UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

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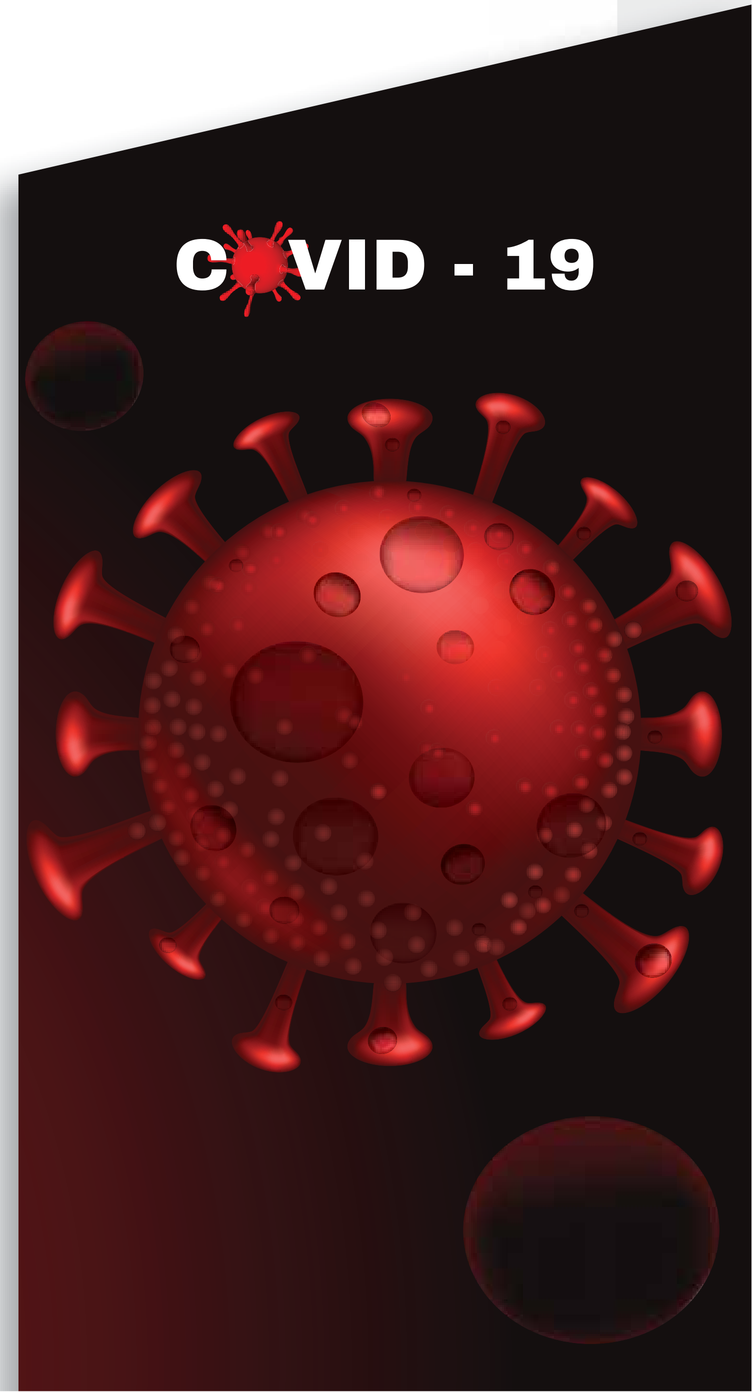
TRADE AND DEVELOPMENT REPORT UPDATE

MARCH 2020

The Covid-19 Shock to Developing Countries:

Towards a “whatever it takes” programme for the two-thirds of the world’s population being left behind



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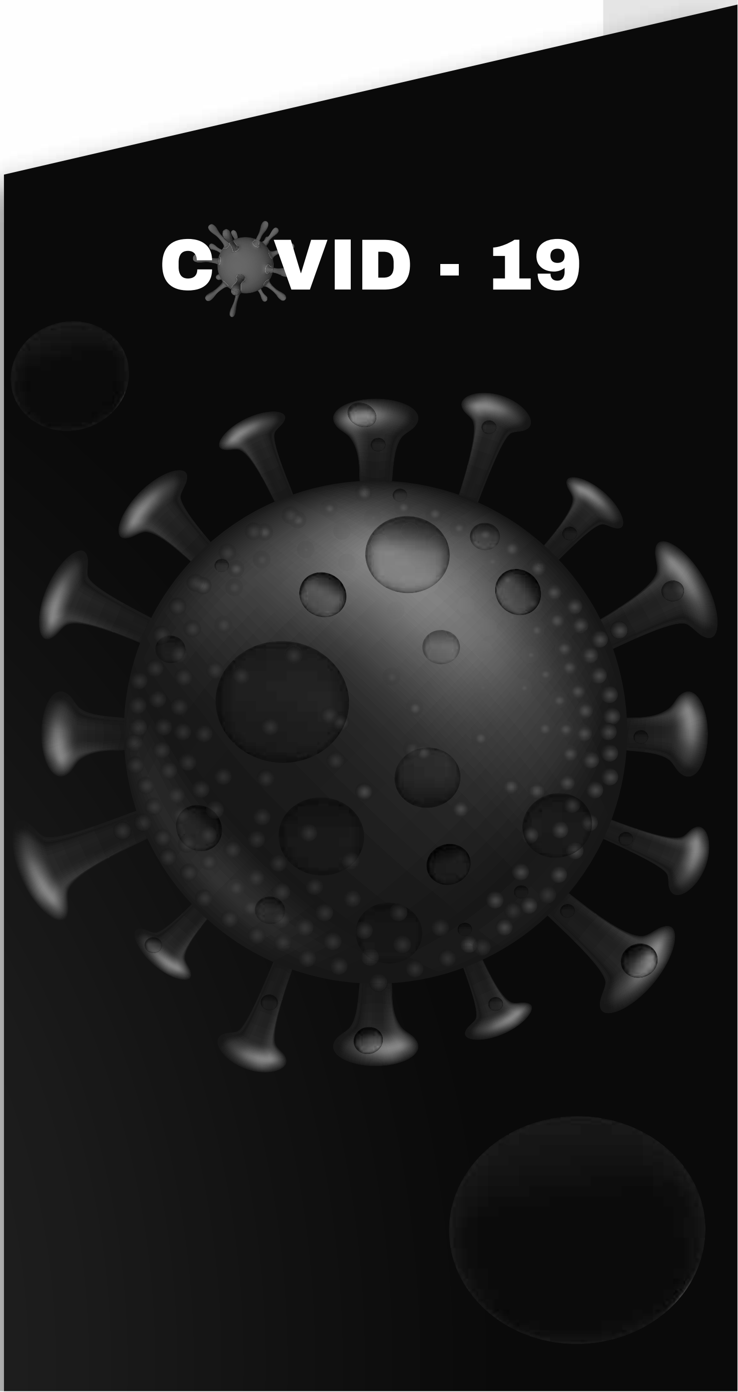

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Averting global depression

Projections of the potential impact of the Covid-19 shock on economies around the world for the year 2020 vary widely. However, there is broad agreement that the global economy will contract given the sudden stop to large swathes of activity and the resulting income loss in the manufacturing and services sectors across most advanced countries and China, combined with the adverse effects on financial markets, consumption (through both income and wealth effects), investment confidence, international trade and commodity prices.

For advanced country governments, now scrambling to contain the economic impact of the Covid -19 pandemic, the challenge -- as discussed in our first *Trade and Development Report Update*[1] -- is compounded by persistent fragilities surrounding highly speculative financial positions, in particular, the already unsustainable debt burdens associated with highly leveraged corporate loans. These have been built up over the last decade of easy money and against a backdrop of heavily underregulated 'high-tech-cum-gig economies' and deeply ingrained income inequalities. In addition, the avalanche of cheap credit since 2008 has also spilled over to developing countries, creating new financial vulnerabilities and undermining their debt sustainability.

In the past days a series of stimulus packages -- unprecedented in both scale and scope -- have been announced by the major developed economies and China to extenuate the mounting economic damage and respond to the health crisis. Aside from financial injections to keep the banking and corporate balance sheets on relatively stable footing, the critical measures to avert contractions of economic activity include government spending (particularly on health care), extended unemployment benefits and cash transfers.

The details still need to be carefully examined but some broad estimates can be made about how this will likely translate into additional demand and thus national income in each economy. Employing our Global Policy Model, we estimate a boost to the national incomes of advanced economies and China of about $1.4 trillion in 2020, substantially smaller than the headline values of the packages.[2] This no doubt will have a positive impact not only on their own economies but the world economy as well.

Although this will, in all likelihood, not prevent a global contraction this year it should (hopefully) avert the recession turning in to a prolonged depression. It should also contribute to stemming the fall in the prices of both financial assets and commodities and will partially alleviate the negative growth impact from the crisis on developing countries.

Developing countries, however, face distinct pressures and constraints which make it significantly harder for them to enact effective stimulus without facing binding foreign exchange constraints. And as these countries do not issue international reserve currencies, they can only obtain them through exports or sales of their reserves. What is more, exports themselves require significant imports of equipment, intermediate goods, know-how and financial business services. Finally, the financial turmoil from this crisis has already triggered sharp currency devaluations in developing countries, which makes servicing their debts and paying for necessary imports for their industrial activity far more onerous.

[1] https://unctad.org/en/PublicationsLibrary/gds_tdr2019_update_coronavirus.pdf

[2] The "stimulus packages" adopted in developed economies and China contain both emergency measures, such as loans to keep businesses solvent while economies are shut down, and demand injections, such as government purchases of goods and services and money transfers to households. The latter are a fraction of the packages adopted. For example, in the US$2.2tn package adopted by the United States these measures amount to less than US$579bn, including spending in goods and services ($193bn), additional unemployment benefits (an estimated $111bn) and cash transfers ($275bn). The largest share of the package comprises loans to business, which may turn in to transfers if they are not repaid. Barring this event and considering the multiplicative effect of government spending on GDP and the fact that cash benefits are partially saved, the additional demand in 2020 generated by these measures is an estimated US$395bn, less than one-fifth of the package's face value.

The shock of the lightning

Many developing countries were slowing down in the final quarter of last year with several entering recession. However, the speed at which the economic shock to advanced economies has hit developing countries – in many cases in advance of the health pandemic -- is dramatic, even in comparison to the 2008 global financial crisis.

As Figure 1.a below shows, net portfolio flows, both debt and equity, from main emerging economies amounted to $59 billion in the month since the Covid-19 crisis went global (21 February to 24 March). This is more than double the portfolio outflows experienced by the same countries in the immediate aftermath of the global financial crisis ($26.7 billion). The drastic and much larger drop in net portfolio flows from developing countries, compared to other recent crisis episodes, is also clearly visible in Figure 2.b below, that includes additional country data available for the Covid-19 crisis period.[3]

Figure 1.a **Net portfolio flows, selected developing countries: Debt and equityPost-GFC and onset of COVID-19 crisis**

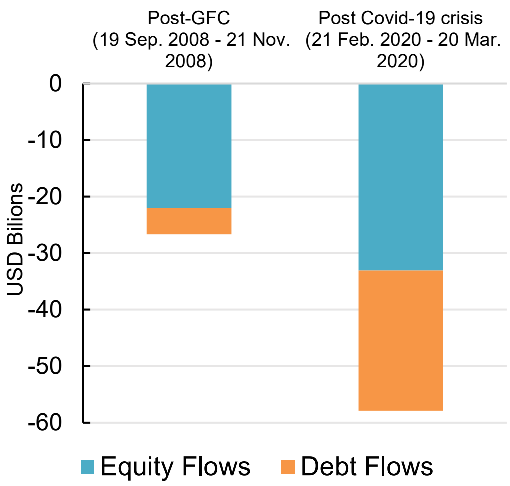
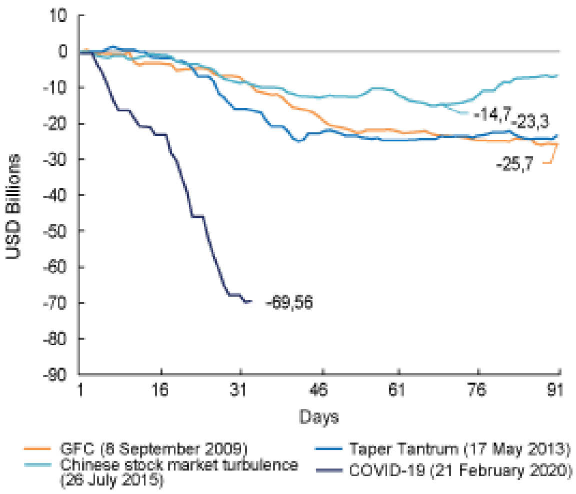


Figure 1.b **Net portfolio outflows from selected developing countries: Total flows after recent crisis**



Source: UNCTAD secretariat calculations based on *IFF Daily Emerging Market Portfolio* database.
Note: Figure 1.a includes: Brazil, India, Indonesia, Philippines, Republic of Korea, South Africa, Thailand and Turkey for both data points. Figure 1.b also includes China, Mexico, Pakistan, Qatar, Saudi Arabia, Sri Lanka and Vietnam.

Concomitantly, the spreads on developing country bonds have been rising sharply (Figure 2), while the value of currencies against the dollar (Figure 3) have dropped significantly since the beginning of this year; and again, in both cases equal to or faster than the early months of the global financial crisis.

[3] On the likely drop in FDI flows, see https://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=2313

Figure 2.a **ICE BofA Emerging Markets Corporate Plus Index Effective Yield, in the days after the main shock** (annual in percent)

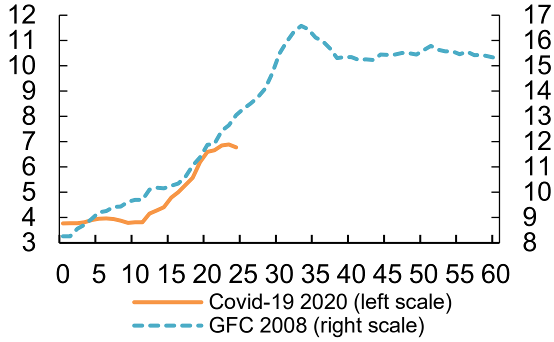
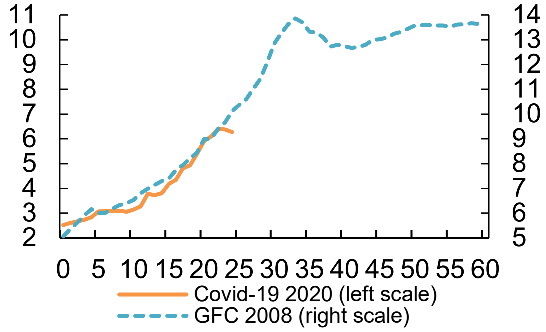


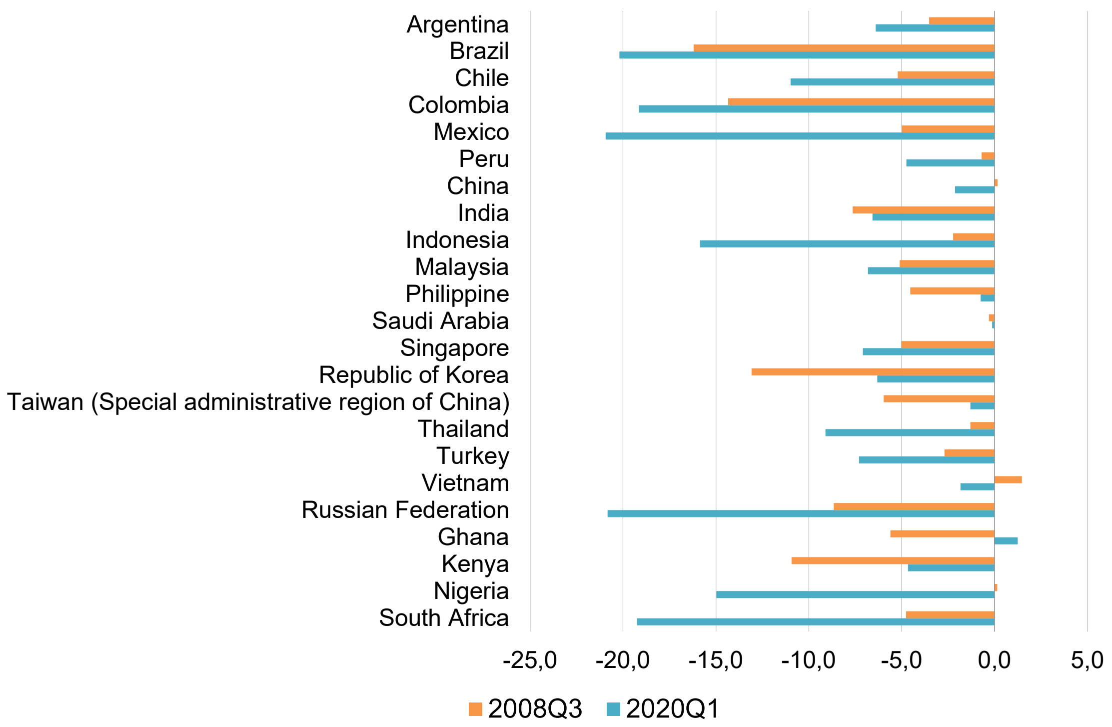
Figure 2.b **ICE BofA Emerging Markets Corporate Plus Index Option-Adjusted Spread, in the days after the main shock** (annual in percent)



Source: FRED, day zero is Friday, 12/Sep/08, for the GFC,and Friday, 21/Feb/20, for the Covid-19 shock.
Note: calculated over US Treasury curve.

Commodity prices have also dropped precipitously since the crisis began (Figure 4). A fall in oil prices, which would be expected from a drop in global demand, has been amplified by disagreements among the main producers on how to deal with this, with Brent crude falling 63 percent in the year to date. In the last 25 years, similar declines occurred only after the Global Financial Crisis (GFC) of 2008 (figure 4).

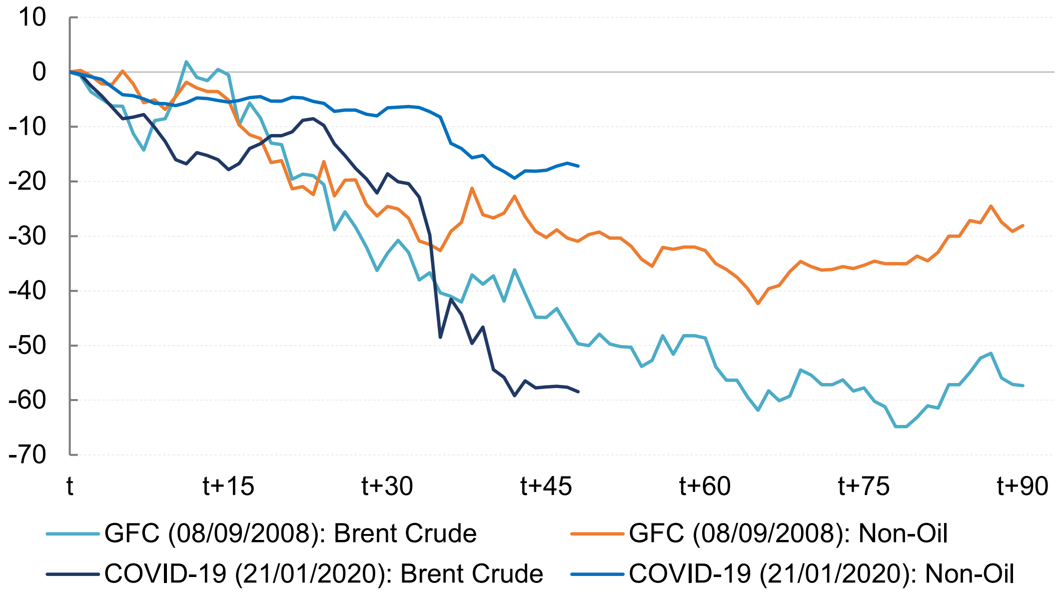
Figure 3 **Currency movements against the dollar, 2008Q3 vs 2020Q1** (Percentage)



Source: UNCTAD secretariat calculations based on *Thomson Reuters Eikon* database.
Notes: Negative values refer to a depreciation of the domestic currency against the dollar. Data for 2020Q1 go until 25 March.

When other commodities are added to the analysis, the overall price decline has been 37 per cent this year, with the other major falls concentrated in metals (with some notable exceptions) and mineral products. The reduction in the price of agricultural commodities has, on average, been smaller but with some notable exceptions (see also Table 1).

Figure 4 **Commodity Prices**
(Percent change: "t + x working days" vs. "t")



Source: UNCTAD secretariat calculations based on Thomson Reuters Eikon.

This time things *are* different

The economic fallout from the Covid-19 shock is ongoing and increasingly difficult to predict but there are clear indications that things will get much worse for developing economies before they get better.

First, the full effects of the health crisis have yet to hit many developing countries, and we have yet to reach the "end of the beginning" of the economic crisis in the advanced economies. Following the collapse of Lehman Brothers in September 2008, the global economy registered 5 consecutive quarters of negative growth, albeit at a decelerating rate after the second quarter of 2009; even if the massive stimulus packages now being implemented prevent a long period of depression, they will not, as already suggested, avert a recession in the global economy this year.

Second, many of the conditions that produced a sharp bounce back in developing countries after 2010 are no longer present or a good deal weaker. China's massive stimulus in 2009 and rapid return to double digit growth had strong positive effects on demand for the exports of developing countries while the search for yield by Northern investors operating under the loose monetary policy adopted by leading Central Banks heightened their appetite for risky assets, producing a rapid rebound in capital inflows in emerging and other developing countries. Moreover, confidence in the developing world was boosted by expanding South-South trade and financial links that had begun before the crisis hit, encouraging the idea that developing countries had "decoupled" from the economic troubles of developed countries. These conditions are unlikely to be repeated this time around. In addition, weakening state capacity, diminishing fiscal space and a rise in illicit financial flows over the past decade, place further constraints on effective recovery strategies in many developing countries.

Third, the strong recovery in developing country trade that occurred in 2010 seems less likely this time. Even if the damage to global supply chains is not irreparable, as lead firms recover from the crisis they will likely have to rethink their business model, including fewer links in these chains, and with more that are closer to home. Moreover, China has steadily diminished its dependence on external suppliers in its chains through an increase in domestically produced intermediate products. At the same time, there has been too little diversification of economic activity in many developing countries over the past decade – with greater commodity dependence in many countries -- leaving them more exposed than ever to new shocks and disturbances.

Fourth, the current fall of commodity prices has started from a lower value compared to what happened in the GFC when the world economy was at the peak of the “super commodity cycle” and appears to be more broad based. Commodity prices have been well off their post-recovery highs since the price slump in 2016 but it seems unlikely that there will be the same kind of pick up in prices seen between 2009 and early 2011 which was well ahead of the recovery in global output (see Table 1).

Fifth, new vulnerabilities have emerged that are likely to hold back growth. Emerging economies, in particular, have seen a rapid build-up of private debt in reserve currencies and increased penetration of their markets by non-resident investors, foreign banks, and other financial institutions, as well as allowing their own residents to invest more freely abroad. There has also been a strong shift in the ownership of central government debt, including public external debt, from official to private creditors and shadow-banking actors. These trends heighten developing countries’ external vulnerabilities and entail large transfers of resources to advanced economies through various financial channels. As argued extensively in previous UNCTAD reports, even with the exceptionally low interest rates seen since the financial crisis, the resulting wave of debt accumulation was looking more and more fragile before the coronavirus crisis hit. The greater presence of foreigners in bond and equity markets has, moreover, increased the potential instability of exchange rates and further exposed domestic financial markets to the vagaries of global risk appetite and liquidity conditions.

Finally, developing countries’ ability to build up international reserves as a buffer against macroeconomic shocks has been weakening. In the aftermath of the global financial crisis, developing countries’ international reserves increased steeply, precisely in response to an evident need for “self-insurance” in a volatile global economic environment. However, since the onset of the commodity price downturn in 2012, reserve holdings, while still high by historical standards, have fluctuated widely, reflecting multiple pressures on developing countries’ ability to maintain high reserve holdings, such as commodity price downturns and growing debt and financial vulnerabilities. Given the massive expected impact of the Covid-19 crisis, reliance on such self-insurance is not an option, with reserves likely being drained very fast.

Table 1 **World primary commodity prices, 2017–2020**
(Percentage change over previous year)

	2017	*2018*	*2019*	*2020**
All commodity	11,1	-15,4	16,5	-37,3
Energy	12,3	-20,9	24,2	-55,1
Industrial metals	31,0	-19,0	1,5	-18,4
Aluminum	34,1	-19,0	-1,9	-15,1
Copper	30,8	-17,5	3,4	-21,3
Lead	23,8	-18,6	-4,8	-14,6
Nickel	27,5	-16,4	31,4	-19,5
Zinc	29,6	-25,6	-8,0	-19,4
Precious metals	12,9	-2,9	18,5	5,0
Gold	13,7	-2,1	18,9	7,3
Silver	7,2	-9,4	15,3	-17,0
Platinum	3,6	-14,7	22,1	-23,7
Agriculture	-3,0	0,6	6,3	-6,8
Cocoa	-11,0	27,7	5,1	-11,5
Coffee	-7,9	-19,3	27,3	0,2
Corn	-0,4	6,9	3,4	-10,1
Cotton	11,3	-8,2	-4,4	-22,6
Soybeans	-4,2	-6,9	6,8	-7,7
Sugar	-22,3	-20,6	11,6	-15,0
Wheat	4,1	16,8	7,7	3,6
Livestock	7,2	-3,0	5,0	-14,7

Source: UNCTAD Secretariat calculations, based on GSCI spot indices.
****Note:*** Data for 2020 refer to year-to-date growth rate as of 25 March 2020.

The looming financing gap in developing economies

The analysis of the impact of the Covid-19 shock has been mostly concentrated on China and advanced economies, since they were initially more affected by the pandemic, account for three-quarters of world output and have the monetary and fiscal policy space to respond. However, since two-thirds of the world population live in the (remainder of the) developing world, the