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CEI GLOBAL REPORT

CEI Centre for International Economy

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WORLD

Changes in the sovereign debt market: higher cost and lower liquidity

According to an OECD report, a favourable decade for sovereign debt issuance may be coming to an end. The break in the trend has its origin in the recession caused by the pandemic, which led to an expansive policy generating an increase in the debt issued by the State: from representing around 70% of GDP in OECD countries during the last decade, it rose to 90% in 2020, fell to 83% in 2022 and it is estimated to represent the same percentage for 2023.

The restrictions existing at the beginning of 2022 on the supply of energy and food were aggravated by the war between Russia and Ukraine, which led inflation –particularly in developed countries– to rise to unusual levels. Central banks' response was a contractive policy: the interest rate in OECD countries rose from an average 0.8% in 2021 to an average 5.3% in December 2022. This policy, coupled with the geopolitical tension triggered by the war, an increased macroeconomic uncertainty and the deterioration of investors' confidence, explains why the cost of financing rose and the liquidity of the debt market went down.

The deterioration in liquidity also affected the economies of developing countries, which faced, as well, an outflow of capital seeking lower-risk debt securities. This exit depreciated the currencies of these countries against the dollar and increased the weight of their debt in that currency. As a consequence, developing countries find it more difficult than developed countries to refinance their debts

In this regard, UNCTAD points out that the greater difficulty in accessing financing means that many developing countries have to choose between paying the debt to avoid a default or financing development. This situation has given rise to the Secretary-General of the United Nations disseminating a document (see CEI Global Report, March 2023) in which he states that the debt of developing countries is in a critical situation and that it is necessary to extend payment deadlines and reduce interest rates. In turn, UNCTAD proposes an increase in liquidity for developing countries through the issuance of special drawing rights.

Recession and global inflation especially affect developing countries

According to UNCTAD, the world economy will grow 2.1% this year, 1 percentage point below that in 2022. Latin America would do so 1.3%, after a 3.9% rise last year; the United States would go up 0.9% (2.1% in 2022); the EU 0.8% (3.5% in 2022); while China would resume an upward trend, growing to 4.8%, a variation greater than the 3% last year.

The lower global growth would be linked to various factors: a contractive monetary policy to face the increase in inflation, which raised the short-term interest rate; the price of energy rise as a result of the war between Russia and Ukraine; a less expansive fiscal policy; and lower household spending and business investment. The difference between China and other economies is partly accounted for by a lower margin of the latter to expand public spending linked to less liquidity in the sovereign debt market (see previous piece of news).

The increase in inflation, the other outstanding feature of the global economic situation, did neither have an adequate diagnosis or approach, according to UNCTAD. The institution understands that governments have mistakenly faced the phenomenon with an increase in the interest rate as if its origin were an excess in demand rather than problems in the supply of goods. Additionally, it points out that higher inflationary targets should have been set –of around 3% per year– so that the monetary policy were less contractive. Finally, instruments should have been used that address other inflationary factors of non-monetary origin, such as controlling the increase in the companies' profit margin. In spite of the fact that some countries have implemented some of these measures, according to UNCTAD, the negative impacts of a contractive monetary policy on the financial market –which damage developing countries in particular– could have been avoided with a generalised approach of this type.

G7 meeting: concerns over macroeconomics, debt and the market economy

The leaders of the G7 countries, meeting in the city of Hiroshima, agreed positions on issues related to economic recovery, public debt, global infrastructure financing and climate change, among others.

Regarding the economic situation, they pointed to short-term measures and long-term aspects. With relation to the former, they expressed their concern about inflation, for which reason they support the current policy of the central banks and consider that the fiscal policy must ensure sustainability in the medium term, support spending to serve vulnerable groups and investment in projects that take care of the environment and aim at digital transformation. Regarding infrastructure financing, they reaffirmed the importance of increasing it in low- and middle-income countries, and so they propose the use of public and private resources.

On more structural aspects, they stated that welfare issues must be taken into account in various policy decisions in order to preserve democracy and the market economy. That is the reason why they argue that more financial resources must be mobilised through multilateral banks, governments or the private sector in order to reduce poverty and face climate change, being the core of the Summit for a New Global Financing Pact that will be held in Paris on 22 and 23 June.

They also expressed their concern about the challenges posed by debt repayment versus meeting the Sustainable Development Goals. For that reason, they support the G20 initiative to help low- and middle-income countries that were particularly affected by the consequences of the war between Russia and Ukraine and by climate change.

In relation to climate change, they committed to transforming economies to reach the goal of net zero emissions by the year 2050, both at country level and for international maritime and air transport. They also stressed the role that the use of carbon markets and the setting of a price on carbon emissions play in achieving this goal. Likewise, they reaffirmed their commitment to mobilise US$ 100 billion a year until 2025 to finance actions aimed at mitigating climate change.

EUROPE

EU adopts deforestation regulation

On 16 May, the process of approval of the EU regulation for the commercialisation of deforestation-free products –which had been presented in November 2021 by the European Commission (see CEI Global Report, December 2021)– ended. This was aimed at limiting the trade of a group of products that, according to the bloc's authorities, are related to the expansion of agricultural pieces of land that promote deforestation and forest degradation around the world.

The regulation establishes a series of obligations for those who introduce or commercialise certain raw materials in the EU: palm oil, cattle, wood, coffee, cocoa, rubber and soybeans; and their derivatives such as chocolate, furniture, printed paper, and others. The rule requires operators to carry out a set of controls, in such a way that they can keep track of the products traded up to the plot of land from which they were obtained.

For EU supplier countries, the regulation represents a new obstacle to continue exporting to the bloc. In the case of Argentina, the main products destined for the territory of the European Union that should be subject to the new controls correspond to the soybean complex, beef and bovine hides.

In this sense, the first response to the approval of the new European regulations was promoted by the authorities of Malaysia and Indonesia, which decided to suspend trade negotiations with the bloc. Both Asian countries are the world's leading producers of one of the products included in the new regulation, palm oil, while the EU is the third largest buyer of this product.

European companies obtain permission to export gas from Venezuela

The consequences of the Russian invasion of Ukraine continue making European countries seek new fuel suppliers. The dependence of the economies of the region on Russian gas and the suspension of shipments caused by the war have led the large European energy companies to seek new trade agreements in different regions of the planet (see CEI Global Report, February 2023).

As part of this search, the companies Repsol (Spain) and ENI (Italy) managed to make the Venezuelan government grant them, at the beginning of May, a permit to export natural gas liquids. The European companies intend to double the production capacity of the joint project that they currently have in the Latin American country and that is destined for the Venezuelan domestic demand. After the agreement reached, part of the additional production will be able to be exported to Europe.

Venezuela has the eighth largest natural gas reserve in the world, but has limitations to export its hydrocarbons due to the sanctions imposed by the United States. However, as in the case of Chevron, with Repsol and ENI the US government relaxed its position and gave the go-ahead to the negotiations that ended with the granting of export permits to Europe by the Venezuelan authorities.

Record fine for US technology company

The European authorities are still concerned about the use that large US technology companies give to the information they obtain from their operations on the continent (see CEI Global Report, February 2022).

On this occasion, the Irish Data Protection Commission accused the company Meta –owner of Facebook, Instagram and WhatsApp– of violating the European Union's data protection regulation and applied it a 1.2 billion euro fine, the highest economic sanction imposed in the EU for offenses related to data protection.

Likewise, the Irish agency gave the US company a five-month deadline for the Facebook platform (on which the investigation and subsequent sanction fell) to stop transferring users' personal data from the EU to the United States.

SOUTH AND CENTRAL AMERICA

Argentine organic citrus fruits re-enter the EU

The European Union reopened its market to organic citrus fruits from Argentina after two decades. This was possible thanks to the admission of sodium bicarbonate as a post-harvest treatment for organic citrus fruits by the Directorate-General for Agriculture and Rural Development of the European Commission (DG AGRI). As a consequence, there was a correction for the lack of admission by said organisation of a post-harvest treatment, which was making it impossible to ship citrus fruits to the EU.

The decision of the European authorities presupposes a positive impact on the production of organic citrus fruits in Argentina, which today has 3,342 hectares cultivated under these characteristics, and is a relevant activity for the economic development of various regional economies. The main Argentine citrus-fruit producing provinces are Jujuy, Salta, Tucumán, Catamarca, Formosa, Misiones, Entre Ríos, Corrientes and Buenos Aires.

Argentine oil exports to Chile resumed through the Trasandino pipeline

After 17 years of not operating, the use of the pipeline connecting the Argentine province of Neuquén with the Biobío region in Chile –along 427 kilometres and through the Andes mountain range– was authorised for the export of crude oil. The first contract, which extends for 45 days, will allow Argentine exports to Chile of 41,000 barrels of oil per day between the months of May and June, for a value that would amount to a figure between US$ 2 million and US$ 2.5 million per day. After 90 days, the pipeline would be able to operate at full capacity, amounting to 17,500 m^3 daily (approximately 110,000 barrels).

Exporting through the Trasandino pipeline will significantly increase Argentine oil sales to Chile, which in 2022 only amounted to US$ 98.5 million. The shipment of crude oil, from Vaca Muerta, will be operated by YPF and the Chilean state-owned oil company Empresa Nacional del Petróleo (ENAP, for its acronym in Spanish). These companies, together with Chevron, share ownership of the pipeline.

Ecuador signs a free trade agreement with China

Following four rounds of negotiations and numerous technical meetings held during 2022, on 10 and 11 May Ecuador and China signed a free trade agreement. The text comprises 17 disciplines, including a chapter on e-commerce, which constitutes the first agreement in this matter between China and a Latin American country. The review and approval by the Ecuadorian Constitutional Court and the National Assembly and the rest of the legal formalities in both countries need still be carried out before its entry into force.

During 2022, Ecuador’s exports to China amounted to US$ 5.8 billion and its imports to US$ 6.3 billion. The Ecuadorian export products that stood out were: shrimp, lead and copper concentrates, other mining products, bananas, wood and its byproducts, and cocoa. Besides, Ecuador mainly imported metal manufactures, automobiles, mobile phones, computers, and machines and their parts.

The government of Ecuador reported that China represents a market of 1.4 billion consumers which will be able to be accessed by producers with 99.6% of their exportable supply in baskets with immediate tariff reduction or in less than 10 years, apart from benefitting from various trade facilitation measures.

As a result, the Ecuadorian authorities estimate that in the next seven years its non-oil exports to that country might increase between US$ 3 and US$ 4 billion and that the exportable supply could be expanded to non-traditional goods such as pitahaya, pineapple, mango, blueberries, quinoa, processed foods, fresh and canned fruits, among other agricultural and agribusiness products. In addition, the Ecuadorian government expects a positive increase in employment and investment attraction and a reduction in production costs of the Ecuadorian industries.

NORTH AMERICA

US agreement on the debt ceiling

On 19 January, US Treasury Secretary Janet Yellen communicated to Congress that the United States had reached its debt ceiling of US$ 31.4 billion, prompting the Treasury Department to resort to various “extraordinary measures”[1] to pay the government’s financial obligations. According to the official, once these resources are used up, the Treasury’s payment capacity could only be extended until 5 June.

Created by Congress in 1917, the debt limit is the total amount of money that the US government is authorised to borrow to meet its existing legal obligations, including health and social security benefits, military salaries, debt interest, tax refunds, and other payments. This debt ceiling is not related to new spending commitments, but refers to the payment of existing legal obligations, incurred in the past.

Once the deadline is over, the government would not have enough income to meet its obligations, including servicing the debt, which could lead to a possible suspension of payment.

To avoid this situation, Congress must vote on a law to permanently increase the debt limit, or temporarily suspend it. This legislation can refer exclusively to the debt ceiling (“clean” bill) or be part of a broader legislative package. It should be noted that over the past 40 years, 48 legislative measures have been enacted on the legal debt ceiling. The last time was in December 2021, when the current amount was set.

In this particular case, while President Joe Biden was aiming for a “clean” bill that would raise the debt limit, the House Speaker, Kevin McCarthy, and the House Republican majority also demanded spending cuts. After weeks of negotiations, on 27 May, a budget agreement in principle was reached, which suspends the debt ceiling until January 2025 while limiting public spending for two years. The bill was approved by the House and Senate and signed into law by Biden on 2 June. Non-defence spending will remain unchanged during 2024 and will be increased 1% in 2025, among other budget adjustments and cuts.

Argentina complains to WTO over US anti-dumping measure

On 25 May, Argentina requested consultations with the US under the WTO Dispute Settlement Mechanism in connection with a US anti-dumping measure on oilfield pipelines (oil country tubular goods, OCTGs) from Argentina.

The definitive anti-dumping duty of 78.3% on oil country tubular goods from Argentina entered into force in November 2022 and will be extended until 2027. It is estimated that it could bring about losses in exports for US$ 1 billion.

1 This refers to measures that temporarily suspend certain intra-governmental debt, allowing programmes or services to be financed for a limited period of time once the legal debt ceiling is reached.

Argentina claims that the measure contravenes several aspects of the WTO Antidumping Agreement and the General Agreement on Tariffs and Trade (GATT) 1994. The request for consultations gives the parties the opportunity to discuss the matter and find a satisfactory solution without going into litigation. If the consultations fail to resolve the dispute within 60 days, Argentina may request the intervention of a panel.

It should be noted that this is the third dispute raised by Argentina in the WTO concerning US anti-dumping measures on OCTGs. The previous cases were raised in 2002 and 2006 (see DS 268 and DS 346).

On the other hand, the United States International Trade Commission (USITC) decided to maintain the anti-dumping and countervailing duties on exports of biodiesel originating in Argentina and Indonesia for a further five years. The decision is part of the five-year sunset review process (by expiration) required by US law. The tariffs were imposed on a preliminary basis in 2017 and became definitive in 2018, causing a complete halt in Argentine biodiesel exports to the US. According to the USITC's decision, the revocation of the measures "could lead to the continuation or reappearance of a significant injury" for US biodiesel manufacturers.

Conflict between Mexico and the State of Texas over cargo transport inspections

The Mexican Secretariat of Economy issued a *communiqué* expressing concerns about the economic losses produced by the cargo transport inspections in the Matamoros-Brownsville border crossing area by the government of Texas (US). The measures, which began to apply on 8 May, are said to be mainly aimed at tackling migrant smuggling and drug trafficking at the border. The Mexican government argues that this is an attribution that corresponds to the federal government, not to subnational governments.

According to the *communiqué*, the new border inspections bring about delays of between 8 and 27 hours in the entry of cargo transports to Texas, which mainly affects perishable products and causes millionaire losses for both Mexican and American companies. It should be noted that Mexico is the main trade partner of the state of Texas, and that the trade exchange represented US$ 231.0 billion in 2021.

Dialogues were initiated from the Secretariat of Economy with the Office of the United States Trade Representative (USTR) to find a solution to the issue and the case is expected to be submitted to the Trade Facilitation Committee of the USMCA.

The conflict resembles a previous one that arose in April 2022, when a similar measure was adopted by the Texas government, which caused enormous traffic retentions along the border and was lifted after reaching agreements with neighbouring Mexican states.

ASIA AND OCEANIA

IMF outlook for the Asia-Pacific region

In its latest IMF's report on regional perspectives, the agency forecasts that growth in the Asia-Pacific region will accelerate to 4.6% this year, after reaching 3.8% in 2022. The improvement may be motivated by the reopening of China, since the increase in consumption in that country is boosting growth in the region, despite the weakening of demand in the rest of the world. However, the outlook could be worse due to the spillover effects of a stronger-than-expected tightening of US monetary policy and supply chain disruptions associated with the fragmentation of the global economy.

According to the IMF, the region also faces significant challenges. In the short term, monetary and fiscal tightening should be maintained to reduce inflation on a lasting basis until central bank targets are met and public debt stabilised. To handle the global shocks, an integrated economic policy response using all available tools will be needed. Even though Asia's financial systems have not experienced significant impacts following the recent banking turmoil in the United States and Europe, they must continue to be closely monitored, given the high leverage of households and businesses.

In the longer term, the Chinese economy, which has been the main driver of regional and global growth for decades, is expected to slow considerably in the face of unfavourable demographic factors and slowing productivity. According to the IMF, the region must prioritise structural reforms that boost long-term growth, such as betting on innovation and digitalisation, in addition to accelerating the transition to green energy.

ASEAN promotes the use of local currencies in cross-border trade

To facilitate regional economic integration, the leaders of the Association of Southeast Asian Nations (ASEAN) made a statement on advancing regional payments connectivity and encouraging local currency transactions.

In the text, the authorities recognise the potential benefits of using the local currency to strengthen financial systems, deepen regional financial integration and improve trade and investment within ASEAN, and reinforce regional value chains.

The leaders pledged to advance regional payments connectivity using the new opportunities offered by innovation to facilitate secure cross-border payments, taking into account the circumstances of each country. They also agreed to encourage the use of local currencies for cross-border transactions in the region and support the establishment of a working group to explore the development of an "ASEAN Local Currency Transactions Framework".

Prior to the summit, the Association of Indonesian Entrepreneurs (Apindo) had expressed hope that Indonesia could drive regional de-dollarisation through its ASEAN presidency in 2023. The head of Apindo's Committee of Economic Policy Analysts stated in an official statement that de-dollarisation became a global phenomenon and, to some extent, an economic orientation.

At the end of March, the meeting of ASEAN Finance Ministers and Central Bank Governors had agreed to strengthen the use of local currencies in the region and reduce dependence on major international currencies for cross-border trade and investment, in an effort to ensure financial stability and avoid the spillover effects of the global crisis, such as high inflation.

Japanese imports of Russian fishery products on the rise

Japan imported a record 155.2 billion yen (US$ 1.2 billion) worth of Russian fishery products in 2022, according to data from the Japanese Ministry of Finance, evidencing its dependence on such products from Russia despite deteriorating relations between the two countries following the war in Ukraine.

Although Japan imposed economic sanctions on Russia following last year's invasion, including a ban on imports of vodka and timber, the fishery products were exempted because the Japanese government considered that the adverse effect on its companies would have been too great.

Japan's low catch and Russia's increased catch in the waters surrounding the disputed islands –known as the Northern Territories in Japan and the Southern Kurils in Russia– were key factors in bringing last year's Japanese imports to the highest level since 1992. It is estimated that Japan imports about 40% of the seafood consumed in the country, and Russia ranks third among its suppliers, behind Chile and the United States.

The most imported product from Russia last year was crab, with an increase in quantities explained by the difficulties of Russian producers to place their production in some Western countries and by restrictions on catches in the United States. Poor fishing conditions in Japan also led to an increase in imports of sea urchins, salmon and trout from Russia, while imports of pollock paste increased approximately seven-fold over the previous year.

AFRICA

African currencies depreciate and inflation on the continent increases

Most currencies in Sub-Saharan Africa weakened against the US dollar since the second quarter of 2022, which, along with increases in food and energy prices caused by the war in Ukraine, pushed up the price of imports and stoked inflationary pressures across the continent.

According to an article published by the IMF, the depreciation of the currencies of the region was mainly due to external factors. Higher risk aversion in global markets and rising interest rates in the United States might have pushed investors away from the region towards assets deemed safer. The currency exodus was combined with a decline in its income from lower exports caused by the economic slowdown in the world's major economies.

Large budget deficits compounded the effects of these external shocks by increasing demand for foreign currencies. Approximately half of the countries in the region had fiscal deficits above 5% of GDP in 2022, which put additional pressure on their exchange rates.

The weaker currencies also raised the level of government debt. In Sub-Saharan Africa, about 40% of public debt is external and more than 60% of that debt is in US dollars. From the beginning of the pandemic until the end of 2022, exchange rate depreciations contributed to the increase in the region's public debt by about 10 percentage points of GDP, on average.

Many central banks in the region tried to shore up their currencies by providing foreign currencies to importers from their international reserves. But as reserves deplete in many countries, monetary authorities see their margins for further intervention in foreign exchange markets shrinking.

According to the IMF, since external shocks are expected to continue, countries where exchange rates are not pegged (fixed) to a currency have no other solution but to let the exchange rate adjust and tighten monetary policy to fight inflation. The organisation explains that whether a country has a fixed exchange rate or not, fiscal consolidation can help control external imbalances and limit the rise in debt related to currency depreciation.

Global geopolitical tensions and their consequences for Sub-Saharan Africa

According to an IMF report, Sub-Saharan Africa could be harmed if the world were divided into two isolated trading blocs centred on China, on the one hand, and the United States and the European Union, on the other. In this scenario, the economies of Sub-Saharan Africa could experience a decline of up to 4% of GDP in 10 years, losses greater than those experienced by many countries during the global financial crisis.

According to the agency, economic and trade alliances with new partners, predominantly China, benefited the region, but have also made countries dependent on food and energy imports more susceptible to global shocks, including disruptions from increased trade restrictions following Russia's invasion of Ukraine. If geopolitical tensions were to increase, countries could be hit by higher import prices or even lose access to key export markets: about half the value of the region's international trade could be hit.

Losses could be worsened if capital flows between trade blocs were disrupted due to geopolitical tensions. The region could lose about US$ 10 billion of foreign direct investment and official development aid inflows, accounting for about half of its GDP per year (based on an average estimate from 2017-2019), according to the international body's calculations.

Africa will have an "energy bank" to reduce its financial dependence

The African Petroleum Producers' Organization (APPO), in collaboration with the African Export-Import Bank (Afreximbank), is finalising plans to establish an energy bank on the continent, which will aim to provide financing for African oil and gas projects.

The measure is planned as international financial institutions, including the World Bank, are cutting funding for oil and gas projects in Africa, motivated by environmental concerns. The Africa Energy Bank (AEB) aims to attract investments from countries such as Saudi Arabia, the United Arab Emirates, Qatar and Kuwait, and address the financing challenges facing African oil companies.

The decision came at a time when environmental activists are pressuring several multinational banks to stop financing oil projects due to their high carbon emissions and when some international banks (HSBC, Standard Chartered and Standard Bank) are reviewing their loans for oil and gas projects on the continent.

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