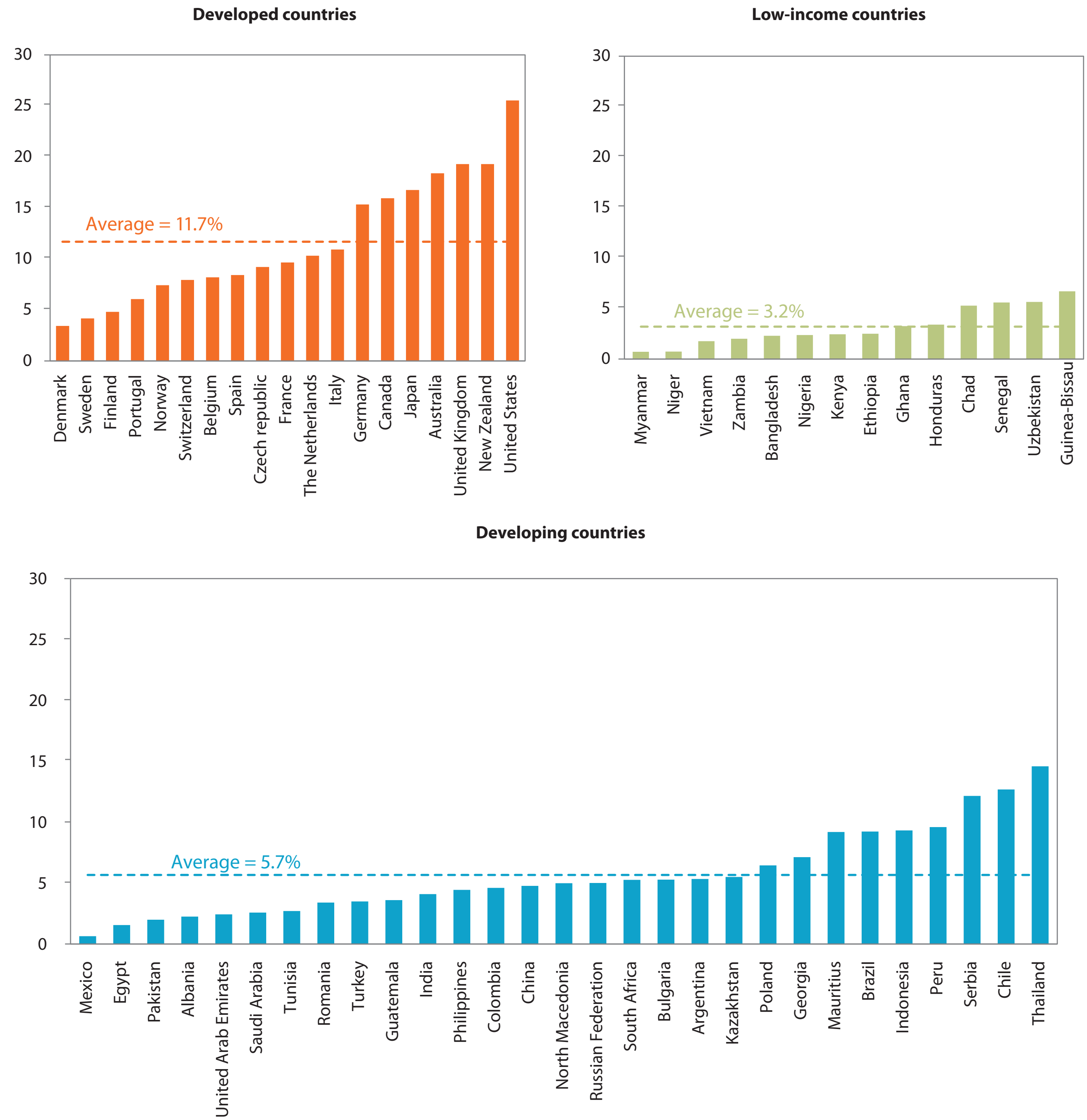
Differences in fiscal space have contributed to the divergence in recovery prospects across countries. Fiscal measures amounted to around 10 per cent of GDP or more in most developed countries and exceeded 20 per cent of GDP in some large economies. Together, developed countries accounted for the vast majority of around $17 trillion in global fiscal measures implemented in response to COVID-19. However, many developing countries entered the crisis with already elevated debt and weak fiscal positions, which severely constrained their ability to effectively manage the health crisis and contain the pandemic's economic fallout[15] (figure I.3). While some developing countries were able to take advantage of low interest rates to finance investment, many others have faced prohibitively high borrowing costs. Sovereign borrowing costs for most of the developing countries able to access markets have remained much higher than those of developed countries during the pandemic (figure I.4).

Large pandemic-related fiscal support and declines in revenue have pushed public debt levels up to record highs. Across regions, government debt-to-GDP ratios have risen sharply (figure I.5) and are expected to remain elevated given persistent weak revenues. While public debt has gone up significantly across all income groups, debt servicing is posing a much greater challenge for low- and middle-income economies due to the higher cost of debt and lower government revenues (see chapter III.E). Moreover, many developing countries have seen a rise in external debt burdens (figure I.6), with the external debt stock of low- and middle-income countries combined rising by 5.3 per cent to $8.7 trillion in 2020, from 2019. Higher commodity prices due to geopolitical risks may put additional pressure on the balance of payments of oil-importing countries, worsening debt sustainability. For many developing countries, high debt servicing costs are diverting resources away from pandemic response and investments towards supporting a sustainable recovery (see chapter II). For more than half of the countries in sub-Saharan Africa, debt servicing costs account for at least one quarter of government revenue. With risks to debt sustainability rising, most developing countries have already withdrawn or are expected to withdraw most fiscal stimulus measures over the outlook period. However, amid a highly uncertain outlook as regards the pandemic, premature fiscal consolidation could stall the recovery process, ultimately resulting in higher—rather than lower—debt-to-GDP ratios.

Policy responses by the international community have been significant but insufficient. The G20's Debt Service Suspension Initiative (DSSI) temporarily eased financing constraints for many developing countries and helped to avert a more widespread and systemic debt crisis. With expiration of the DSSI, however, the implementation of the Common Framework for Debt Treatments Beyond the DSSI (Common Framework) needs to be stepped up and several of its design elements need to be improved. Despite still-elevated risks of debt distress in many developing countries, only three countries have requested debt treatments under the Common Framework thus far (see chapter III.E). In addition, while the IMF's new allocation of Special Drawing Rights (SDRs) of $650 billion constitutes an important measure to enhance liquidity, it is not sufficient to address the financing challenges of developing countries (see chapter III.F).

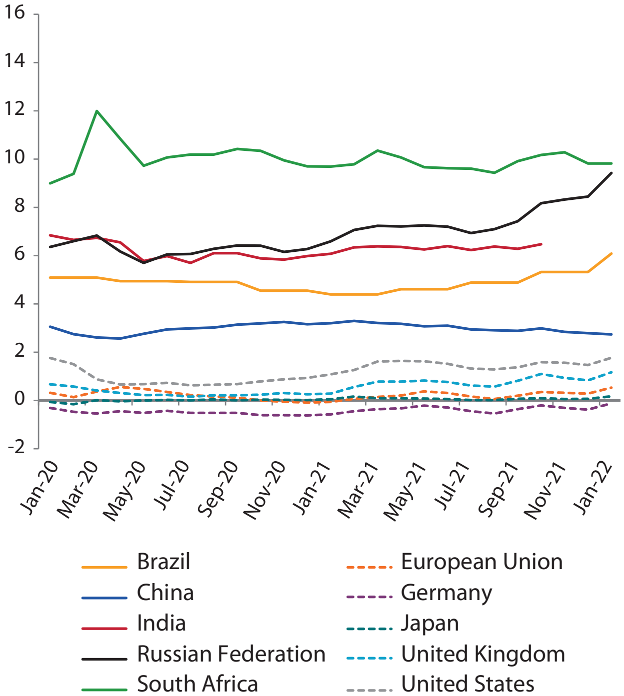
Many developing countries have been diverting resources from public investments that promote sustainable development. In several developed countries, the availability of sufficient fiscal space has enabled them to not only roll out immediate measures to counter the pandemic, but also to channel resources towards strengthening social protection and supporting productive investments, such as in research and development, green energy and digital technologies. Examples include the European Union's Next Generation EU recovery plan and the Infrastructure Investment and Jobs Act in the United States. In contrast, for many developing economies, especially low-income countries, fiscal stimulus packages to counter the pandemic effects were largely funded by cutting public investment and reallocating resources from many key areas of

Figure I.3
Fiscal response to COVID-19 in selected countries, as a share of GDP
(Percentage of GDP)



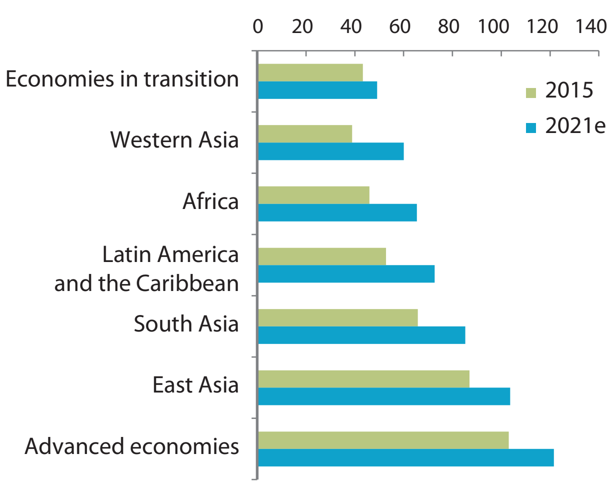
Source: IMF, Fiscal Monitor Database of Country Fiscal Measures in Response to the COVID-19 Pandemic (October 2021 version), available at www.imf.org/en/Topics/imf-and-covid19/Fiscal-Policies-Database-in-Response-to-COVID-19.
Note: A country's fiscal response is estimated as the sum of its additional public spending and foregone revenue, between January 2020 – September 2021. The average fiscal response for each country group represents the mean of the selected countries.

Figure I.4
10-year government bond yields of selected developed and large economies
(Percentage)



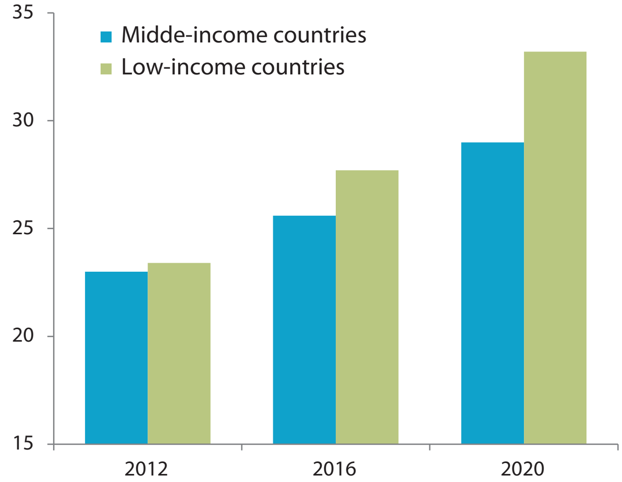
Source: CEIC (accessed on 23 February 2022).

Figure I.5
General government gross debt
(Percentage of GDP)



Source: World Economic Outlook Database, IMF.
Note: e = estimates.

Figure I.6
External debt to GNI
(Percentage)



Source: World Bank, International Debt Statistics, October 2021.

sustainable development. International support such as the DSSI enabled beneficiaries to increase COVID-related spending, but nowhere near the levels of richer countries; it also could not prevent spending cuts in areas critical to long-term sustainable development.

As countries face rising fiscal pressures, the impact of fiscal consolidation would be disproportionately larger for certain segments of society. About two thirds of low- and lower-middle-income countries have cut education budgets since the onset of the pandemic.[16] Recent estimates also suggest that the pandemic has impacted social spending on child protection, nutrition and water and sanitation.[17] Women would also disproportionally suffer from any austerity going forward as they are more likely to be employed in the public sector and fill the gap—often through their unpaid work—when health and education services are cut.[18] As a result, unmet financing needs for the SDGs have further increased with a worsening baseline, with estimates of a 20 per cent increase in spending needs for key SDG sectors.[19]

2.3 Growing challenges for monetary policy

Rising inflationary pressures have prompted a shift towards tighter monetary policy stances globally. In 2021, global headline inflation surged to 5.2 per cent, more than 2 percentage points above its trend rate over the past 10 years. The rise in inflation in 2021, from a low base, was attributed to a combination of factors, including supply-side bottlenecks, a rebound in demand, higher commodity prices and the expiration of tax benefits and subsidies in some countries. Heightened geopolitical risks could further fuel global inflation by possibly exacerbating supply disruptions and energy shortages. The recent rise in inflation has been particularly pronounced in countries such as the United States and regions including the euro area, Latin America and the Caribbean and the Commonwealth of Independent States. Further price shocks could threaten to de-anchor inflation expectations and raise concerns over a wage-price spiral. In efforts to contain inflationary pressures, a growing number of central banks have started to tighten their monetary policy stances (figures I.7a and I.7b). In the first five weeks of 2022 alone, 24 central banks increased interest rates.[20] The Federal Reserve started the tapering of its asset purchase programmes in November 2021, raised its key policy rate in March 2022[21] and hinted at several additional rate hikes in the coming months. Since December 2021, the Bank of England has raised its key policy rate by a total of 75 basis points to 0.75 per cent. The European Central Bank (ECB) confirmed it would be ending asset purchases under its pandemic emergency purchase programme at the end of March 2022. Given the uncertainties arising from increased geopolitical tensions, however, several central banks including the ECB have announced that they could re-assess policy paths incorporating the latest developments.

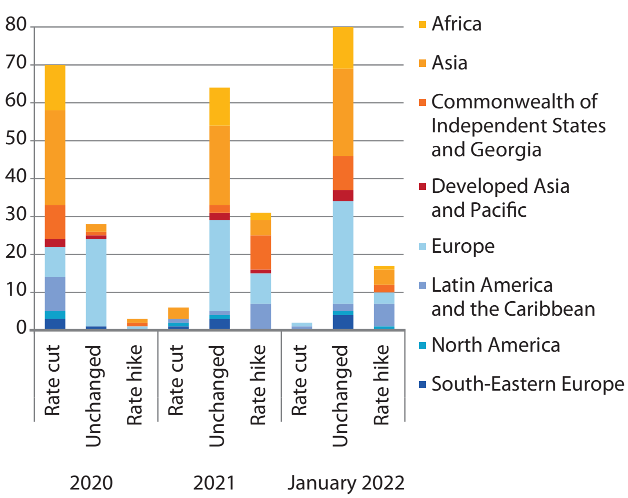
In many developing countries, concerns over rising inflation and exchange rate pressures have led to even earlier withdrawals of monetary support. Central banks in more than one third of developing economies, particularly energy importers, increased their policy rates in 2021. While 27 developing countries adopted asset purchase programmes for the first time during the pandemic, these asset purchases were much smaller in scale and shorter in duration compared to those in developed countries. This was largely due to concerns over currency depreciations, inflation and weak local currency portfolio flows.[22]

A faster-than-expected pace of monetary tightening in developed economies could lead to heightened global financial market volatility, with adverse spillovers on developing economies. High uncertainty over the tightening of global monetary conditions caused a deterioration in investor risk sentiments in late 2021 that extended into early 2022, as inflation concerns were exacerbated by rising geopolitical tensions and the global spread of the Omicron variant. Excluding China, emerging economies experienced non-resident portfolio outflows of $7.7 billion in January 2022, following outflows of $3.8 billion in the last quarter of 2021. A sharper-than-expected monetary tightening cycle, particularly in the United States, or a renewed “flight to safety” could trigger more disorderly corrections in global financial markets. In this environment, developing economies could suffer even larger capital outflows and currency depreciations, which could destabilize domestic financial conditions and affect growth. Policymakers should have the full range of policies at their disposal to mitigate the effects of large capital flow volatility. In turn, clear and transparent communication of monetary policy shifts by the major developed economies can help to reduce negative spillovers on developing economies (see chapter III.F).

Tightening global financial conditions further increase risks for developing countries with high debt levels and large external financing needs. With revenue prospects still weak, an increase in global interest rates would exacerbate debt vulnerabilities for many developing country Governments. Higher debt service costs and an increase in refinancing and roll-over risks will cause more countries to face challenges in repaying their debt obligations. The increase in interest rates could prompt the Governments of many developing countries to undertake premature fiscal consolidation, posing a drag to growth and hindering the recovery prospects.

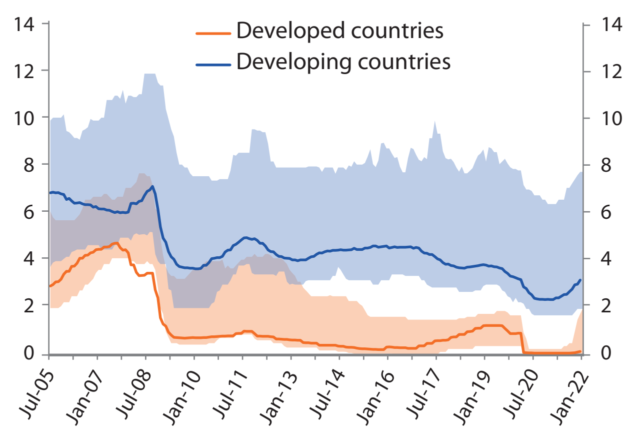
Central banks worldwide face difficult trade-offs in unwinding policy support. Against a backdrop of heightened geopolitical risks, an ongoing pandemic, rising inflationary pressures and an incipient economic recovery, there is a substantial risk of monetary policy mistakes. The strong financial market turbulence and market sell-offs in January 2022 illustrate how rapidly investor sentiments can change in an environment of high economic and policy uncertainties. For many developing economies, monetary tightening is taking place amid large COVID-19-related output shortfalls and weak employment. While too-fast monetary tightening could derail a still fragile economic recovery, too-slow monetary tightening could potentially entrench inflation expectations.

Figure I.7a
Policy rate decisions by region
(Number of countries)



Source: CEIC (accessed on 23 February 2022).
Note: 101 central Banks are covered in 2020 and 2021, and 99 central banks are covered in January 2022, based on available data.

Figure I.7b
Policy rates of developed and developing countries
(Percentage)



Source: UN/DESA, based on data from the Bank for International Settlements, CEIC and World Bank Open Data (accessed on 23 February 2022).
Note: The lines display the GDP-weighted average policy rates for a set of 36 developing countries and a set of 14 developed economies plus the euro area. The shaded areas indicate the range between the twenty-fifth and seventy-fifth percentile of the respective policy rates.

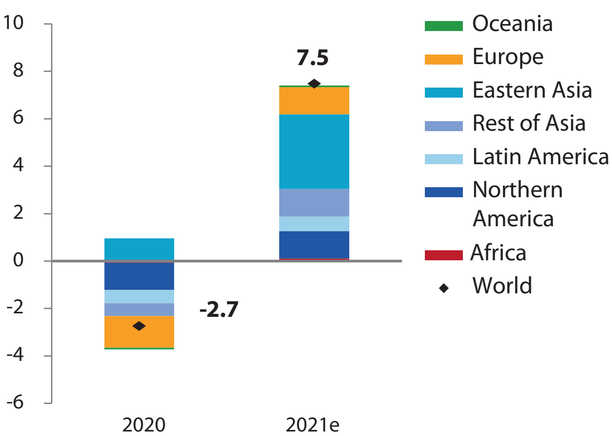
2.4 Weak investment prospects

Amid high uncertainty, investment prospects are weak in most developing countries. Global investment rebounded by 7.5 per cent in 2021, following a contraction of 2.7 per cent in 2020. The strong growth figure, however, was primarily due to a low base and an exceptionally supportive policy environment in most economies. The recovery in investment was highly uneven across countries and regions (figure I.8). Investment growth in China and the United States accounted for more than 50 per cent of the improvement in global investment in 2021. While global foreign direct investment (FDI) rebounded strongly in 2021, almost three quarters of the increase was recorded in developed economies. The recovery in investment was more subdued in developing economies, particularly in LDCs (see chapter III.B).

Recovery in investment is also uneven across sectors. In major developed countries, the rebound in investment was driven mainly by an increase in spending on machinery and equipment (figure I.9). In the United States, the sharp rebound in overall gross fixed capital formation was also attributed to a strong performance in the intellectual property products sector, which includes software and research and development. While the Federal Reserve's shift to a less accommodative policy stance will weigh on investor sentiment, the recently passed Infrastructure Investment and Jobs Act will provide a boost to public investment in the United States going forward. In China, while construction investment is likely to continue slowing, targeted fiscal policies will support investment in technology and innovation.

Global investment growth is projected to slow against a backdrop of high global uncertainty, tighter financial conditions and waning policy stimulus. For many developing countries, elevated public debt and rising borrowing costs will constrain the ability of Governments to sustain large-scale public investment. Private investment across countries will likely be dampened by persistent high uncertainty over the growth outlook, demand conditions and increasing interest rates. Given the weak recovery in revenues, many firms are faced with weak balance sheets and high debt, constraining capital expenditure plans. Compared to before the pandemic, the debt-to-GDP ratio of non-financial corporations has risen sharply across advanced and emerging economies (figure I.10). At the same time, in some countries, heightened geopolitical risks, elevated political uncertainty and social unrest will continue to depress investment prospects. A prolonged period of weak investment will not only weigh on productivity growth, but also threaten progress in all areas of sustainable development.

Figure I.8
Regional contribution to global investment growth
(Percentage points)



Source: UN/DESA.
Note: e = estimates.

Longer-term investment prospects are particularly challenging for developing economies that depend heavily on fossil fuels. Despite the sharp rise in oil and gas prices in 2021, which has extended into 2022 due to geopolitical risks, investment in many large fossil fuel producers has been slow to recover. As the world transitions towards net-zero carbon emissions, these countries face the prospect of significant economic and financial losses. A recent study[23] estimates that fossil fuel assets worth $11 trillion to $14 trillion could become worthless by 2036.[24] Comprehensive plans are therefore needed to ensure that investment promotes economic diversification towards new, low-carbon technology sectors.

2.5 Climate risks

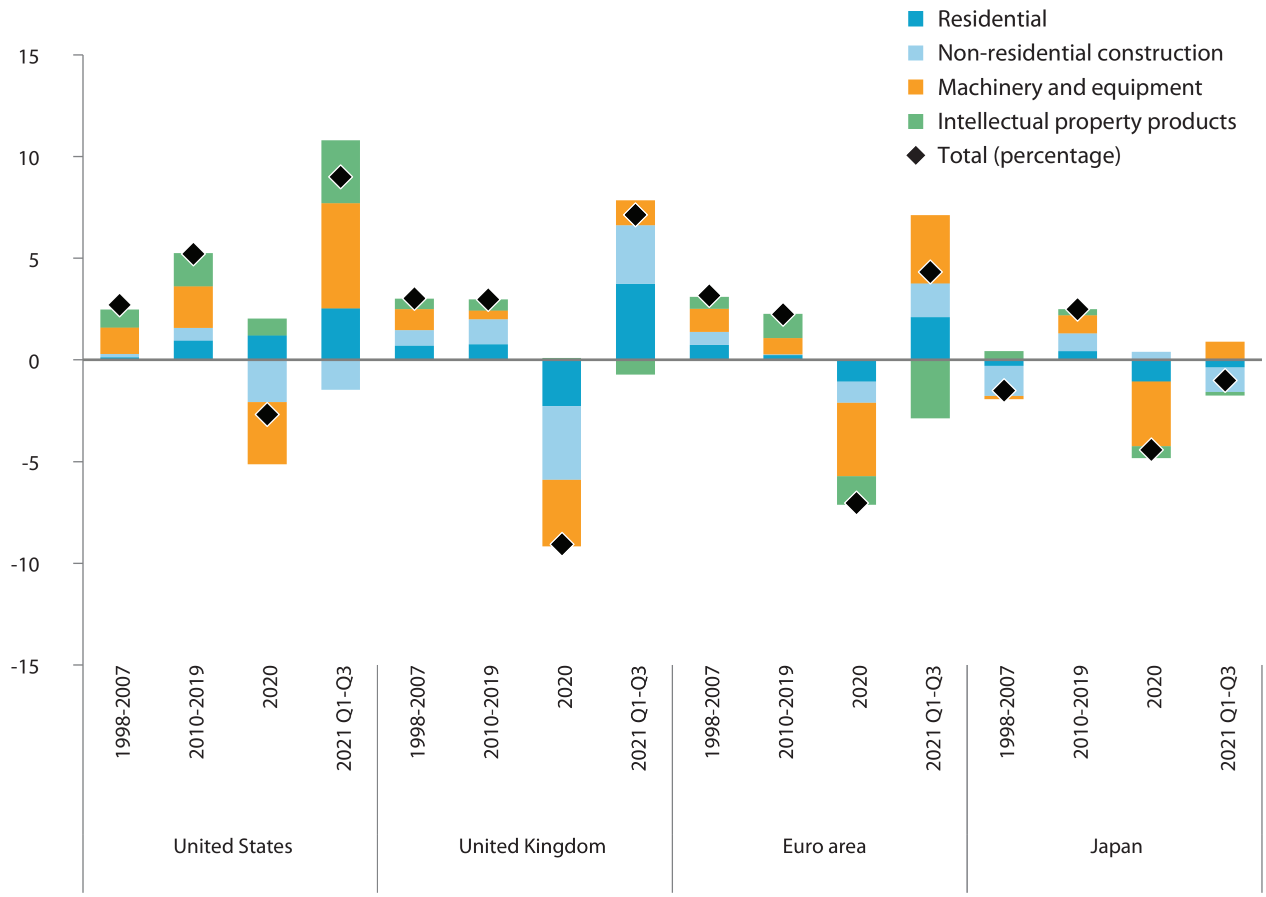
More frequent and intensified climate-related shocks pose a major threat to global development prospects. According to the International Disaster Database,[25] more than 10 million people were affected by storms and heatwaves in 2021. Arctic temperatures recorded a new high of 38°C.[26] Many developing countries—including some with large numbers of extremely poor people[27]—suffered from droughts, threatening people's access to water and nutritious food. After a short period of reduction due to pandemic-related mobility restrictions, carbon emissions have started to increase again, exacerbating climate risks. The Intergovernmental Panel on Climate Change (IPCC) warns that if the current warming rate continues, the world will reach human-induced global warming of 1.5°C around 2040, breaching the Paris Agreement.[28]

Economic damage and losses from climate change are disproportionately higher for already vulnerable countries, leaving these economies further behind. Many of the economies that are highly susceptible to climate-related disasters, including LDCs and SIDS, have limited policy space to provide additional support to the economy following a climate shock. Climate shocks could also exacerbate debt burdens, leaving the affected countries more vulnerable to sovereign debt crises. For SIDS, the economic impact could be disproportionately large as their coastal infrastructure—their lifelines for external trade, food and energy security and tourism—is at high and growing risk of climate change effects. For instance, the annual average loss in capital investment due to disasters in developing SIDS in the Pacific is estimated to be about 18 per cent of their total investment, compared with a 1.9 per cent average loss for all Asia-Pacific countries.[29] Unmitigated climate change would contribute to a widening of inequality between countries.

2.6 Policy options for countries to build back better

Bold and decisive actions are needed at all levels to avert a lost decade for sustainable development. Countries need to create sufficient fiscal space and mobilize financing from all sources to

Figure I.9
Annual investment growth in selected developed economies, by asset type
(Percentage points)

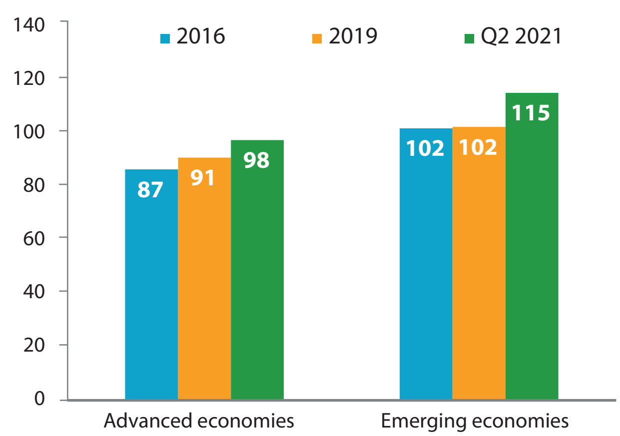


Source: UN/DESA, based on data from CEIC and EuroStat.
Note: Figures are in constant prices. Data for the United Kingdom, euro area, and Japan are total investment, data for the United States are private investment.

avert a protracted crisis and slow recovery, and to invest long term in climate action and the SDGs (see chapter II). Required actions include well-targeted fiscal policies that support a resilient, inclusive and sustainable recovery while preserving fiscal sustainability and contributing to carbon emissions reductions (see chapter III.A). Contributions of private finance and investments to sustainable development must also increase, which can be supported by policy measures to strengthen the investment climate and set appropriate regulatory frameworks (see chapters II and III.B). Concerted efforts by the international community are needed to help developing economies, particularly LDCs and SIDS, address urgent balance-of-payment needs and expand the resources available to finance pandemic recovery efforts and invest in sustainable development (see chapters III.C and III.F).

The Addis Ababa Action Agenda provides a comprehensive framework to address the policy challenges outlined in this chapter. The subsequent chapters of this report highlight progress and implementation gaps in each action area of the Addis Agenda and put forward detailed policy recommendations that can help countries to overcome the current crisis and get back on track to achieve the SDGs.

Figure I.10
Debt of non-financial corporations
(Percentage of GDP)



Source: Bank for International Settlements.

Endnotes

1 This chapter is based on the following reports: *World Economic Situation and Prospects 2022*; *World Economic Outlook Update, January 2022: Rising Caseloads, A Disrupted Recovery, and Higher Inflation*; *World Economic Outlook, October 2021: Recovery during a Pandemic; Trade and Development Report 2021: From Recovery to Resilience: The Development Dimension*; and Global *Economic Prospects, January 2022*.

2 Debt may not be a concern for some commodity-exporting countries due to high global commodity prices.

3 World Tourism Organization. 2022. *UNWTO World Tourism Barometer* (January).

4 Chancel, Lucas, Thomas Piketty, Emmanuel Saez, Gabriel Zucman et al. 2021. "World Inequality Report 2022". *World Inequality Lab*.

5 Azcona, Ginette et al. 2020. "From insights to action: Gender equality in the wake of COVID-19". *UN Women*.

6 See IMF. 2021. *World Economic Outlook* (October).

7 Chapter II of the *World Economic Situation and Prospects 2022* provides a comprehensive assessment of the distributional effects of asset purchase programmes.

8 Sanchez-Paramo, Carolina et al. 2021. "COVID-19 Leaves a Legacy of Rising Poverty and Widening Inequality". *World Bank*. 7 October 2021. Available at https://blogs.worldbank.org/developmenttalk/covid-19-leaves-legacy-rising-poverty-and-widening-inequality.

9 Ahmed, Nabil, Anna Marriott, Nafkote Dabi, Megan Lowthers, Max Lawson, Leah Mugehera. 2022. "Inequality Kills: The unparalleled action needed to combat unprecedented inequality in the wake of COVID-19". *Oxfam International*.

10 Food and Agricultural Organization of the United Nations (FAO). 2021. *FAO Food Price Index*. Rome: FAO.

11 World Bank. 2021. "World Bank: Pandemic Threatens to Drive Unprecedented Number of Children into Learning Poverty". *World Bank*. 29 October 2021.

12 ILO. 2022. *World Employment and Social Outlook Trends 2022*.

13 The ILO (2021) shows that higher rates of vaccination are associated with less stringent workplace restrictions. ILO Monitor: COVID-19 and the World of Work, Eighth Edition. Available at www.ilo.org/global/topics/coronavirus/impacts-and-responses/WCMS_824092/lang--en/index.htm.

14 The ILO (2021) estimates that a 1 per cent increase of annual GDP in the fiscal policy response is associated with 0.3 percentage points increase in working hours. ILO Monitor: COVID-19 and the World of Work, Eighth Edition.

15 For instance, Angola, Bahrain, Belize, Cabo Verde, Congo, Dominica, Egypt, Jamaica, Pakistan, Sri Lanka, Sudan, Zambia entered the pandemic with general government gross debt above 80 per cent of GDP and their discretionary fiscal response to the pandemic during January 2020 and September 2021 was less than 3 per cent of GDP.

16 World Bank and United Nations Educational, Scientific and Cultural Organization (UNESCO). 2021. *Education Finance Watch 2021* (February).

17 United Nations Children's Fund (UNICEF). 2021. *COVID-19 and the Looming Debt Crisis*.

18 UN Women. 2014. *The Global Economic Crisis and Gender Equality*. New York: UN Women.

19 Benedek, Dora et al. 2021. "A Post-Pandemic Assessment of the Sustainable Development Goals". IMF Staff Discussion Note.

20 Central Bank News. Available at http://www.centralbanknews.info/p/eas.html.

21 After reducing the volume of net asset purchases by $15 billion in November and October 2021, the Federal Reserve announced to speed up the tapering process to counter persistently high inflation. From January 2022, net asset purchases are expected to decrease by $30 billion per month and end in March.

22 See for example IMF. 2021. *Global Financial Stability Report* (October).

23 Mercure, Jean-Francois et al. 2021. "Reframing Incentives for Climate Policy Action". *Nature Energy*, 6: 1133–1143. Available at www.nature.com/articles/s41560-021-00934-2.

24 Stranded assets comprise investments, infrastructure, equipment, contracts and know-how that suffer from unforeseen or premature write-downs or devaluation due to the energy transition.

25 International Disaster Database. Available at www.emdat.be.

26 World Meteorological Organization (WMO). 2021. "WMO recognizes new Arctic temperature record of 38°C". *World Meteorological Organization*. Available at https://public.wmo.int/en/media/press-release/wmo-recognizes-new-arctic-temperature-record-of-38%E2%81%B0c.

27 Including Afghanistan, Somalia and Syrian Arab Republic.

28 The Paris Agreement sets long-term goals to limit the global temperature increase in this century to 2 degrees Celsius while pursuing efforts to limit the increase even further to 1.5 degrees.

29 United Nations, Economic and Social Commission for Asia and the Pacific (ESCAP). 2019. *Economic and Social Survey of Asia and the Pacific 2019: Ambitions beyond Growth.* Available at https://www.unescap.org/publications/economic-and-social-survey-asia-and-pacific-2019-ambitions-beyond-growth.

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