



Chapter I



The global economic context and its implications for sustainable development¹

1. Introduction

The global economic outlook remains fragile amid a highly challenging environment. While some of the clouds looming over the global economy may be lifting, the baseline outlook is subject to a high degree of uncertainty. Task Force members are projecting a slowdown in global growth in 2023, but with a wider forecast range compared to the past. On a market exchange rate basis, 2023 global growth forecasts by Task Force members range from 1.9 per cent to 2.4 per cent, following growth of 3.0 per cent in 2022. Downside risks include more persistent-than-expected inflation leading to a wage-price spiral, a sharp and disorderly tightening of global financial conditions and a further escalation of geopolitical tensions.

While inflation is expected to have peaked, monetary policy will remain tight in most countries. The moderation in global commodity prices and China's reopening are expected to ease global price pressures going forward. In recent months, weaker-than-expected inflation has driven expectations for a slower pace of monetary tightening, contributing to improvements in global financial conditions. However, headline inflation is expected to remain elevated in many countries, fuelling concerns that inflation expectations could still become de-anchored. In this environment, central banks are likely to maintain tight monetary policy stances.

Countries are facing difficult monetary and fiscal policy trade-offs. Elevated inflation has prompted central banks across the world to embark on aggressive monetary tightening despite incomplete economic recoveries from the COVID-19 pandemic. The rapid tightening of global financial conditions has also fuelled debt sustainability concerns in a number of developing countries (see chapter III.E). High borrowing costs will be particularly damaging for countries with already large

debt service burdens and foreign currency denominated debt. Public finances of countries that rely heavily on commodity imports have been particularly strained by the increase in food and energy prices. As fiscal consolidation pressures intensify, there is a risk of significant delays or cutbacks to investment in sustainable development, including in climate action. Moreover, fiscal retrenchment often entails cuts to social expenditure which disproportionately hurts the most vulnerable populations, including women and children.

Recent shocks are threatening to further reverse progress on the Sustainable Development Goals (SDGs), especially for the poorest and most vulnerable countries. The war in Ukraine and the pandemic have reversed years of progress across many areas of sustainable development, including poverty, healthcare and education. Some of the world's most vulnerable countries, including the least developed countries (LDCs) and small island developing States (SIDS), have been the hardest hit by the recent confluence of crises. Many of these economies also face the highest risk of losses and damage due to the increasing frequency and severity of climate-related shocks. The sharp rise in inflation has also caused real wage growth to turn negative in many countries, eroding the purchasing power of households with a stronger impact on low-income groups. Soaring food and energy prices have pushed tens of millions more people into extreme poverty and acute food insecurity. The highly challenging macroeconomic environment has also not been conducive to productive and sustainable investments, posing a setback to countries' pursuit of sustainable and inclusive structural transformation (see chapter II). As policy space narrows, many developing countries are at risk of falling into a vicious cycle of weak growth, unsustainable debt and austerity. Other ongoing structural shifts in

the global landscape, including the accelerated pace of digitalization and the changing nature of jobs (see chapter II), could exacerbate inequalities, leaving already disadvantaged segments of society further behind.

Investment prospects in most developing countries remain weak, raising the risk of deeper and more protracted scarring.

Since the onset of the COVID-19 pandemic, many developed economies have announced large fiscal packages, which include increases in public investment, in order to support their economic recoveries. In contrast, developing countries have been more constrained, with many of the poorest forced to cut spending in areas such as infrastructure and education. For the developing countries, a prolonged period of subdued investment is exacerbating already large climate and SDG investment gaps.

On a national level, governments need to address the immediate needs of vulnerable groups and invest in the SDGs, while preserving fiscal sustainability. Countries will need to strike a delicate policy balance to rein in inflation without derailing growth. They also need to address the immediate crisis while also investing in long-term productivity and the SDGs. Such investments can create jobs in the near term and lead to a virtuous cycle of increased growth and tax revenues, while improving long-term debt ratios (see previous *Financing for Sustainable Development Reports*). Domestic macroeconomic and financial policies should also be better aligned with the SDGs, while considering the growing interlinkages between economic, social and environmental risks.

Stronger international cooperation is needed to mitigate the long-term impact of multiple crises and to promote a sustainable recovery. Bold and decisive global policy efforts are needed to address the multitude of challenges faced by developing countries. This includes efforts to better manage spillovers from developed country policies, address looming debt distress risks, boost investment in the SDGs, accelerate climate action and support people affected by crises and hunger.

2. Outlook and risks for the global economy

2.1 Global and regional growth trends and outlook

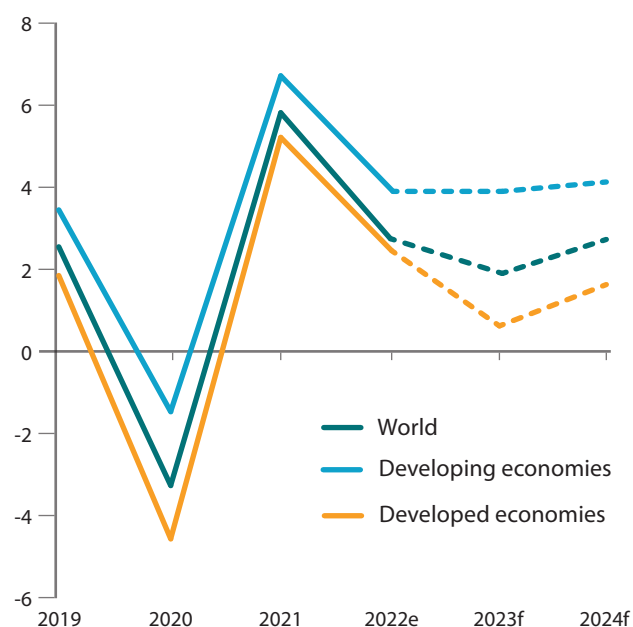
The world faced a series of severe and mutually reinforcing shocks in 2022, causing the global economic recovery to lose momentum.

World output growth slowed from 5.8 per cent in 2021 to 3.0 per cent in 2022. The war in Ukraine triggered a global cost-of-living crisis at a time when most economies were still struggling to recover from the pandemic. Acute supply disruptions drove up food and energy prices to record levels, impacting the most vulnerable populations the hardest. With global inflation reaching a two-decade high of 9.0 per cent in 2022, most central banks worldwide tightened their monetary policy stances in efforts to contain demand-side inflationary pressures. The rapid pace of interest rate hikes by the United States Federal Reserve generated strong spillovers on developing countries, with many experiencing bouts of sizeable capital outflows and currency depreciations during the year. Investor risk appetite was also dampened by the uncertain growth outlook, persistent inflation and continued geopolitical tensions. The sharp tightening of global financial conditions has increased balance of payment pressures and debt

vulnerabilities in many developing countries. By the end of 2022, nearly 60 per cent of all low-income countries were at high risk of or in debt distress (see chapter III.E).

The global growth momentum is expected to weaken further in 2023 before rebounding modestly in 2024. *The United Nations World Economic Situation and Prospects 2023* projects that global growth will decelerate to 1.9 per cent in 2023 (see figure I.1),² marking one of the lowest growth rates in recent decades. As some of the current global headwinds subside, world output growth is expected to pick up to 2.7 per cent in 2024. The outlook, however, remains highly uncertain, which is reflected in the differences in growth projections across the Task Force members. While downside risks, such as stubbornly high inflation, remain, there are also upsides to the global growth outlook. These include a more rapid pace of disinflation allowing for less monetary tightening, a more measured slowdown in domestic demand in Europe and the United States (in part due to the mild winter), and a stronger-than-expected recovery in China buoyed by the reopening of the economy. The projected slowdown in global growth in 2023 largely reflects the impact of synchronous monetary policy tightening on demand as well as the economic effects of the war in Ukraine. In developed economies, aggregate growth is expected to slow to 0.4 per cent in 2023, from 2.6 per cent in 2022. The United States and Europe are expected to experience slower economic activity as higher interest rates and lower real incomes constrain consumer spending and investment. In several European countries, continued energy supply disruptions will keep gas and electricity prices elevated, reducing the purchasing power of households and raising firms' production costs.

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



Source: UN DESA.
Note: e = estimates, f = forecasts.

Recent shocks have had a differentiated impact on countries. Growth in developing countries as a group is expected to be sustained at 3.9 per cent in 2023, but growth prospects vary significantly across regions and countries. Persistently high food and fuel prices will weigh on household expenditure in all regions to varying degrees. Elevated energy prices are projected to lend support to the economic recovery of energy exporters, including in Western Asia. Tighter global financial conditions and domestic monetary policy stances are expected to have the most pronounced effects on countries with pre-existing macroeconomic vulnerabilities. Net commodity importers, including many countries in Africa and South Asia, will continue to be affected by elevated global commodity prices. In China, domestic demand is projected to strengthen in 2023, buoyed by the lifting of pandemic restrictions and more accommodative policies. While this will benefit many of the East Asian economies, given deep trade and financial linkages with China, the region's trade prospects are dampened by weaker demand from the major developed economies. For many vulnerable developing countries such as the LDCs, recent global shocks will greatly exacerbate challenges towards sustainable development. Many of these countries face significant fiscal constraints and rising debt vulnerabilities, hindering their ability to mitigate the impact of shocks on their domestic economies.

The global food crisis has hit vulnerable countries the hardest. In the aftermath of the COVID-19 pandemic, global food prices were on an upward trend, buoyed by the recovery in global demand, higher prices of fertilizer and fuel, higher transportation costs and supply chain disruptions. In March 2022, global food prices soared to a record high as the war in Ukraine caused severe disruptions to global food production and distribution. The UN Food and Agriculture Organization's Food Price Index showed that food prices were 50 per cent higher in 2022 compared to 2019.³ Over 90 per cent of developing countries experienced food price inflation of over 5 per cent, while a large number of countries in Africa, Latin America and the Caribbean, and South Asia are contending with double-digit food price increases. The number of people facing acute food insecurity has more than doubled compared to pre-pandemic levels, rising from 135 million in 2019 to a projected 345 million in 2023.⁴ Although global food prices have been on a downward trend since the second half of 2022, they remain elevated compared to pre-pandemic levels. Food inflation affects low-income groups the most as up to half of their household expenditure is on food items. In addition to the devastating impact on human lives, the food crisis also entails large economic costs. In 2022, the world food import bill reached a record high, surpassing \$1.94 trillion. For the 48 countries most affected by the war in Ukraine, most of which are low-income countries, higher food and fertilizer prices are estimated to add \$9 billion to their import bills in 2022 and 2023, leading to a sharp deterioration in balance of payment positions.⁵ International efforts such as the Black Sea Grain Initiative have helped to ease global food supply shortages, while the IMF's new food shock window has eased urgent financing pressures in some of the hardest-hit countries. However, weak global growth, persistent conflicts and the intensifying impact of climate shocks will continue to weigh heavily on the global food security outlook.

The challenging global growth outlook will continue to set back progress towards higher living standards. In per capita terms, global growth slowed from 5.0 per cent in 2021 to 2.1 per cent in 2022 and is projected to weaken further to 1.0 per cent in 2023. By region, per capita income losses compared to pre-pandemic projections have been the largest in South Asia (see figure I.2a). Given limited policy buffers and

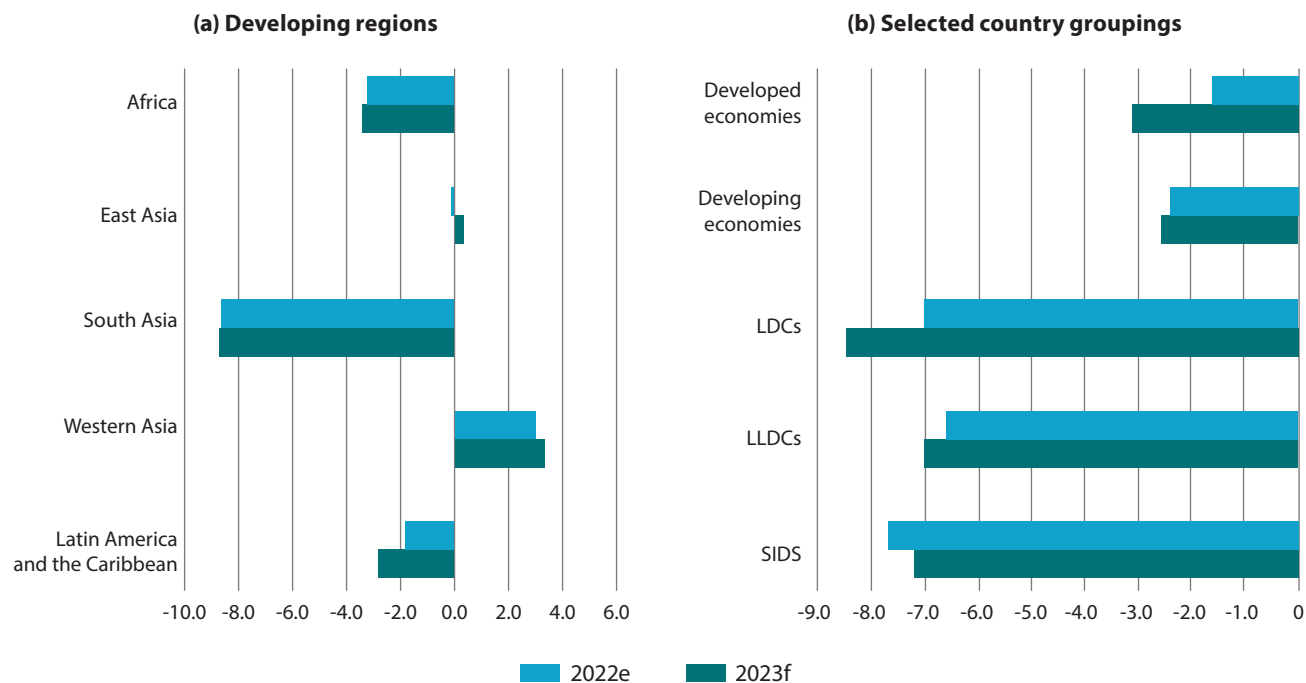
large external imbalances, shocks emanating from higher food and energy prices as well as rising interest rates have triggered economic crises in a few countries, pushing families into hunger and poverty for the first time. In contrast, income per capita in Western Asia has exceeded levels projected before the pandemic as higher-than-expected global oil and gas prices benefited fuel exporters. By country groupings, developed countries experienced smaller output-per-capita losses in 2022 compared to developing countries (see figure I.2b), due in part to larger fiscal support measures to buffer the impact of the pandemic and cost-of-living crises. In 2023, however, tighter monetary policies and elevated energy prices are expected to have a stronger impact on growth in the developed countries, resulting in higher output losses compared to developing countries. Importantly, such losses are expected to remain persistently high for the developing countries that were already lagging behind. Many LDCs, landlocked developing countries (LLDCs) and SIDS have been impacted by the sharp rise in global commodity prices, given their high dependence on imports of these items. These countries also remain highly susceptible to damage caused by natural disasters and extreme weather events. Country-specific shocks, including economic and political crises, have also dampened the growth outlook in a few countries. For the SIDS, international travel has yet to fully recover from the pandemic.

Global progress towards poverty eradication has stalled. The pandemic and the war in Ukraine have reversed almost three decades of progress in poverty reduction. A new report by the World Bank found that in 2020 alone, the global extreme poverty rate rose from 8.4 per cent to 9.3 per cent as the pandemic drove 70 million more people into extreme poverty.⁶ In 2022, poverty reduction faced a stronger setback amid weaker global growth and elevated inflation. An additional 70 to 89 million people were living in extreme poverty in 2022, compared to pre-pandemic projections. Given current trends, 574 million people—nearly 7 per cent of the world's population—will still be living in extreme poverty in 2030. Against this backdrop, global inequality has also risen for the first time in decades.⁷ In 2020, income losses of the poorest 40 per cent of the world's population were double that of the richest 20 per cent.

The recovery in global labour markets is at risk given the challenging economic environment. As pandemic-era restrictions were lifted, global hours worked rebounded in 2021 and early 2022 (see figure I.3). Amid weakening economic growth and sentiments, however, the recovery subsequently reversed, as reflected in lower vacancies and slowing employment growth in several countries, including the United States. Across countries, differences in the pace of labour market recovery remain large. In most developed countries, employment has reached or surpassed pre-crisis levels with employers facing labour shortages. In contrast, many developing countries have not yet recovered to pre-pandemic levels of hours worked. This is attributed, in part, to the lack of policy support, including job retention schemes and wage subsidies to help businesses and workers weather the multiple crises. Elevated inflation will continue to erode the purchasing power of workers, with global real wages falling by 0.9 per cent in the first half of 2022.⁸ Minimum wage earners will be hit the hardest, while the number of working poor is expected to increase.

The asymmetric impact of recent shocks on labour markets has also worsened inequalities within countries. Recent crises have inflicted stronger and more long-lasting damage on already disadvantaged groups of workers, including women, youth and low-skilled workers.

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

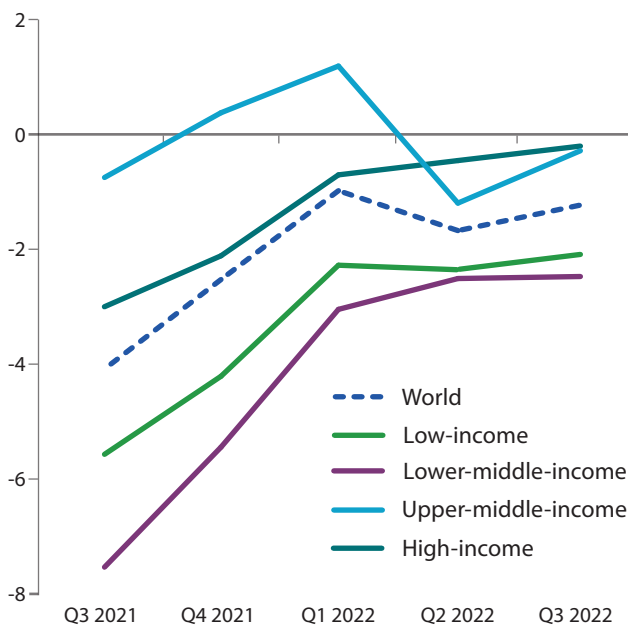


Source: UN DESA.
 Note: e = estimates, f = forecasts.

In 2022, employment in many high-skilled jobs (including managers, professionals and technicians) had already surpassed pre-pandemic levels, but employment in many low- and medium-skilled occupations has yet to recover (see figure I.4). At the same time, informal employment, where workers often lack social protection, has been recovering at a strong pace, particularly in low- and low-middle-income countries. This could jeopardize the trend towards formalization that has been observed over the past 15 years.⁹ While women experienced a stronger rebound in employment following the pandemic, this recovery has been mainly driven by informal employment. In 2022, four out of five jobs created for women were informal.¹⁰ Meanwhile, young people continue to face significant challenges in securing decent employment. Youth employment was hit particularly hard during the pandemic and its recovery remains far behind that of adults, with more than one in five young people not in education, employment or training.¹¹

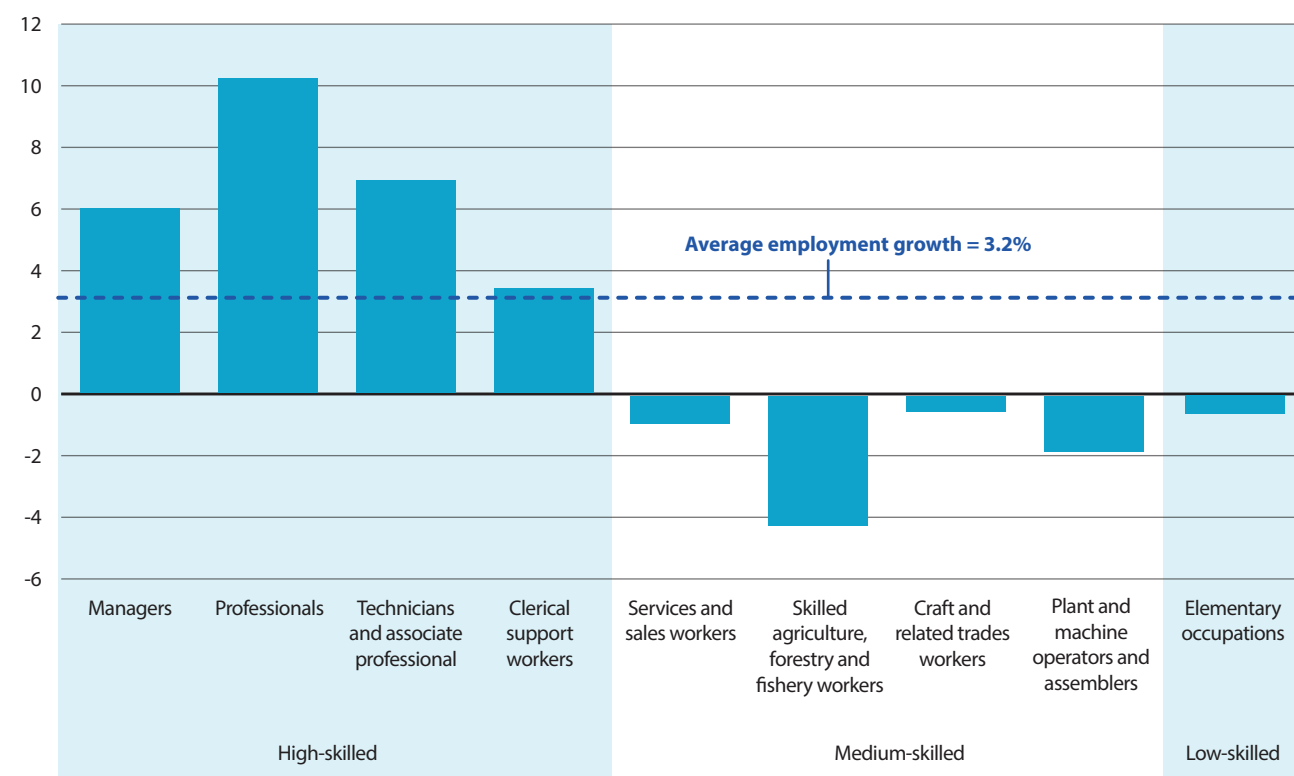
The worsening effects of climate change pose a major risk to global development prospects. According to the International Disaster Database,¹² climate and weather disasters over the last decade were over four times more frequent compared to 50 years ago. Fuelled by rising greenhouse gas concentrations, the past eight years have been the warmest on record.¹³ Global carbon emissions continued to rise in 2022, exceeding pre-pandemic levels. Extreme weather events such as heat waves, floods and droughts have become more frequent and intense, leading to substantial human and economic costs. These costs are disproportionately higher for already vulnerable countries, particularly the LDCs and SIDS. The impact of climate-related disasters has also been pronounced

Figure I.3
Changes in hours worked by country income group
 (Percentage)



Source: ILO.

Figure I.4
Employment growth rates by occupation, 2Q 2019 - 2Q 2022
 (Percentage)



Source: ILO.

for countries that are reliant on the agriculture sector. Between 2008 and 2018, 26 per cent of the overall effects of climate change loss and damages affected the agriculture sector—including agriculture, forestry and fishery.

Deepening interlinkages between environmental, social and economic challenges highlight the need for comprehensive policy action. For example, the adverse impacts of climate change on economic outlooks have become evident. For the LDCs and SIDS, individual disasters can amount to multiples of GDP, while the return needed to compensate for the increased exposure to disasters raises their cost of commercial financing.¹⁴ Climate shocks also deplete fiscal buffers and exacerbate debt burdens, leading to a higher risk of sovereign debt crises with substantial economic costs. At the same time, economic policy choices can affect environmental and social outcomes. In countries with rising poverty rates, there is a risk that people may be driven towards the use of cheaper but dirtier energy, posing major setbacks to the renewable energy transition. In addition, the deterioration in economic conditions, such as weakened income and job prospects, has the potential to trigger social unrest.

2.2 Monetary and financial stability risks

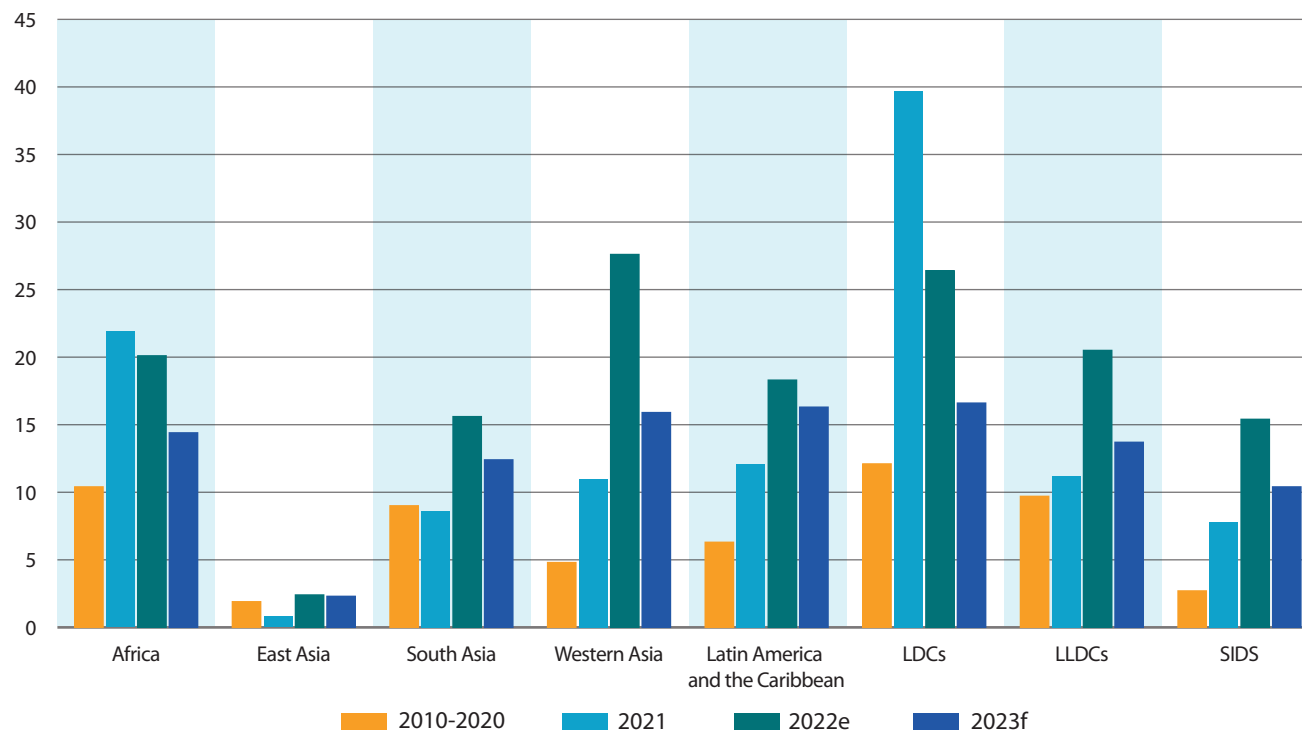
Elevated inflation has prompted rapid and synchronous global monetary policy tightening. Global inflation surged to 9.0 per cent in 2022, with headline inflation reaching multi-decade highs across regions and countries (see figure I.5). Global inflation has been fuelled by supply shocks, including disruptions to global supply chains and commodity

markets, as well as demand pressures, including from earlier policy support measures. To contain inflationary pressures and anchor price expectations, central banks worldwide have pivoted towards sharply tighter monetary policy stances. In 2022, central banks across the major developed economies hiked interest rates (see figure I.6a), with a main exception being the Bank of Japan. The United States Federal Reserve raised the federal funds rate from near zero to a target range of between 4.25–4.50 per cent, its highest level in 15 years. The cumulative 425 basis points rate hike also marked its most aggressive pace of monetary tightening since the 1980s. The Federal Reserve also accelerated its pace of balance sheet reduction, further tightening liquidity conditions. The European Central Bank increased its main refinancing operations rate by a cumulative 250 basis points in 2022 to 3.0 per cent and announced that it would begin to trim its holdings of bonds bought under its Asset Purchase Programme from March 2023 onwards.

For many developing countries, capital outflows and currency depreciations compounded pressures to raise interest rates.

Despite incipient recoveries from the pandemic, central banks in 85 per cent of developing economies hiked policy rates in 2022 (see figure I.6b). In addition to rising domestic inflation, developing country central banks also had to contend with cross-border spillovers from higher policy rates in the major developed countries. Narrowing interest rate differentials and higher investor risk aversion drove capital outflows and the weakening of domestic currencies, particularly in March 2022 when the Federal Reserve introduced its first policy rate increase in over three years. In October 2022,

Figure 1.5
Inflation in developing countries and selected country groupings
 (Percentage)



Source: UN DESA, based on estimates and forecasts produced with the World Economic Forecasting Model.

Note: e = estimates, f = forecasts. Data for Latin America and the Caribbean excludes the data for Venezuela (Bolivarian Republic of).

the United States dollar index rose to its highest level on record in nominal terms, but gradually retreated as the Federal Reserve's monetary tightening became less aggressive towards the end of 2022 and into 2023. However, as of 17 February 2023, the index is still 6.6 per cent higher than its 2021 average.

The performance of financial markets differed considerably between developing countries as investors scrutinized each country's fundamentals. Financial markets were subject to stronger pressures in commodity-importing countries, particularly those with inherent structural and policy weaknesses. For many of these economies, the weakening of domestic currencies against the dollar not only increases the burden of servicing debt denominated in foreign currencies, but also exacerbates challenges caused by higher international prices for food, fuel and fertilizer. In 2022, about one fifth of developing economies liquidated more than 15 per cent of their international foreign reserves to cushion the pressure on domestic currencies, with larger losses faced by countries with large macroeconomic imbalances and higher inflation.¹⁵

As inflation is expected to have peaked in 2022, several central banks have slowed or paused monetary tightening. The prices of many commodities have softened, while China's reopening is expected to ease global supply chain disruptions. However, headline inflation is expected to only moderate gradually and will remain elevated and above central bank targets in the near term. Given persistent risks to price stability, a few major developed country central banks have stated that policy rates will be kept higher for a longer period of time. Many developing country central

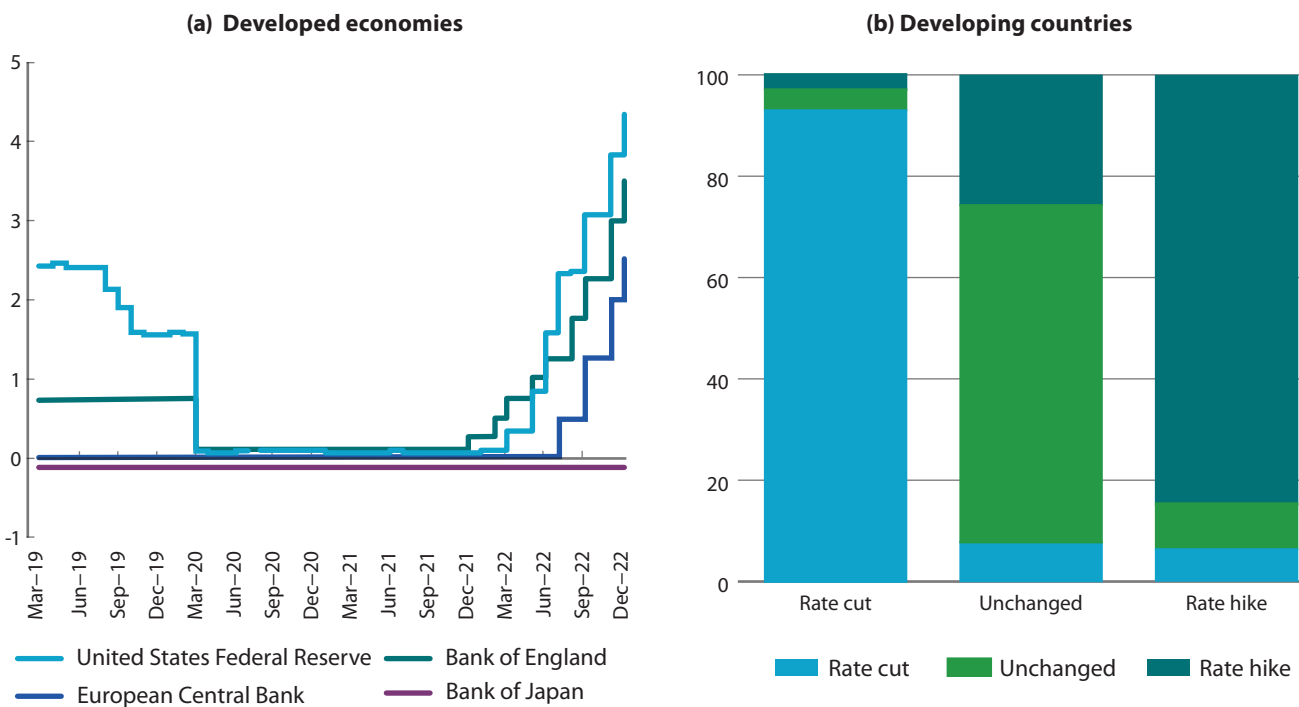
banks are also likely to maintain relatively tight monetary policy stances to prevent a de-anchoring of inflation expectations.

The rapid withdrawal of monetary support has helped to rein in inflation, but has contributed to higher financial stability risks.

Uncertainty over the magnitude of policy tightening exacerbated already weak investor risk sentiment generating intensified financial pressures for many developing economies. The 25 emerging economies tracked by the Institute of International Finance cumulatively experienced a reversal of non-resident portfolio flows for five consecutive months (see figure 1.7) in 2022. Trends, however, were mixed across regions and countries. China experienced large debt outflows, amid COVID-19 restrictions and slowing economic activity. At the same time, several Latin American and Western Asian economies benefited from high global commodity prices, while capital flows to a few other emerging economies were affected by domestic political and policy uncertainties.

Tighter global financial conditions have further constrained the fiscal space of developing countries. The increase in borrowing costs and broad-based strengthening of the dollar have exacerbated debt vulnerabilities for many developing country governments. In 2022, the local currency bond markets of emerging economies saw large net non-resident portfolio outflows, with yields surging to the highest in a decade.¹⁶ Between January and November 2022, 20 emerging economies (excluding China) collectively experienced outflows of \$27.0 billion from local currency non-resident government debt, in contrast to the \$25.6 billion of inflows received in the previous year.¹⁷ Hard currency yields of emerging market

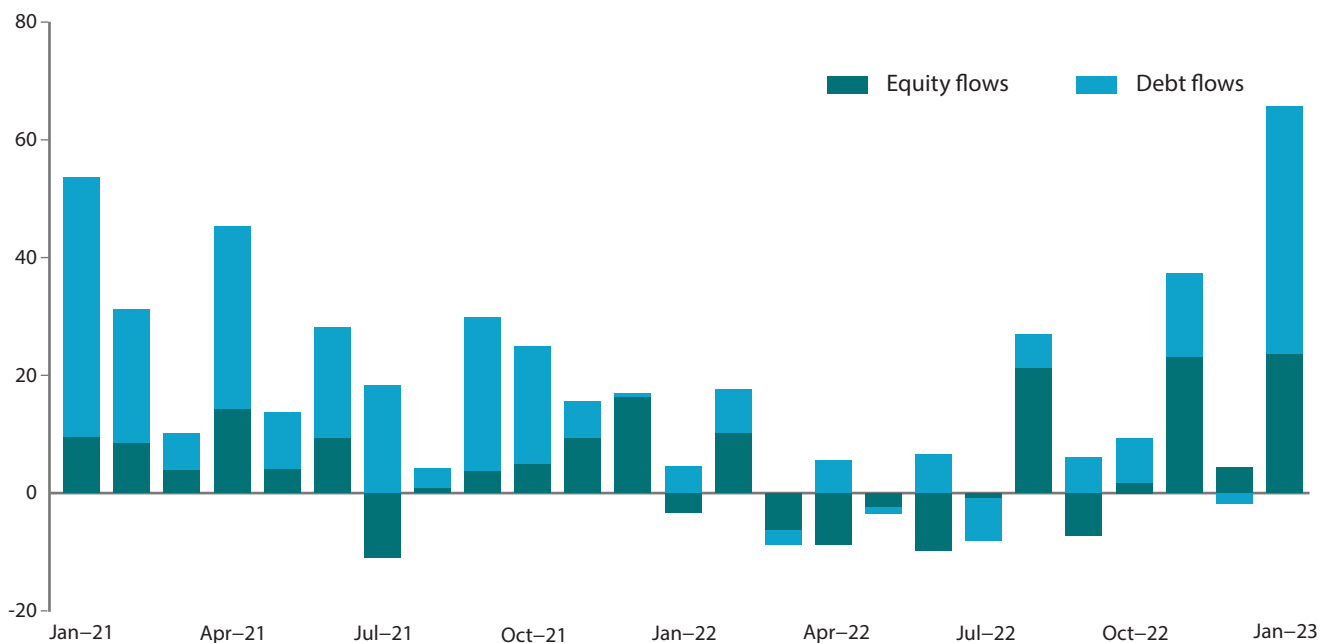
Figure I.6
Central bank policy rates
 (Policy rate, percent)



Source: CEIC.

Source: UN DESA, based on data from CEIC.
 Note: Based on a sample of 45 developing countries across all regions.

Figure I.7
Non-resident portfolio flows to emerging economies
 (Billions of United States dollars)



Source: Institute of International Finance.

sovereign bonds have also increased, with 22 per cent of issuers trading on the secondary market with spreads above 1,000 basis points and 30 per cent having yields above 10 per cent¹⁸ (see chapter III.E).

Despite recent improvements, financial markets remain susceptible to renewed turbulence and stress. Global financial conditions have eased somewhat in recent months as weaker-than-expected inflation drove expectations for a slower pace of future monetary tightening.¹⁹ However, given high uncertainty and a fragile growth outlook, financial stability risks remain elevated (see box I.1). The protracted period of low interest rates since the 2008 world financial and economic crisis incentivized financial risk-taking and investors' "search for yield", contributing to the build-up of leverage in financial markets to record highs. However, amid the rapid increase in interest rates and deterioration in investor risk appetite, conditions in leveraged finance markets have deteriorated significantly. In the United States, corporate credit spreads widened sharply, and leveraged loan issuances dropped to post-global financial crisis lows during 2022.²⁰ A disorderly correction in global financial markets could destabilize domestic financial conditions while exacerbating vulnerabilities in developing countries. In this context, policymakers can deploy a range of policy tools, including macroprudential and capital flow management measures, to mitigate the effects of large and disruptive capital flows. Clear and transparent communication of monetary policy decisions by the major developed economies can also help to reduce adverse spillovers on developing economies. The increasing presence of financial technology (fintech) in the global financial landscape also presents both opportunities and risks. A case in point is the growing volatility of cryptoassets, which could be a source of systemic risk in the future (see chapter III.F).

Central banks have to strike a delicate policy balance between reining in inflation and preserving growth. Against this backdrop, risks of policy mistakes are high. The rapid and synchronized monetary tightening by major central banks led to a sharp withdrawal of liquidity from markets, generating significant negative spillovers on developing countries. An overtightening of monetary policy would drive the world economy into an unnecessarily harsh slowdown. This risk, however, could be mitigated if central banks consider the reciprocal impacts of similar rate hikes by others. The current environment of elevated global inflation has raised discussions over whether central banks should revisit strict inflation targets in order to enhance policy flexibility while ensuring the continued credibility of monetary policy. When doing this, however, clear and effective central bank communication is necessary so that price expectations remain well anchored.

2.3 Deterioration in public finances

Soaring food and energy prices in 2022 drove governments to introduce a range of new fiscal measures to support households and businesses. While pandemic-related stimulus has been gradually withdrawn, many countries rolled out new support measures in response to high inflation. In most countries, the new measures, which included tax cuts, subsidies and cash handouts, amounted to more than 0.5 per cent of GDP.²¹ In many cases, however, support to households has been insufficiently targeted towards those most in need, leading to what some consider unnecessarily high spending and potentially adding to inflationary pressures.²² The cost-of-living crisis has exerted further pressure on developing country governments whose budgets were already strained by

Box I.1

Turbulence in the banking sector

Banking failures in the United States and Switzerland in March 2023 have once again highlighted risks in the financial sector, shortcomings in financial institutions' risk management practices and potential gaps in regulatory and supervisory systems. The past several *Financing for Sustainable Development Reports* warned about the risk rising interest rates could pose to financial sector stability. Maturity mismatches and leverage—which are inherent to the financial system—increased during the prolonged period of low interest rates and the search for yield among investors. How and where these risks would materialize was difficult to identify. Much of the analysis focused on risks in the non-bank financial sector, where institutions are generally subject to less prudential regulation (see chapter III.F).

Though the banks that failed each had unique weaknesses, common factors include inadequacies in both internal risk management and external supervision. Rising interest rates exposed balance sheet weaknesses and triggered depositor withdrawals, cascading into liquidity spillovers across the sector. Policymakers acted decisively to address the financial stability risks, including by dealing on a timely basis with the failing banks and enhancing the provision of dollar liquidity to banks and cross-border to other central banks.

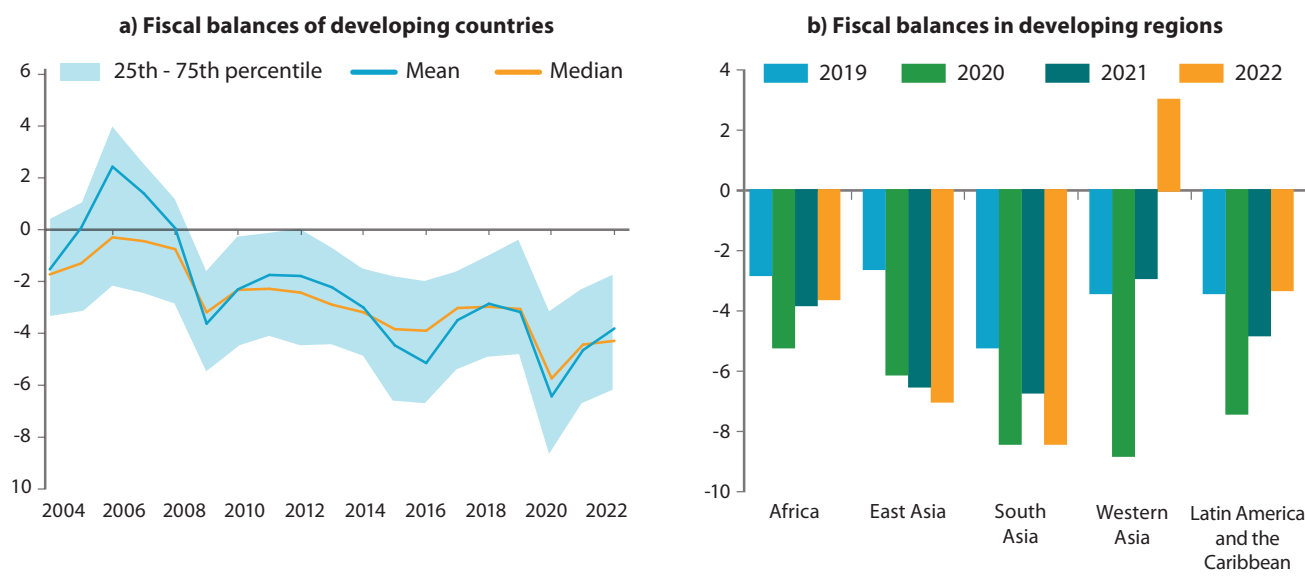
The recent developments have complicated monetary policy. Central banks are often mandated to maintain both price stability and financial stability. Interest rate hikes in pursuit of the first goal could cause further instability if not well managed. On the other hand, slowing down or abandoning interest rate hikes could risk de-anchoring inflation expectations.

Looking forward, economic growth prospects for developed economies face greater uncertainty and downside risks, which could impact global growth and implementation of the SDGs. While direct contagion to developing country banking sectors from the current financial market stress is not imminent, rising global interest rates have also amplified capital flow volatility and risks (such as those due to currency mismatches, see chapter III.F). It is also unclear if there are more pockets of risk that will be exposed by ongoing tightening of financial conditions, such as in the non-bank financial sector.

the pandemic, and many of which have seen a steady deterioration of fiscal balances since the 2008 world financial and economic crisis (see figure I.8a). In 2022, most developing regions continued to experience large fiscal deficits (see figure I.8b).

The rapid tightening of global financial conditions has contributed to an increase in debt service burdens. The increase in global interest rates and strengthening of the dollar have raised the debt service costs of developing countries, leading to an increase in refinancing and roll-over risks. As interest burdens rise, an increasing share of government revenues are being devoted towards debt service, reaching about 2 per cent of GDP and 10 per cent of public revenues in 2022 on average. Governments in about a dozen countries, including several large developing economies, were estimated to have spent more than 20 per cent of revenues on interest payments during the year. In Africa, debt servicing

Figure I.8
Fiscal balances
(Percentage of GDP)



Source: UN/DESA, based on data from the IMF World Economic Outlook database, October 2022.

Note: Regional and country group averages for panel b) are unweighted averages across countries. Median values show similar trends.

on public and publicly guaranteed external debt rose from 3.1 per cent in 2011 to 10 per cent of government revenues in 2021. For a large number of developing countries, the increase in debt servicing costs is diverting resources away from crisis response and investments towards supporting a sustainable recovery (see chapter III.E).

Debt distress risks have risen, particularly for developing countries that are already in vulnerable situations. In 2022, rising interest rates and import bills pushed several countries into debt default, including a few middle-income countries. Amid volatile investor sentiment and weak revenue prospects, more countries may effectively lose access to international capital markets. The share of low-income countries that are at high risk of or in debt distress has more than doubled, from 27 per cent in 2015 to almost 60 per cent in 2022 (see chapter III.E).

As fiscal space narrows further, governments are facing increasingly difficult trade-offs in prioritizing competing spending needs. Trade-offs are particularly acute for countries with already elevated debt vulnerabilities and very limited fiscal space. Even in the immediate aftermath of the pandemic, many developing countries were constrained in their ability to effectively manage the health and economic crisis. In 2020 and 2021, total fiscal support of the developed economies amounted to \$12,200 per capita, in stark contrast to \$410 per capita in the developing economies and a mere \$20 per capita in the LDCs. Mounting fiscal pressures will constrain national capacities to invest in sustainable development, including in the areas of health, education, physical and digital infrastructure, and the energy transition.

Nonetheless, fiscal austerity would disproportionately harm the poorest and most vulnerable. As countries face rising fiscal pressures, there is a risk of a widespread shift towards fiscal austerity, which would be costly and potentially self-defeating. Fiscal consolidation tends to be

associated with lower social spending, disproportionately hurting the most vulnerable. Cuts to fiscal expenditure often entail the scaling down of programmes that benefit women more than men, resulting in income losses for women, restricting their access to healthcare and education, and increasing unpaid work and time poverty. Such impacts further exacerbate the already dire situation of those who have yet to regain employment due to the fragile economic recovery. In addition, further reductions to spending on education will inflict more harm on already disadvantaged students, widening learning inequalities. In 2022, the share of education in public budgets declined in low- and lower-middle-income countries, despite students still struggling with significant learning losses due to the pandemic.²³ This contrasts with the situation in developed economies where education as a share of government budgets in 2022 exceeded the 2019 level. In many developing countries, the channelling of financial resources towards pandemic response resulted in cuts to other healthcare services, including for the prevention and treatment of infectious diseases such as malaria, cholera, HIV/AIDS and tuberculosis.²⁴ As public finances become increasingly stretched, countries need to generate the fiscal space needed to support the SDGs but not at the expense of the already vulnerable. It is imperative that governments do not cut social protection programmes during periods of fiscal consolidation. Pro-growth fiscal measures include raising revenues from windfall taxes on fossil fuels and the removal of inefficient subsidies, and channelling this revenue towards strengthening social protection schemes as well as the provision of essential public goods and services (see chapter III.A).

2.4 Weak investment prospects

Global investment growth is likely to remain subdued amid rising borrowing costs and high uncertainty. In several developed countries, including the United States, the euro area and Japan, the growth of total

gross fixed capital formation in 2022 was dampened by a contraction in residential and non-residential investment. However, this was partially offset by increased investment in intellectual property products (see figure I.9). Looking ahead, heightened global uncertainty will continue to weigh on private investment in developed economies. However, investment growth in several major economies, including the United States and euro area, will be supported in part by government policies to boost infrastructure and green investments.

Weak investment prospects in developing countries follow a widespread slowdown in investment growth over the past decade.

Foreign direct investment (FDI) in developing countries is also projected to extend its weakness into 2023,²⁵ further hindering capital accumulation. The recent succession of global shocks has disproportionately affected investment flows to the poorest countries, with FDI flows to the LDCs contracting by 30 per cent in 2022.²⁶ The subdued investment outlook follows a trend of stagnating investment in many developing countries over the past decade. Between 2010 and 2021, gross fixed capital formation in per capita terms stagnated in Africa and declined by almost 20 per cent in Latin America and the Caribbean (see figure I.10). Weak fiscal positions were already a constraint on public investment even prior to recent crises. In the five years before the pandemic, about half of the countries in Latin America and the Caribbean and one third in Africa experienced a decline in public investment in real terms.

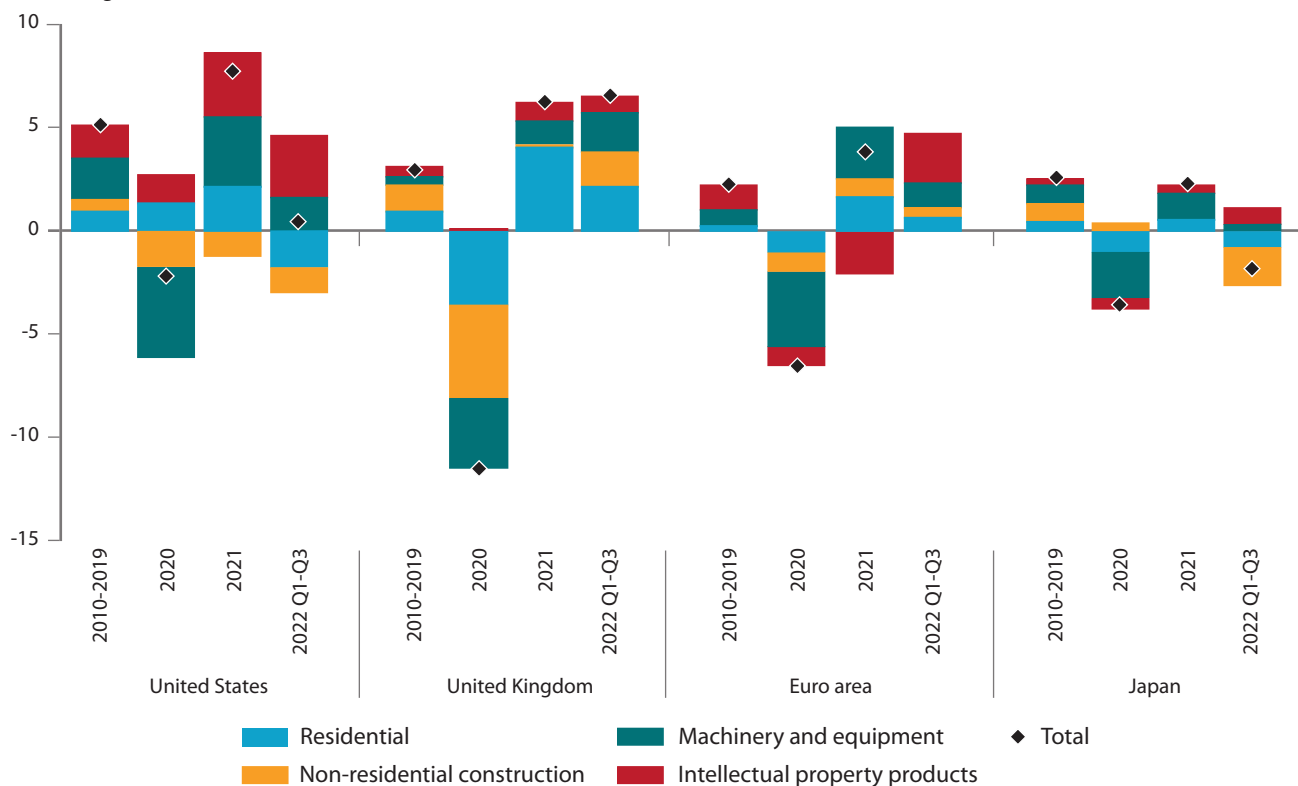
A prolonged period of subdued investment will dampen productivity growth, contributing to deeper and more persistent economic scarring.

While developed economies were able to roll out large fiscal stimulus packages to support their recoveries from the pandemic-induced recessions, many developing countries are faced with protracted scarring to potential output, amid larger cumulative investment and output losses.²⁷ Recent overlapping shocks have further exacerbated already wide investment gaps in many developing countries, threatening to further derail progress towards sustainable development. A strong push towards productivity-enhancing structural reforms is needed to mitigate the scarring effects from the pandemic and other recent shocks. These include sustainable industrial and financial policies which are key to boosting the necessary public and private investments for countries to progress towards sustainable and inclusive structural transformation (see chapter II).

Countries' efforts to bolster energy security drove two competing trends in energy investment, with implications for the green transition.

In 2022, investment in clean energy is estimated to have exceeded \$1.4 trillion, accounting for almost three quarters of the growth in overall energy investment (see figure I.11). While this is an important step in the right direction, it is still well short of what is required to hit international climate goals. Moreover, the increase in clean energy investment has been concentrated in developed economies and China. Excluding China, clean energy spending in developing economies remains stuck at

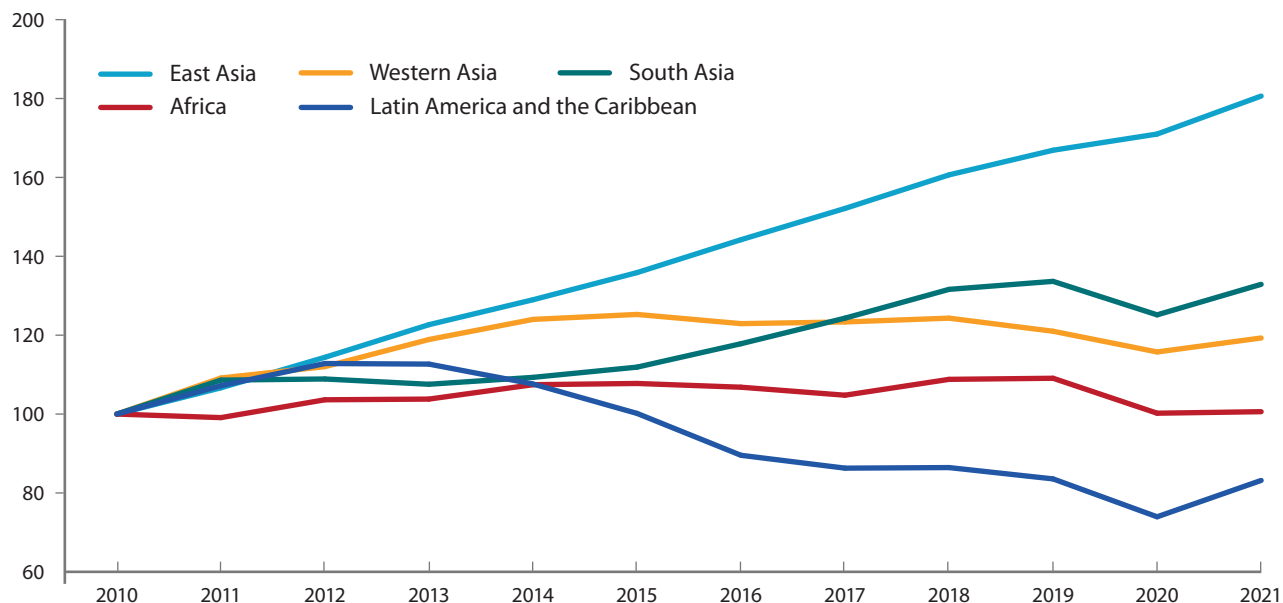
Figure I.9
Annual investment growth in selected developed economies, by asset type
(Percentage)



Source: UN DESA, based on data from CEIC and EuroStat.

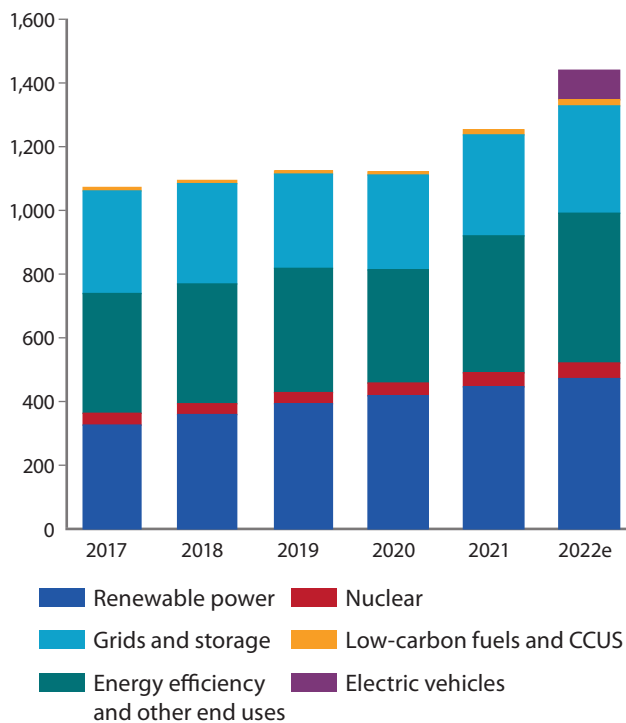
Note: Figures are in constant prices. Data for the United Kingdom, euro area, and Japan refers to total investment, data for the United States refers to private investment.

Figure I.10
Gross fixed capital formation per capita in developing regions
 (Constant United States dollars, index 2010 = 100)



Source: UN DESA.
 Note: Regional averages are population weighted.

Figure I.11
Annual clean energy investment
 (Billions of United States dollars)

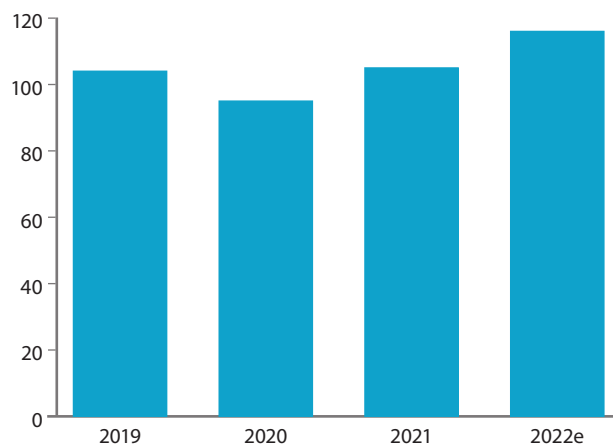


Source: IEA.
 Note: e = estimate. CCUS refers to carbon capture, utilisation and storage.

2015 levels. The high costs of capital and rising borrowing costs threaten to undercut the economic attractiveness of capital-intensive clean technologies in many developing countries. At the same time, investment in fossil fuels continued to rise in 2022 (see figure I.12).

Large-scale, rapid actions are needed to avert a climate catastrophe and invest in sustainable and inclusive structural transformation. Despite growing calls for countries to revisit and strengthen their 2030 climate mitigation targets, progress has been slow

Figure I.12
Coal supply investment
 (Billions of United States dollars)



Source: IEA.
 Note: e = estimate.

and inadequate.²⁸ To achieve these ambitious targets, massive investments are required to accelerate transformations, including in electricity supply, industry, farming, transportation and buildings. Stronger international cooperation, particularly in the areas of financing as well as the transfer and scaling-up of low-emission technologies, will be crucial.

3. Policies for a stronger recovery

Beyond urgent actions in response to the overlapping crises, policymakers must ensure that they do not lose sight of longer-term sustainable development objectives. Proactive fiscal policies geared towards promoting inclusive and sustainable industrialization can drive progress across many areas of sustainable development (see chapter II). Financing policies can help to enhance domestic revenue mobilization (see chapter III.A) and increase the private sector's role (see chapter III.B)

in expanding the resources available to support crisis recovery efforts. There needs to be a massive boost in public and private investment geared towards strengthening resilience to shocks and supporting the SDGs, including in climate action (see chapters III.A, III.B and III.C). Stronger policy actions by the international community are needed to help vulnerable countries to mitigate the effects of recent shocks and avert a lost decade for sustainable development (see chapters III.C and III.E).

The Addis Ababa Action Agenda provides a comprehensive framework for countries to consider policies that can support a resilient, inclusive and sustainable recovery. The subsequent chapters of this report provide progress updates on the implementation of each of the Addis Agenda's action areas. They also lay out the policy options at both the national and international levels for countries to make stronger progress towards the SDGs in the context of a highly challenging macroeconomic environment.

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 The United Nations *World Economic Situation and Prospects* (WESP) report forecast of 1.9 per cent global growth for 2023 is based on market exchange rates, which is in line with the forecast of the World Bank's *Global Economic Prospects* report. When adjusted to reflect market exchange rates, the IMF's *World Economic Outlook*'s projection is for global output to expand by 2.4 per cent for 2023, which is higher than the WESP. This is due mainly to the WESP's less optimistic growth projections for the United States, the euro area, and China.
- 3 Food and Agricultural Organization of the United Nations (FAO). 2022. *FAO Food Price Index*. Rome: FAO.
- 4 World Food Programme. 2023. *2023: Another year of extreme jeopardy for those struggling to feed their families*. Available at www.wfp.org/global-hunger-crisis
- 5 Björn Rother, Sebastian Sosa, Lukas Kohler, Gaëlle Pierre, and others. 2022. *Tackling the Global Food Crisis: Impact, Policy Response, and the Role of the IMF?* IMF Note 2022/004, International Monetary Fund, Washington, DC.
- 6 World Bank. 2022. *Poverty and Shared Prosperity 2022: Correcting Course*. Washington, DC: World Bank
- 7 Ibid.
- 8 International Labour Office (ILO). 2022. *Global Wage Report 2022–23*. Geneva: ILO, 2022.
- 9 ILO. 2023. *World Employment and Social Outlook: Trends 2023*. Geneva: ILO, 2023.
- 10 Ibid.
- 11 Ibid.
- 12 International Disaster Database. Available at www.emdat.be.
- 13 World Meteorological Organization. 2023. *Past eight years confirmed to be the eight warmest on record*. Available at <https://public.wmo.int/en/media/press-release/past-eight-years-confirmed-be-eight-warmest-record>
- 14 World Bank. 2023. *Global Economic Prospects, January 2023*.
- 15 Ibid.
- 16 International Monetary Fund. 2022. *Global Financial Stability Report – Navigating the High-Inflation Environment*. Washington, DC, October.
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- 19 International Monetary Fund. 2023. *World Economic Outlook Update*. Washington, DC, January.
- 20 International Monetary Fund. 2022. *Global Financial Stability Report – Navigating the High-Inflation Environment*. Washington, DC, October.
- 21 International Monetary Fund (IMF). 2022. *Fiscal Monitor: Helping People Bounce Back*. Washington, DC: IMF, October.
- 22 World Bank. 2023. *Global Economic Prospects, January 2023*.
- 23 United Nations Educational, Scientific and Cultural Organization (UNESCO) and World Bank. 2022. *Financing for Education Stagnant or Declining Despite Chronic Learning Needs Post-COVID-19*. Press release, 28 June. Washington, DC: UNESCO and World Bank.
- 24 After declining for many years, the total number of malaria cases increased in 2020 amid disruptions to health services during the pandemic. With a shortage of vaccines, a record number of cholera outbreaks occurred, including in Africa, Western Asia, South Asia and the Caribbean. Sources: World Health Organization. 2021. *World Malaria Report 2021: Tracking Progress Against Malaria*. Geneva: WHO; World Health Organization. 2022. *Shortage of Cholera Vaccines Leads to Temporary Suspension of Two-Dose Strategy, As Cases Rise Worldwide*. News release, 19 October. Geneva: WHO.
- 25 UNCTAD. 2023. *Global Investment Trends Monitor, No.44*. Geneva, January.
- 26 UNCTAD. 2023. *Global Investment Trends Monitor, No.45*. Geneva, January.
- 27 World Bank. 2021. *Global Economic Prospects, January 2021*.
- 28 United Nations Environment Programme (2022). *Emissions Gap Report 2022: The Closing Window – Climate crisis calls for rapid transformation of societies*. Nairobi.