Cátedra Valenciaport de Economía Portuaria

valenciaport Autoridad Portuaria de Valencia

VNIVERSITAT DE VALÈNCIA

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INTRODUCTION

Our *Quarterly Reports* on the international economic situation begin at a rather challenging time. The heritage of the imbalances introduced into the global economic system derived by the COVID-19 pandemic, a highly adverse geopolitical situation and the ultra-expansionary (probably too-expansionary) macroeconomic policy response to the last two recessions place the international economy, and especially the West, in a series of serious difficulties. Inflation rates unprecedented in almost half a century, continued disruptions in global value chains, the need to reverse (but not too much, in intensity and temporality, to avoid a significant recession) current monetary and fiscal policies, and the dilemma of whether (and how) globalisation should be reconsidered, not only for reasons of efficiency (not in terms of cost, but of greater security of supply, at least of certain strategic goods - and raw materials) but also for geopolitical reasons.

These issues, amongst many others, will be addressed in our pages in order to offer the reader data, ideas and perspectives that will contribute to a better understanding of the current economic reality. To this end, our *Quarterly Reports* will be divided into a series of sections, which we will present in some detail in this first exercise. After the *Introduction*, each report will continue with a *Spotlight*, a graph featuring some of the most critical elements of the period under analysis.

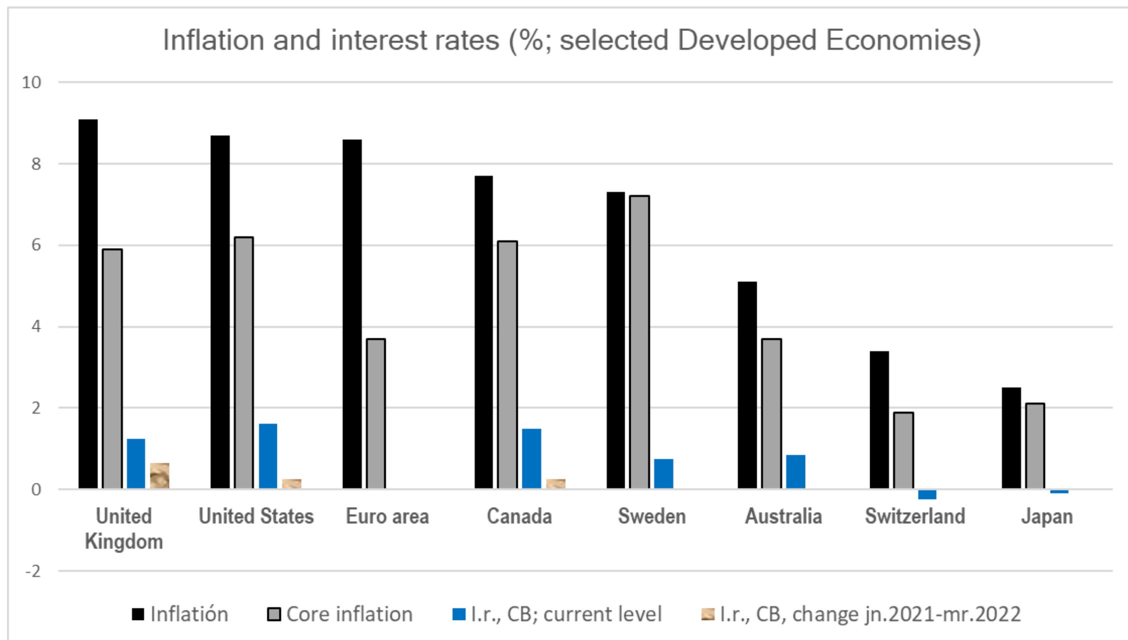
We will continue with a section focused on recent variations (in general, over the last year and the last quarter) in *International Reference Prices*, i.e. those prices that determine, to a large extent, the pattern of behaviour of the world economy. Thus, we will show the main interest rates set by the twenty most important Central Banks, both in developed and emerging and developing economic areas. We will continue with the prices of the major commodity groups, highlighting in each *Report* a product whose price's recent evolution is of particular interest. Finally, we will review the behaviour of the main international currencies, including those incorporated in the basket of International Monetary Fund's Special Drawing Rights (US dollar, euro, yen, yuan and pound sterling), together with the Australian dollar and the Swiss franc, currencies that often have very different trajectories depending on the global economic situation.

The central core of our *Reports* will be the *Understanding the Quarter in Seven Keys*, a section in which we will address different key aspects to understanding events in the recent period and future developments in the international economy.

Finally, we will close with the section *The World in Two Variables*, for which, in each Report, we will select two important macroeconomic indicators and show their trajectory in the world economy as a whole since the beginning of the 21st century. To this end, we will differentiate between developed, emerging and developing countries, summarising their evolution by looking at the ten largest economies, according to their population and weighted in terms of their Gross Domestic Product in Purchasing Power Parity, in each of the three blocks. As this is the first Quarterly Report, the approach followed will be further detailed in the section itself.

We hope that this analysis conducted within the *Valenciaport Chair in Port Economics* framework will interest readers and become a valuable resource for them to follow international economic developments.

II.- SPOTLIGHT: once upon a time…



Source: Own elaboration. Data: National central banks.
Notes: inflation and core inflation correspond to the latest known annual rate (May or June). The last two columns show the End-June level of the respective central banks' main interest rate and the change in its level between the beginning of 2021 and March 2022.

More than a quarter of a century ago, first as a student in economics and then for many years as a lecturer and researcher, the author shared the widely accepted idea that one of the keys to successful monetary policy is that it should be *forward-looking*. In other words, decision-makers in this area should anticipate problems to be able to combat them. The fundamental reason is that monetary measures require an extended period (usually three to five quarters, the empirical analysis concludes) to be fully effective. To achieve this, central banks monitor some intermediate variables, both real and financial, related to their ultimate objective (usually price stability, sometimes supplemented by others, ranging from full employment to an exchange rate target) and which they can, in turn, influence through their monetary decisions. By detecting potential future problems in their ultimate objective through the present behaviour of intermediate variables and acting, if necessary, to alter that behaviour, central banks (in what is often defined as "half art, half science") could contain such future difficulties.

On the contrary, if the monetary authorities wait until the problem is clearly perceived, they will not only be late in solving it (being "behind the curve", in the slang), given the delay between action and its full effectiveness (and this is true even if the effects of a change in the tenor of the monetary policy start to be felt as soon as it is announced before it is implemented). The additional severe handicap with such a delay is that, when the new policy is implemented, the economy faces precisely the opposite problem to the one that motivated the policy change.

Let us now turn to our chart and the current situation. The first column reflects the skyrocketing inflation rates (goods and services) a selection of major developed economies are experiencing. Equally or more worrying is the information provided by the second column on core inflation (excluding the more volatile, energy and unprocessed food items), which reveals, in almost all cases, a generalised profile of excessive price growth[1]. The third column reflects how current interest rates in all these economies encourage (if not drive) the continued acceleration of prices. Yet it is the last column that reveals that the idea of *forward-looking* policy has disappeared from the current monetary policy strategy in the West. Actually, the reader might think that some data are missing from the chart, given that there are columns anchored at zero. Nevertheless, the reality is that monetary tightening in the five quarters previous[2] to the last one has been zero or close to zero, even though year-on-year inflation has been above the central banks' target for a whole year in Europe and almost a year and a half in North America and Australia.

True, this condescending attitude towards inflation has changed very vigorously since June... and it runs the particular risk of failing to solve one problem, inflation, and pushing towards another, recession. A return to the stagflation of the 1970s? Central banks as sources of instability? We will return to this issue in the following sections of this report.

But, for now, it is worth reflecting on how Western Central Banks may have gone along with such an evolution in inflation. To summarize their key argument, these excessive price tensions have come from supply shocks, COVID-19 and the Russian invasion of Ukraine, with the well-known repercussions on trade flows, supply chains and energy costs. And, of course, the Central Banks have no instruments to combat this type of disruption, which, in fact, with surprising determination, they have been describing for months as "transitory".

One feels sympathy for the economic policymakers who had to deal with these exceptional situations but finds their inhibition rather mistaken. First, quite a few experts warned that frictions in global value chains would continue for years (for example, there will be a shortfall in shipping capacity until a considerable number of new ships are commissioned, which will not happen until the end of this year and 2023). Second, if the 1970s taught us anything, it is that even if inflation comes from the supply side, if it becomes entrenched, generalized, and transferred into agents' expectations, restoring price stability may require raising interest rates to levels that are unimaginable today. Third, it is hardly credible for Central Banks, particularly (but not only) for the US Federal Reserve, to ignore that over twenty trillion dollars of fiscal and monetary expansion introduced in the West in response to the pandemic have generated pressure on prices also on the demand side, which not only increased dramatically with the recovery but was irregularly oriented (more to goods, less to services) as a result of the changes in mobility and spending possibilities of citizens due to the fight against COVID-19 itself.

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[1]Even for Switzerland and Japan, the inflation rates, which are far more moderate, are unusually high. While the Japanese central bank seems to be less concerned about this than Japanese society, the Swiss central bank has already raised interest rates... although the main interest rate is still below zero.

[2] Remember: three to five quarters elapse between the monetary decision and its full effectiveness.

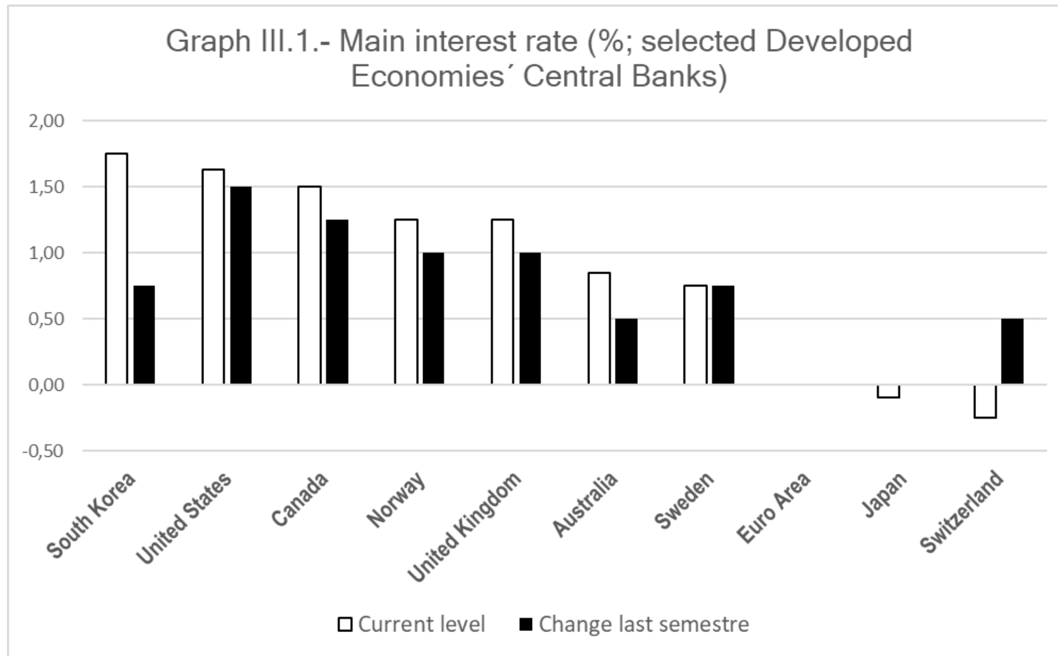
In fact, part of the profession, including this author, believes instead that the monetary authorities have been very comfortable - too comfortable - with the practice, which in the United States goes back more than two decades[3], of an increasingly asymmetric policy, with drastic and rapid monetary expansions in the face of deflationary threats, but slow and tepid monetary contractions (if any), in periods of inflationary pressures. Of course, the fact that these have been concentrated in the asset sphere, real and financial, makes it easier for Central Banks to claim that, as regards their objective, price stability of goods and services, there have been no such tensions for a long time. Indeed, external factors (globalization and its lower cost producers, new technologies, improvements in logistics and transportation, loss of bargaining power of the labour factor...) have ensured such stability. Meanwhile, extremely low interest rates and non-conventional expansion have made growing private and especially public indebtedness cheaper over the last years.

Unfortunate but not unforeseeable, the deterioration of the global economic and political situation has ended the comfort mentioned above for Western Central Banks. They must now manage a scenario in which recession lurks, sooner or later, in the sight of any mistake. And in which it will be the economic agents as a whole who, through their behaviour, can make it possible to advance along the difficult path that would lead to avoiding this crisis. Further details will follow shortly.

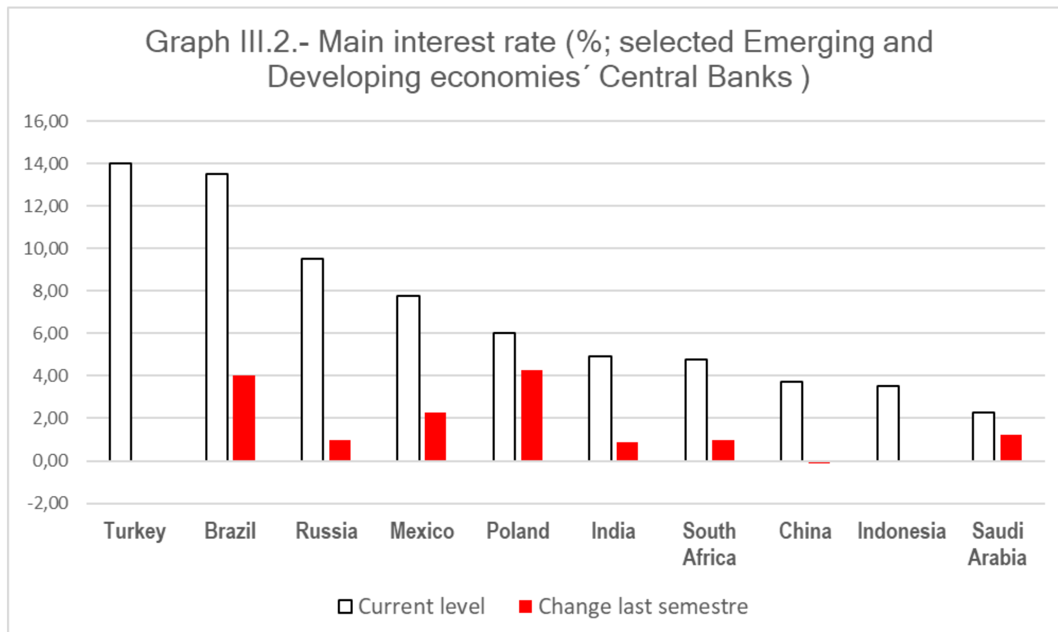
[3] See, for example, Leonard, C. (2022); The Lords of Easy Money: How the Federal Reserve broke the American Economy; published by Simon & Shuster.

III.- INTERNATIONAL REFERENCE PRICES

A.- Main interest rates



Source: Own elaboration. Data: National Central Banks.



Source: Own elaboration. Data: National Central Banks.

Leading up to the present the story developed in *Spotlight*, the beginning of the rate hikes cycle in developed countries should be highlighted, particularly in the last three months, marked by the three upward movements of the US Federal Reserve, including a very infrequent one (75 basis points, the first increase of such magnitude in 28 years). Although the European Central Bank did not move rates in the first half of 2022, it will

do so at its immediate meeting on 21 July, leaving Japan as the exception to this monetary tightening[4]. Note in any case that reference rates are below 2% in all selected countries.

In the emerging and developing world, rates are almost always more aligned with proper attention to the behaviour of inflation. With a few exceptions (Brazil, Poland), efforts had been made earlier, not only to curb price growth, which in these economies (with less intensive public support in the face of the pandemic) is more likely to be caused by supply shocks but also to prevent capital outflows to the West, which reached worrying levels in 2020 but were subsequently reversed. Nevertheless, again in the first half of 2022, international capital's outflow from the emerging world (mainly bonds) has reached potentially destabilising levels.

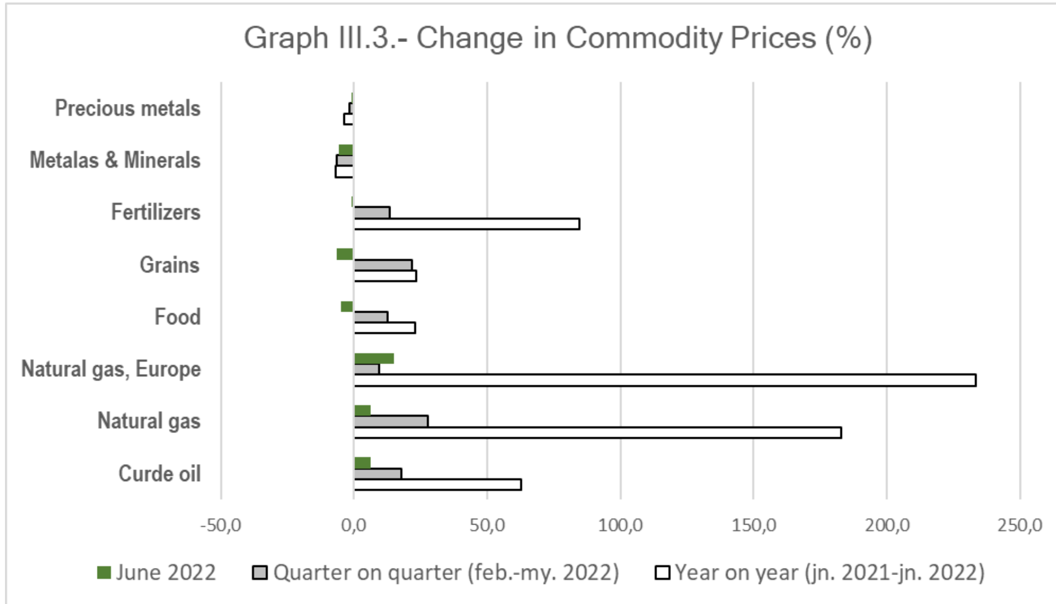
A brief note on the attitude of two of these Central Banks of emerging countries is necessary. First, Elvira Nabiullina, governor of the Russian monetary authority, raised rates to 20% in defence of the rouble in the wake of the invasion of Ukraine. When a series of measures by the Central Bank itself and the Russian government stabilised the currency, it fell to 11%, still above its pre-war level. Second, in Turkey, President Erdogan has turned the country's Central Bank into a puppet in the service of his bizarre alternative "economic theory" (so to speak), whereby it is high-interest rates that accelerate prices. Not surprisingly, in the face of the monetary authority's passivity, year-on-year inflation has reached 80%, devastating citizens' purchasing power.

B.- Raw material prices

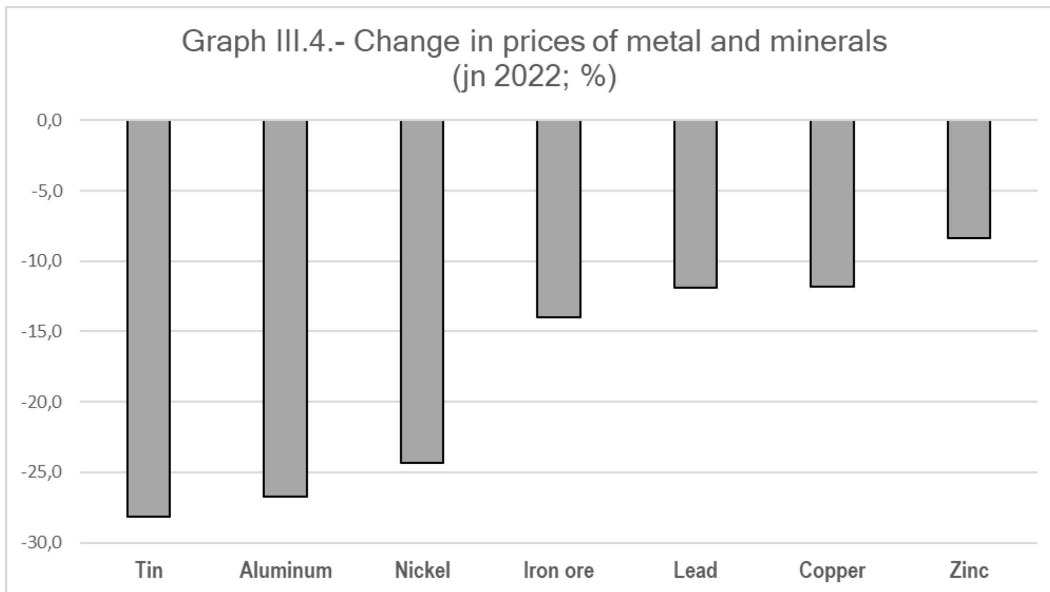
Recent commodity price developments show a considerable change in the weeks before this *Report*'s preparation. Graph III.3 reveals that even from a year-on-year perspective, price increases can be perceived, particularly in energy (with special mention of natural gas in Europe) or fertilisers, which have hampered the recovery from the pandemic, eroded the purchasing power of the average citizen and boosted inflation. In the shorter term, in the quarter following Russia's invasion of Ukraine, the greatest stresses are on foodstuffs, particularly cereals, whose prices have increased by 22% in just those three months. But the threat of a severe slowdown in the world economy is starting to be perceived, particularly (Graph III.4) in the commodity category that suffers most in a severe crisis, metals and minerals. Price declines between 10% and 30%, point to expectations fraught with concern.

In any case, it is essential to underline that the World Bank's data correspond to the evolution of these primary goods on international markets. However, in a background of significant ongoing irregularities in global supply chains, even significant decreases in average prices do not exclude that certain business sectors in certain countries are not only facing a different evolution but may not even be able to access these raw materials regularly.

[4] Indeed, its Governor, Haruhiko Kuroda, has been extolling the benefits of a weak yen and indicating, it is not clear on what grounds, that the Japanese people had reduced their concern about price rises. His subsequent apology for the latter comment was inevitable, but it is unlikely to lead to changes in the CB's interest rates or in its policy of anchoring ten-year government bond rates at around zero.



Source: Own elaboration. Data: World Bank.

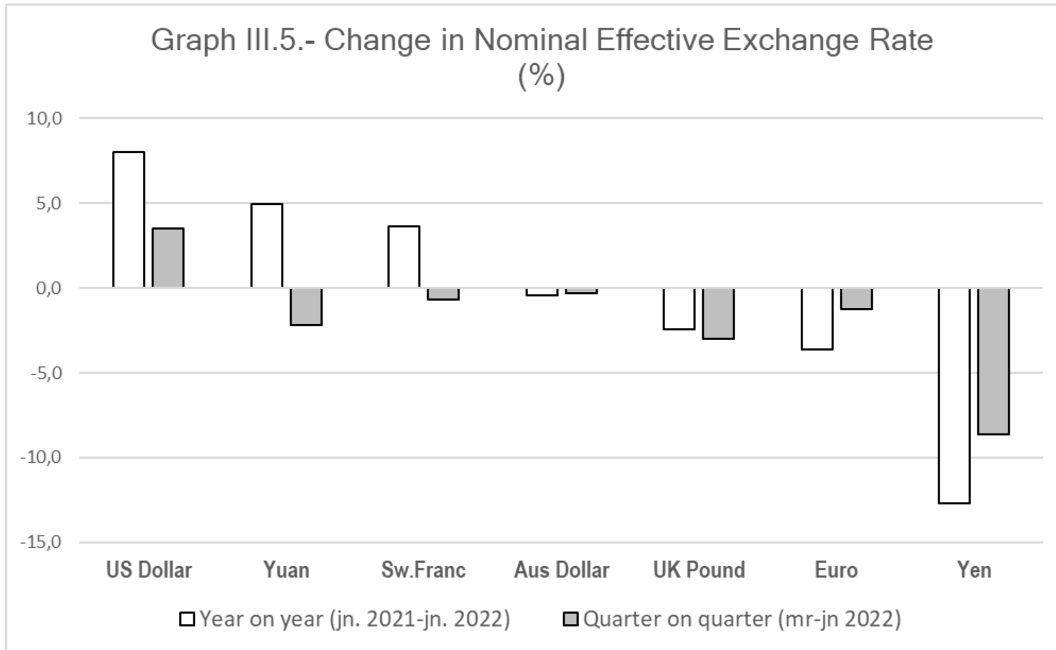


Source: Own elaboration. Data: World Bank.

<u>C.- Main currencies</u>

The considerable difference in the intensity of monetary unwinding by the various central banks has been reflected in the performance of the major international currencies in recent months. Thus (Graph III.5), the US dollar shows a recently accelerated appreciation as the Federal Reserve not only increases its reference rate and converts its asset purchases into asset sales but also points to a more accelerated tightening in the rest of 2022. At the opposite extreme is the yen, whose depreciation seems to have the full blessing of its central bank. Something similar happens with the euro, albeit to a lesser extent, as the ECB has never supported (explicitly at least) a weakening of the currency, which actually aggravates the inflationary problems. Note also the shift,

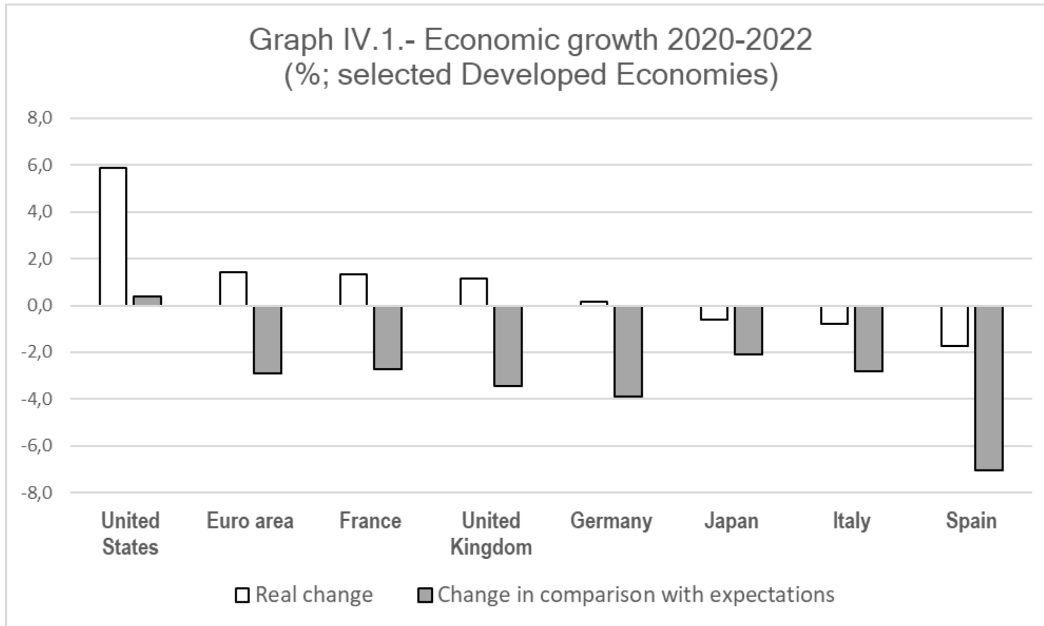
induced by growing doubts about the viability of China's "COVID-zero" strategy, between the yuan's strength in annual perspective versus its weakness in the last quarter.



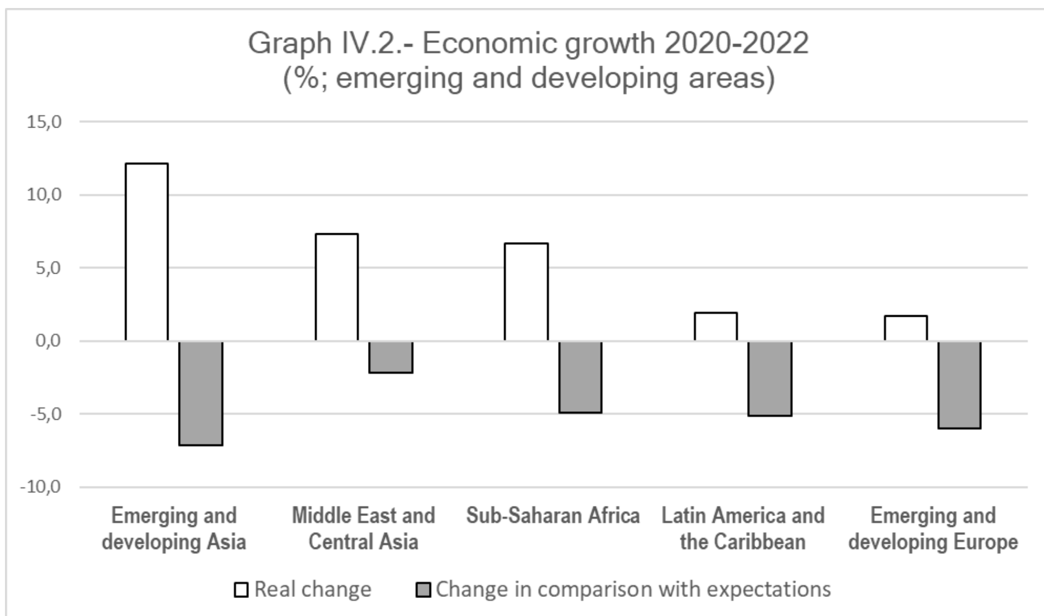
Source: Own elaboration. Data: Bank for International Settlements.
Note: Upward (downward) movements imply appreciation (depreciation) of the currency vis-à-vis those of the country's trading partners as a whole.

IV.- UNDERSTANDING THE QUARTER IN SEVEN KEYS

1.- Let us begin the tour of the second quarter of 2022 by introducing some perspective on the consequences of the shocks sequence (and measures in response to them) occurring in the three-year period 2020-2022. The two graphs below show the outcome of all these developments for the major Western economies and large parts of the rest of the world[5].



Source: Own elaboration. Data: International Monetary Fund.



Source: Own elaboration. Data: International Monetary Fund.

[5] The forecasts provided by the International Monetary Fund in its World Economic Outlook are used, to compare the most recent (April 2022) with the pre-pandemic (October 2019).

As can be observed, the evolution is pretty uneven. In the West, most economies (excluding southern Europe or Japan) will have exceeded their pre-COVID-19 levels of activity by the end of this year, albeit by a small margin. The exception is the United States, where not only would the margin be a remarkable 6%, but the economy would have grown *more* with the pandemic than without it, a unique case globally, along with some oil and gas producers. In the case of the United States, the explanation comes from the enormous magnitude of the fiscal and monetary injections. Spain, losing 7 points of GDP compared to what was anticipated at the end of 2019, is among the countries with the worst results.

All the emerging and developing world areas, despite the major problems in extending to a significant proportion of them the vaccination against COVID-19 (in addition to the negative shocks shared with the West), will close 2022 with a higher level of GDP than they had in 2019, but, also across the board, they will have lost five points or more of growth compared to what was expected before the pandemic. The exception, as a result of the increase in the price of raw materials, especially energy, is the Middle East and North Africa[6], with a much minor loss. While emerging Asia continues to lead global growth, losses from the pandemic are also the highest. At the other extreme are Latin America and emerging Europe, with very modest growth.

Given that geopolitical problems are not abating and that an abrupt change in the monetary cycle is already underway, it is more than likely that growth revisions in 2022 will be downward in the coming months. Therefore, the data reflected here, while worrying for not a few economies, are more favourable than data we will be able to present when we review actual growth later on.

2.- In this *Report*'s previous sections, we have already discussed the past and present of inflation and monetary policy. The crucial question, however, is what can be expected in the immediate future? There should be little doubt about the monetary tightening (conventional - rate hikes - and non-conventional - ending the purchase of additional volumes of debt and progressively reducing that remaining on central banks' balance sheets) that we will witness in the West in the coming months. It is essential not only - especially in the United States - to eliminate the inflationary component coming from demand, but it is even more vital, especially in this case of the Eurozone, to avoid the de-anchoring of inflation expectations, which is already occurring, and which, if translated into second-round effects (due to the pressure of the different agents to index their incomes to unleashed inflation rates), would complicate the situation to the extreme.

However, on the other hand, Western Central Banks should remember that their very late response to inflationary pressures may lead to a concentration of the impact of current measures at a moment where concerns are directed at slowing growth... and the sustainability of governments' runaway public debt (more on this factor shortly).

[6] Indeed, if we look exclusively at the Middle East area, the data with the pandemic would be higher than expected before the pandemic.

The search for equilibrium to which the Central Banks are now forced by the external shocks and the need for a response to their own parsimony is highly complex. At the same time, it is a question of curbing inflation, avoiding the de-anchoring of expectations without inducing recession in their economies.

One would bet that we are heading to a sharp monetary tightening in the coming months on both sides of the Atlantic and the South Pacific (not in Japan), accompanied by anti-inflationary language (already being used) even more radical than the measures themselves, aimed at convincing public and private agents that, however painful, it is necessary to accept a significant loss of purchasing power, preferably in a balanced way among workers, firms, owners, renters and public institutions. Thereafter, and even before the end of 2022, the rate hikes will end much sooner than would be required for inflation to return to the price stability target, but soon enough not to generate - or aggravate - a recession.

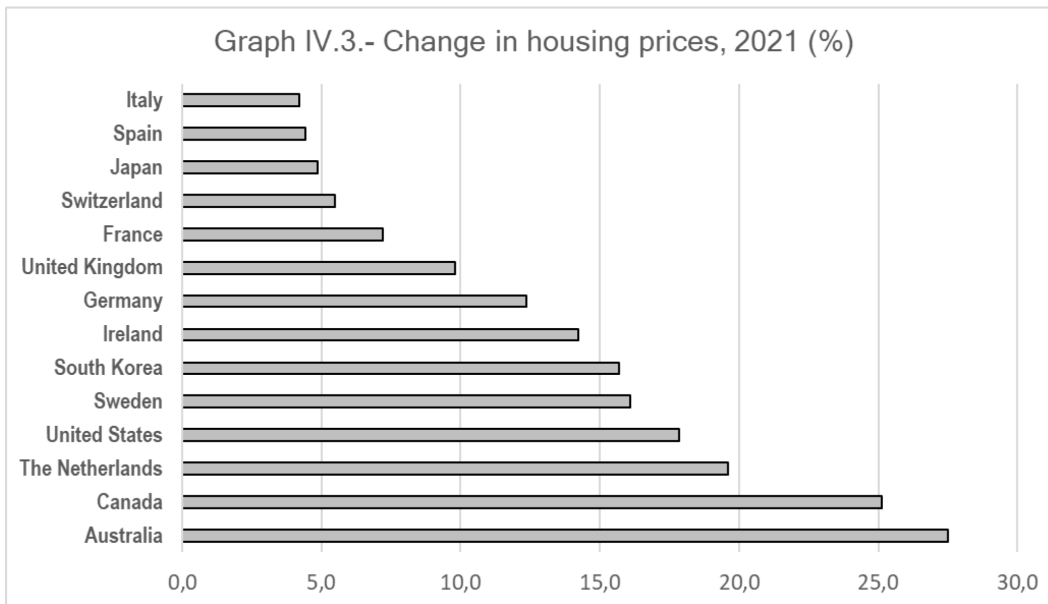
In other words, the world upside down. Avoiding the consolidation of unacceptable inflation rates will depend on the responsibility of private agents and governments and the hope of an improvement in the global geopolitical situation. Central banks, some with an explicit and unambiguous mandate to ensure price stability (including the European Central Bank), will play a minor role in the desirable return to normality at an obvious cost to their credibility. It is time to rethink the ostensible asymmetry in monetary policy decisions that has been going on for too many years now (see our *Spotlight* on this issue).

But, regardless of this last point, let us hope that the strategy outlined above works because if the de-anchoring of inflation expectations leads to the perpetuation of inflation, it will be time to resurrect Paul Volcker (Governor of the Federal Reserve between 1979 and 1987) and his manual on how to liquidate inflation (with lasting effects) ... and generate, because there is no free lunch, a severe recession. If necessary, we will return to this moment (hopefully not) in future *Quarterly Reports*.

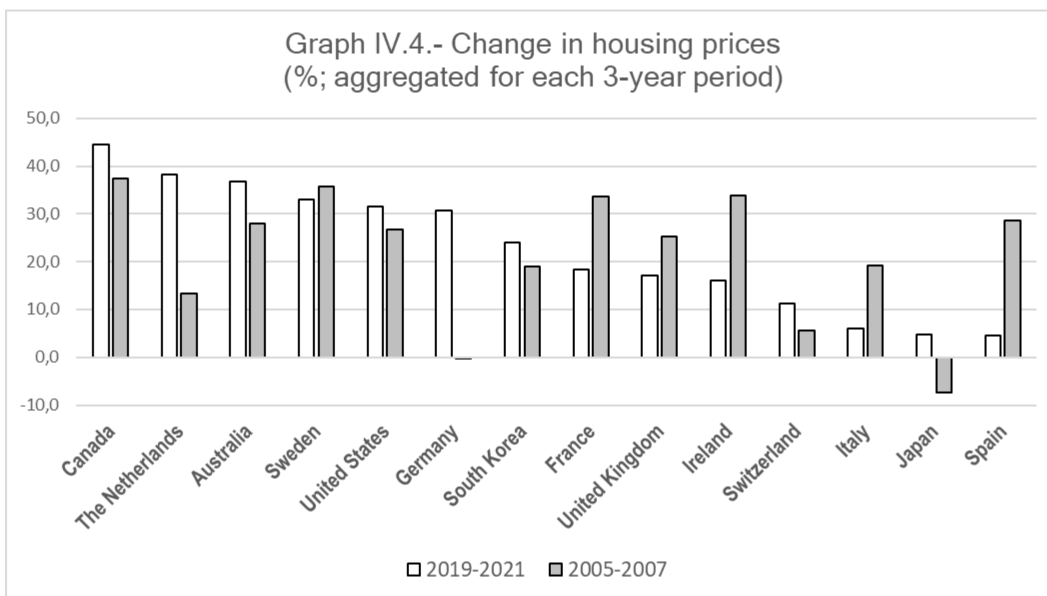
3.- One of the most noticeable consequences of the change in the monetary cycle in the United States and Europe, in addition to the enormous uncertainty caused by the global geopolitical situation, has been the widespread collapse of financial markets, from the more traditional ones (double-digit declines in the main stock markets) to the new sources of rapid enrichment (evaporation of two-thirds of the aggregate capitalisation of cryptocurrencies). Actually, the best-covered lie of the past decade is the repeated claim that ultra-expansionary monetary policy did not generate inflation problems during that period. It was simply asset inflation, not goods and services inflation.

Regardless, there are two assets that should be of most concern in the immediate future due to the size of the amounts involved and the agents affected. First, in this third key point of the quarter, let us look at the trend in house prices, which is crucial because it is the area in which invests a large part of the population (in its dual role as a durable consumer good and investment asset). Graph IV.3 reveals a disproportionate growth in house prices in almost all Western countries, except for southern Europe and Japan. To explain this development, we must add the exceptionally accommodative credit conditions (volume and rates), the magnitude of fiscal support in 2020 and 2021, and

the desire of many citizens to change their residence as a result of the circumstances triggered by COVID-19 and the health restrictions to control the pandemic.



Source: Own elaboration. Data: Federal Reserve Bank of Dallas.



Source: Own elaboration. Data: Federal Reserve Bank of Dallas.
Note: Data for the United States refer to the three-year period 2004-2006,

Of more relevance, the rise in prices last year is not a rebound from the trend of previous years but an accentuation. Needless to recall, the implosion of housing market excesses was behind the severity of the Great Recession in more than a few developed countries. But, again, with the marked exception of the southern European economies - still with the fresh memory of a crisis from which they had only just recovered when the pandemic broke - Ireland (also severely hit by that housing bubble) and Japan, Graph IV.4 shows how price increases in the rest of the major Western economies were, between 2019 and 2021, similar to or higher, and sometimes substantially higher, than between 2005 and 2007, the three-year period before the Great Recession.

Note, in particular, that the rise in US house prices between 2019 and 2021 has already exceeded the cumulative at the end of the previous bubble (2004-2006). It was precisely the fall in these prices from 2007 onwards, linked to the opaque and complex financial engineering built on the lower-quality mortgages that underpinned much of the purchases in previous years, which was at the root of the Great Recession. Equally remarkable is the 30% growth in house prices in Germany over these three years, in contrast to the sluggishness of house prices in the first decade of this century.

The concern about this increase in house prices lies, of course, in the risk of repeating of what happened a decade and a half ago. With interest rates on the rise, demand is falling, mortgages defaults are increasing, worse expectations are causing prices to fall, and, as a result, the value of this key asset for families is also falling (while the amount of debt contracted remains the same)—a certain risk, which grows in proportion to the rise in interest rates.

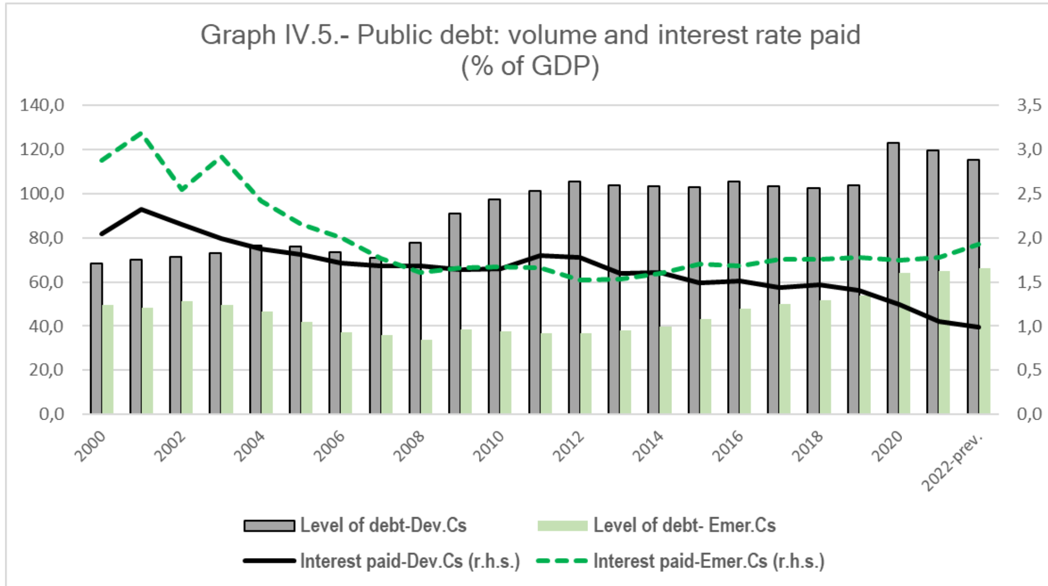
4.- No less significant is the fear of falling government bond prices[7] (equivalent to rising interest rates on these bonds), especially in the Eurozone, as this factor put the euro's very survival[8] at serious risk between spring 2010 and mid-2012.

The prospect of a significant increase in Central Bank's main interest rates, coupled with the fear of continued inflation rates higher than those experienced in the past quarter of the century (higher inflation for which, of course, investors need to be compensated) has led to this higher cost of debt for developed countries. In reality, these countries have become habituated to a fictitious scenario, caused, among other not negligible but secondary factors (such as more conservative savings in line with demographic ageing) by the non-conventional policies of Central Banks, particularly the massive purchases of public debt. With a buyer[9] of such unlimited purchasing power, Western countries have raised their debt to unprecedented levels at very low or even negative cost. Thus, for the countries as a whole (see Graph IV.5), while the debt climbed to more than 120% of GDP, interest payments on it were as low as 1% of GDP. The same graph contrasts with the evolution in the emerging world, where the volume and cost of debt follow, with fluctuations, a parallel trajectory.

[7] According to data compiled by the Financial Times, the US ten-year bond has experienced its worst performance since 1788 in the first half of 2022.

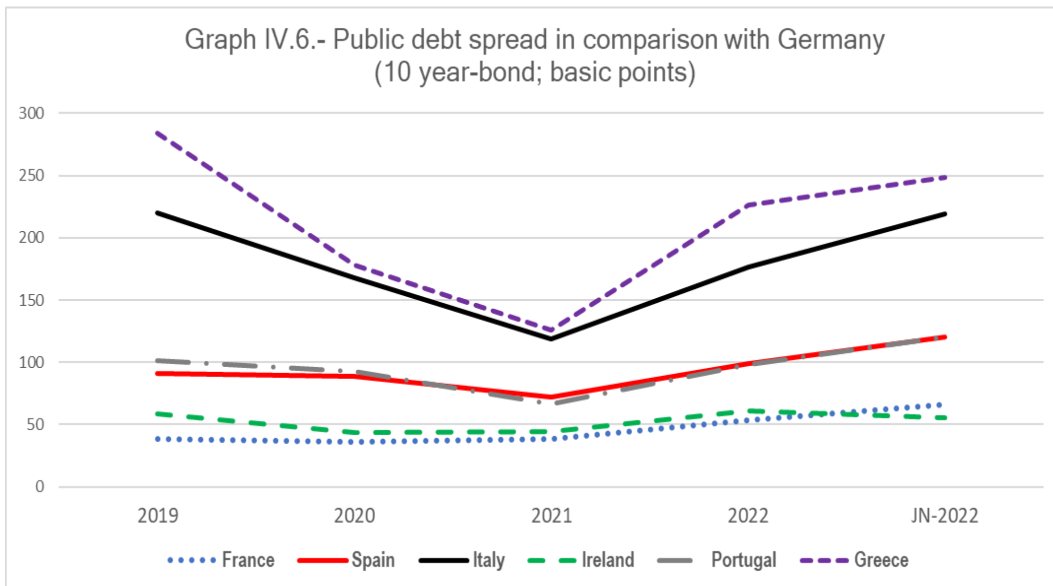
[8] With such doubts nipped in the bud by the most memorable phrase of the entire Great Recession era, uttered by the current Italian Prime Minister and then President of the European Central Bank, Mario Draghi: "Within its mandate, the ECB will do whatever it takes to preserve the euro. And believe me, it will be enough".

[9] For example, in the first two years since the pandemic outbreak, the European Central Bank purchased an equivalent of more than 100% of the vast volume of debt issued by all Eurozone members.



Source: Own elaboration. Data: International Monetary Fund.

This fictitious "zero-cost" of public debt could only be sustained as long as monetary policies continued to validate[10] an otherwise unsustainable mode of growth, supported only by ever-increasing levels of public and private indebtedness. The total or partial termination (Japan being an exception) of these debt purchases has put a stop (and an end?) to the privilege of Western governments to finance themselves at "zero cost". Many, including the author, thought it was about time.

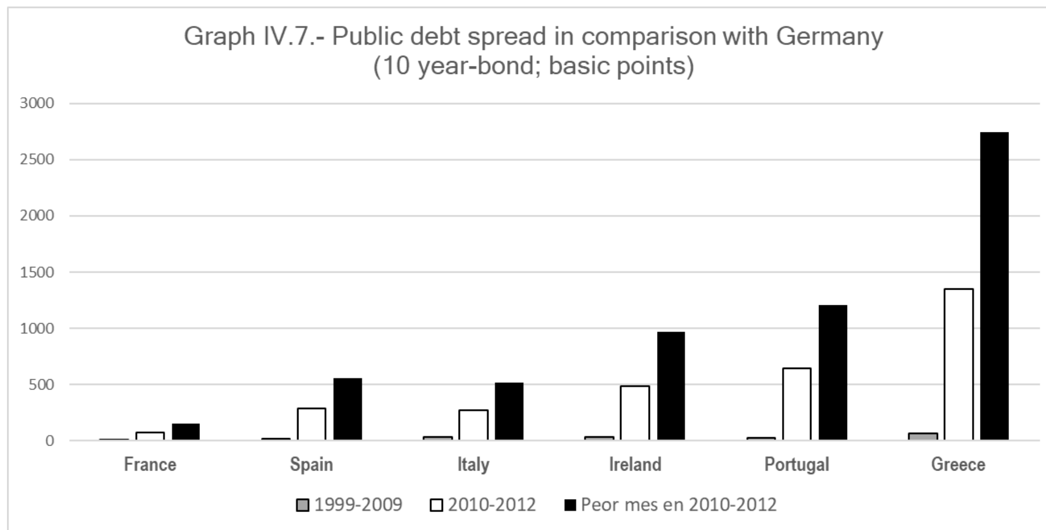


Source: Own elaboration. Data: European Central Bank.

As already noted, and looking back a decade ago, the scene change has been particularly alarming in the Eurozone, where (see Graph IV.6) the risk premia (i.e. the extra cost of financing relative to Germany) for the southern economies have risen considerably in the last couple of months. Considering that in the first half of 2022, Germany's ten-year

[10] With severe costs on which we will reflect in the future.

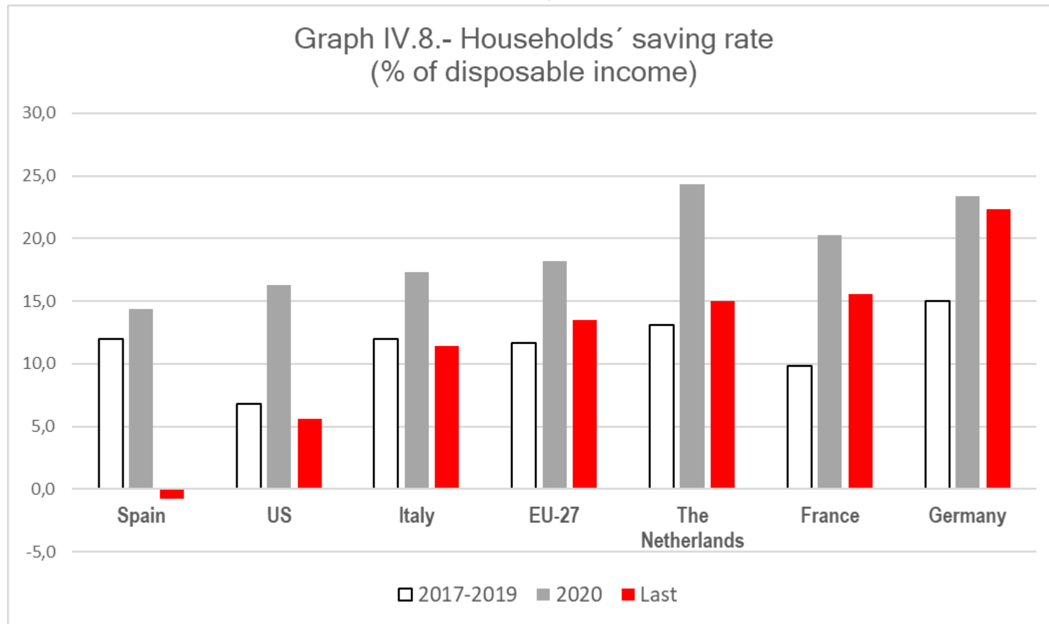
debt rate has risen by just over 200 basis points, the increase for the southern Eurozone countries is already more than 300 basis points.



Source: Own elaboration. Data: European Central Bank.

Certainly, these values are far from those experienced at the worst moments of the previous crisis (see Graph IV.7), but the trajectory of interest rates and the market anxiety is threatening. For this reason, as anticipated, and from days after the appearance of this *Quarterly Report* (which is why we will analyse the proposed mechanism in October), the European Central Bank will have to launch a programme that is capable, simultaneously: 1) of convincing investors that they do not face a reproduction of what happened in 2010-2012 and, with this, avoiding the fragmentation of the Eurozone in the scope of financing its members; 2) of avoiding the perception that it is preferentially financing the countries of the South; 3) to make compatible, technically and conceptually, what will continue to be a non-conventional expansionary monetary policy (and with a new mechanism to carry it out) with interest rate hikes and the end of previous programmes; 4) to reject the criticism, recurrent in Germany, that its policies are as such fiscal as monetary. A remarkable balancing act for the members of the Governing Council, indeed.

5.- One of the most interesting variables to observe since the start of COVID-19 is the household savings rate in Western countries, where most public aid has been channelled towards household economies, at the same time as restrictions on certain economic activities conditioned citizens' consumption, especially of services. When to these two elements an undoubted increase in savings due to the uncertainty inherent in facing a global pandemic episode is added we find a spectacular jump in the before mentioned savings rates (see Graph IV.8).



Source: Own elaboration. Data: Federal Reserve Bank of St. Louis; Eurostat.
Note: The latest data refer to the first quarter of 2022 or the last quarter of 2021, depending on the country.

The 9.5% increase in savings of net household disposable income in the United States and 6.5% in the EU-27 between the average rate in the three years prior to the pandemic and the average for the year 2020 means, taking 2019 GDP as a reference, an additional saving of around 2.3 trillion euros for the 28 economies as a whole. An exceptional accumulated consumption capacity, therefore. And much of it is already used.

Indeed, in all cases, the savings rate has already fallen from the 2020 peak, although in some countries, it is still above pre-pandemic levels (Germany, France, the Netherlands), bringing the EU-27 to a buffer of almost 2% above that average for the period 2017-2019. Many others are already below this level, as in the United States, where the magnitude of the additional savings and the speed of subsequent dissaving explains in no small measure why it is the only large economy that has grown *more* with the existence of the pandemic than expected without it.

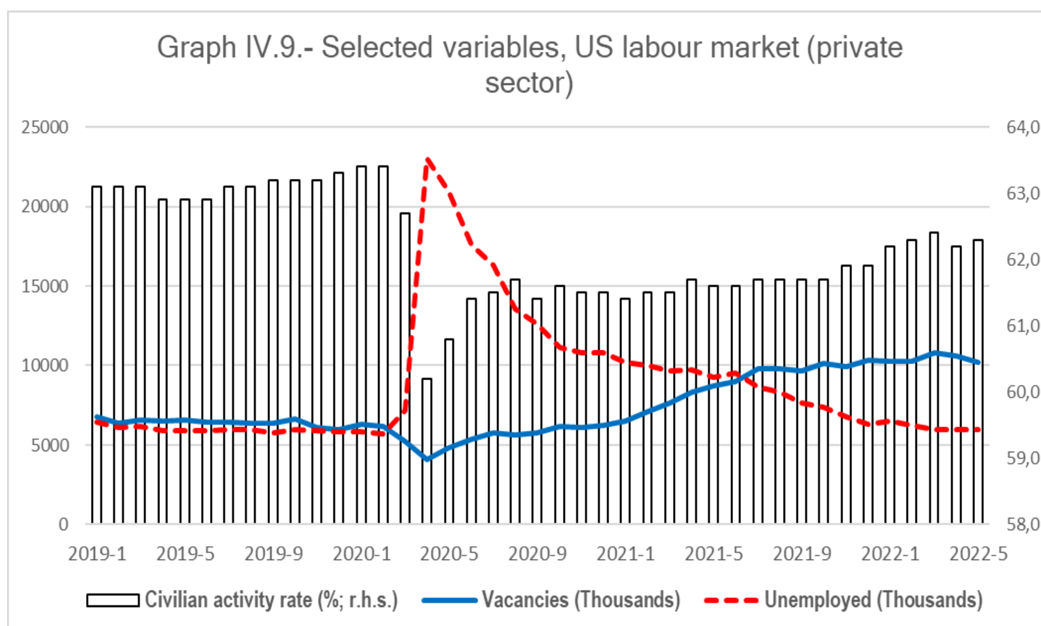
Undoubtedly, the Spanish case is the most severe and worrying. The household savings rate grew modestly from pre-crisis levels, consistent with less generous subsidies than in other countries. But the latest records reveal a negative household savings rate, implying that households have spent more than their entire disposable income in those three months.

Given the rising cost of living and tightening monetary conditions, households face an increasingly unfavourable scenario. In those countries, led by Spain, where additional savings have already been spent in high proportion[11], this could lead to a sharp economic growth slowdown.

[11] Note that the latest alarming figure is for one quarter only. If we extended the calculation to the previous year, the average figure would be around 7%. In any case, clearly below the pre-COVID-19 rate.

6.- The behaviour of the US labour market has also attracted much attention in the last two years. First, because, in contrast to the abundant direct aid to households articulated in successive waves by both the Trump Administration and the Biden Government, and unlike in Europe, jobs were not protected in the United States, leading to unimaginable fluctuations in employment: from falling by 22 million between February and April 2020 (non-agricultural paid employment) to rising by 10.5 million in the following four months (and by 21.5 million by June 2022), returning to unemployment rates of around 3.5%.

Then came the idea of a massive abandonment of the labour market, either due to temporary factors (fear of the reduced extent of vaccination compared to the rest of the West; absence of certain services - nurseries, schools, care for the elderly - which took a long time to be restored) or more structural ones (rethinking life, the anticipation of retirement). Special attention continued to be paid to the growing difficulties of companies in filling their increasing job vacancies, and not only in specific sectors (health, transport, technology) as in Europe. And finally, there is the discussion of the intense upward pressure on wages, with severe implications for demand pressure and, thus, on the Federal Reserve's effort to contain inflation. Let us offer some clarifying facts about these debates.



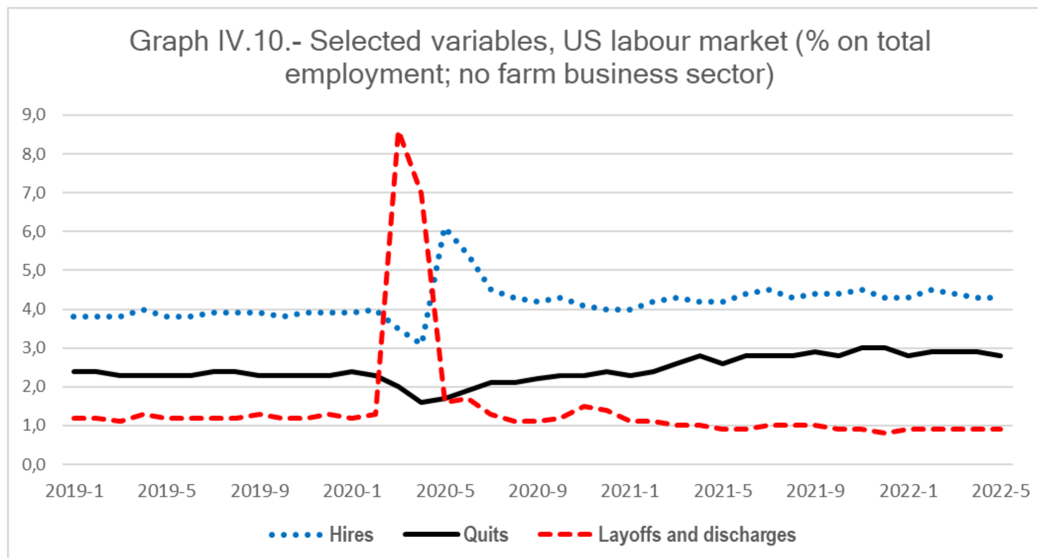
Source: Own elaboration. Data: Federal Reserve Bank of St. Louis.

First, regarding the labour force activity rate (Graph IV.9), it seems that the theories about a significant and voluntary withdrawal of people from the labour market overstated the reality slightly and that there were temporary factors closely associated with COVID-19 itself and how the United States' response has been handled, that account for most of the decline in the activity rate. Today, two-thirds of the reduction in that rate has already been reversed. Admittedly, it is still 1% below the pre-pandemic rate (just over 1.5 million people), but it does not seem to be the most relevant factor in the current labour market tensions.

The same graph shows with crystal clarity the opposite trajectory of the levels of unemployed and job vacancies in the country. Since mid-2021, the two series have

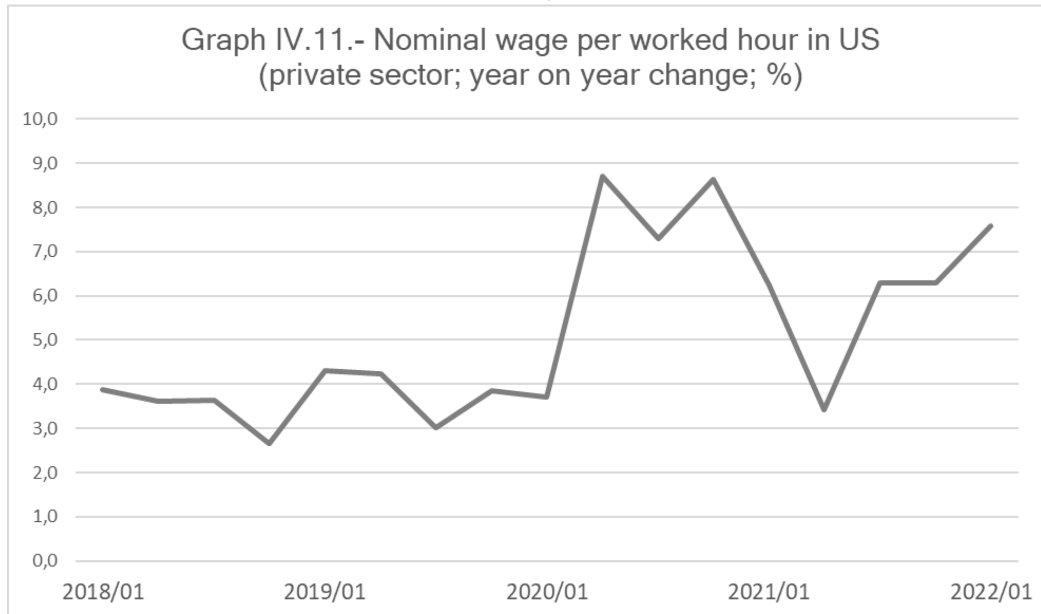
crossed paths, and in recent months the vacancy/unemployment ratio is already at 1.7-1.8 or; in other words, there are 4.2 million more unfilled jobs than unemployed people willing to take up a job in the United States. This imbalance far exceeds the above-mentioned number of assets that would have to return to the labour market to recover the pre-pandemic activity rate and makes the idea that "the problem is solved if companies pay more" rather simplistic.

We will return to the issue of wages briefly, but first, let us look at Graph IV.10, which shows hiring and reasons for exiting jobs in the United States. Note that the monthly rate of new hires slightly exceeds the pre-COVID-19 rate, while the rate of layoffs is 25% lower. Voluntary departures, on the other hand, are 20% to 30% higher than in 2019 and, in fact, reach the highest values (close to 4.5 million per month) since the beginning of the series in December 2000. Therefore, workers are moving voluntarily (three times more than as the result of a dismissal) because companies other than their own are offering better conditions. This improves the situation of this group but does not close the gap between vacancies and the unemployed.



Source: Own elaboration. Data: Federal Reserve Bank of St. Louis.

How is this expressed in terms of wages? This is illustrated in Graph IV.11. Nominal wage growth per hour worked has accelerated by more than three points between the two years before the pandemic and the two years after its onset (3.7% vs 6.8%). To find a higher year-on-year average than the past four quarters, one has to go back, not by chance, to the early 1980s. Because, apart from the insufficient number of people willing to work compared with available vacancies, which forces companies to compete with each other, there is a growing need to compensate workers for the loss of purchasing power caused by inflation rates not seen since... indeed, the early 1980s. Then, getting to eliminate that inflation forced Paul Volcker to set the Federal Reserve's interest rates at 18%. As already discussed in this *Report*, let us hope that Jay Powell can achieve this with much less, or the consequences will be devastating.



Source: Own elaboration. Data: Federal Reserve Bank of St. Louis.

Regarding the matter of how to fill vacancies in the US labour market, one would suggest that rethinking the severe immigration restrictions of recent years (for lower-skilled jobs) and investing in more and better training (for higher-skilled vacancies) would be far more successful than populist slogans along the lines of "pay more".

7.- To close our *Quarter's Keys*, a brief note on a topic on which we will insist not only in these *Reports* but also in the activity of the *Valenciaport Chair* as a whole, and which, to summarise the myriad of ideas being debated on the subject, we will call "a new globalisation".

Some features of the wave of globalisation that began in the 1990s and was accelerated by China's incorporation (with preferential treatment) into the World Trade Organisation had already given rise to intense debates about its sustainability. Among them: the scarcity of margins in supply chains, dominated by cost efficiency and just-in-time; the concentration of suppliers of primary, intermediate and final strategic goods; the constraint caused by manufacturing offshoring (together with robotisation) on the Western middle class, feeding populist recipes; and the environmental costs of the latter.

But it was the pandemic that further fuelled these doubts. Initially, out of certain desperation for what was implied at that critical time by the first couple of features mentioned above, there was talk of a radical change in global value chains (GVCs). With greater perspective, it has been soon understood that there will be a change, but much more moderate and progressive. Thus, there will be a recomposition of GVCs in strategic sectors (life sciences, rare earths, microchips), partly by shifting production back to the West, primarily by shortening (regionalising) the chain. There will be a lower concentration of producers in many sectors, although most will remain in Asia (and primarily in China), whose production capacity cannot be replaced in short to medium term. Finally, the only cost-oriented decisions will be no more prevalent, and "just in

time" will give up some of its absolute dominance to "just in case". A big change, but less so. Reshoring and nearshoring[12] will not end with globalisation.

In a similar process, the immediate reaction to Russia's invasion of Ukraine, stemming from outrage with the event itself and with the lack of support for Western sanctions on Russia from much of the emerging and developing world, has been an exponential increase in support for the idea of fracturing globalisation and directing all Western trade towards countries considered democratic (or, in the new terminology, "liberal democracies", as opposed to "illiberal democracies" and "autocracies and dictatorships"). Again, an inevitable return to realism is to be expected. No doubt Europe and Japan will accelerate their efforts to reduce their dependence on the other strategic sector, energy, which was already done some time ago by the United States. And maybe, just maybe (ask Germany), the prioritisation of business above all other considerations will be a little slighter.

But in a fully interconnected world, where 50-70% (depending on the methodology employed) of all global trade is integrated into GVCs, "friendshoring" and "decoupling"[13] will not end globalisation either.

[12] Respectively, reversing the process of delocalisation of activities from the West to the rest of the world and bringing new locations of these activities geographically closer together

[13] Respectively, skewing international economic relations towards friendly countries and separating the economic world into two spheres, democratic and non-democratic.

V.- THE WORLD IN TWO VARIABLES

As we pointed out in the Introduction of this *Report*, we will close these quarterly tours with the presentation of two macroeconomic indicators of interest, which we will review from time to time, displayed on a comparative basis for the three major groups of world economies: developed countries, emerging countries and developing countries[14]. To this end, the ten countries with the largest populations in each group are selected. The data for the largest (by far the largest in each case, which would distort the weighted average if they were included in the aggregate), respectively, the United States, China and India, are shown separately. Data for the other nine countries in each group are weighted according to their weight in the world economy (measured in Purchasing Power Parity) and shown together. The 2021 population and world GDP share data for the 30 selected economies are presented in the *Annex* to this Report.

Using annual data, we will look at what has happened since 2000 in the following sub-periods: 2000-2007, a phase of strong global growth, especially in the non-developed world; 2008-2011, the main years of the Great Recession, which primary affected North America and Europe but had broad global repercussions; 2012-2019, again an expansionary period, much less dynamic than the previous one, especially for the non-Western world (with crises in many countries in these areas during the sub-period), and with growth sustained by rising indebtedness (in quite a few countries in all three groups) and extremely expansionary monetary policy in the developed world. Next is the initial year of the pandemic associated with COVID-19 (2020) and the initial rebound year of the latter (2021).

We begin our journey with a classic indicator, such as real Gross Domestic Product growth, corrected by population growth, a factor of particular relevance to the developing world, where high population growth rates persist in many countries. The second indicator takes up the American economist Arthur Melvin Okun's original formulation to measure the dissatisfaction caused to citizens by two economic processes: unemployment and inflation. In that original presentation, Okun simply aggregated the values of both variables[15].

V.1.- PER CAPITA REAL GDP GROWTH EVOLUTION

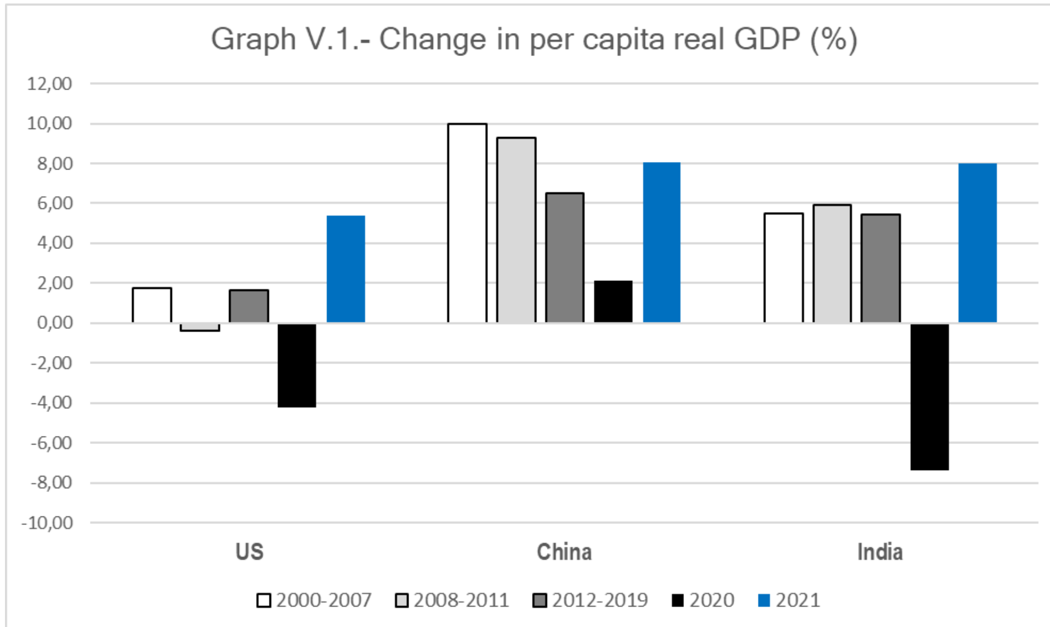
Graphs V.1 and V.2 reproduce this indicator's behaviour with the selected group of countries and in the sub-periods explained.

The most critical elements are the following: first, the added population element does not change the general idea of how growth has behaved in these twenty years and, in

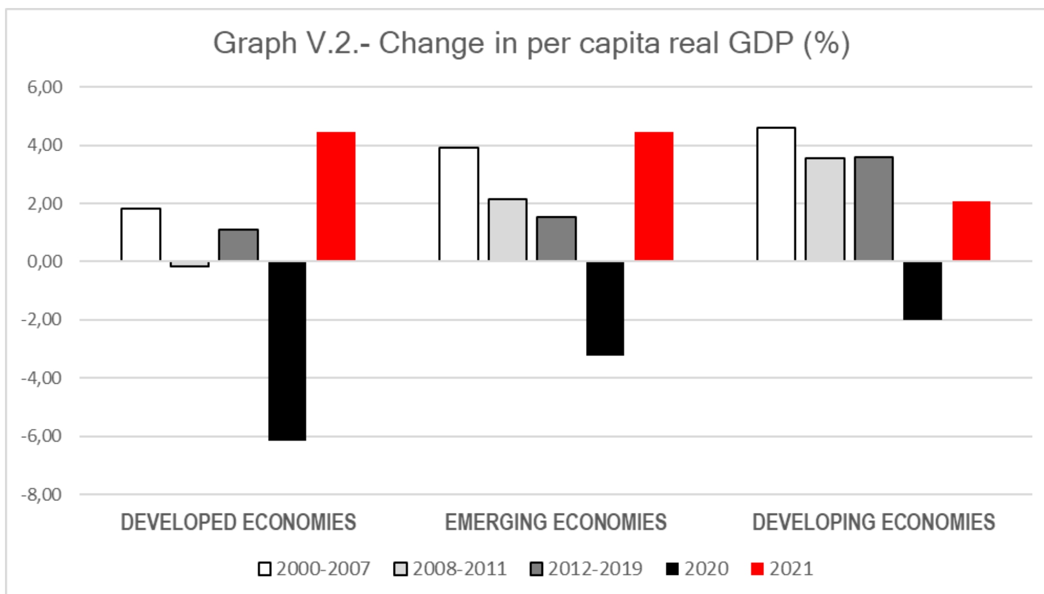
[14] The differentiation between these two groups is established exclusively in terms of their respective per capita incomes, with a separation figure of 13,000 dollars in Purchasing Power Parity in 2020. This explains India's presence in the third group, which is usually considered emerging due to the overall size of its population and economy.

[15] For decades, weights other than 50% have been discussed in the economic literature. We maintain the equal weighting, considering only the nuance of the absolute value of inflation, which implies assuming a negative impact on the citizen of deflationary processes. However, the idea itself is debatable, especially if deflation is caused by supply factors.

particular, the greater impact of the last two recessions (Great Recession and pandemic) in the West, being lower in the emerging countries and even weaker (due to their lesser interconnection with the globalised world of trade and finance) in the developing countries (with the crucial exception of India, suffering an extreme COVID-19 effect).



Source: Own elaboration. Data: International Monetary Fund.



Source: Own elaboration. Data: International Monetary Fund.

Second, this demographic evolution consideration widens China's growth advantage over India between seven-tenths and one percentage point, depending on the sub-period, and erodes the developing world's advance by about two percentage points, a cause for concern as overall growth has slowed.

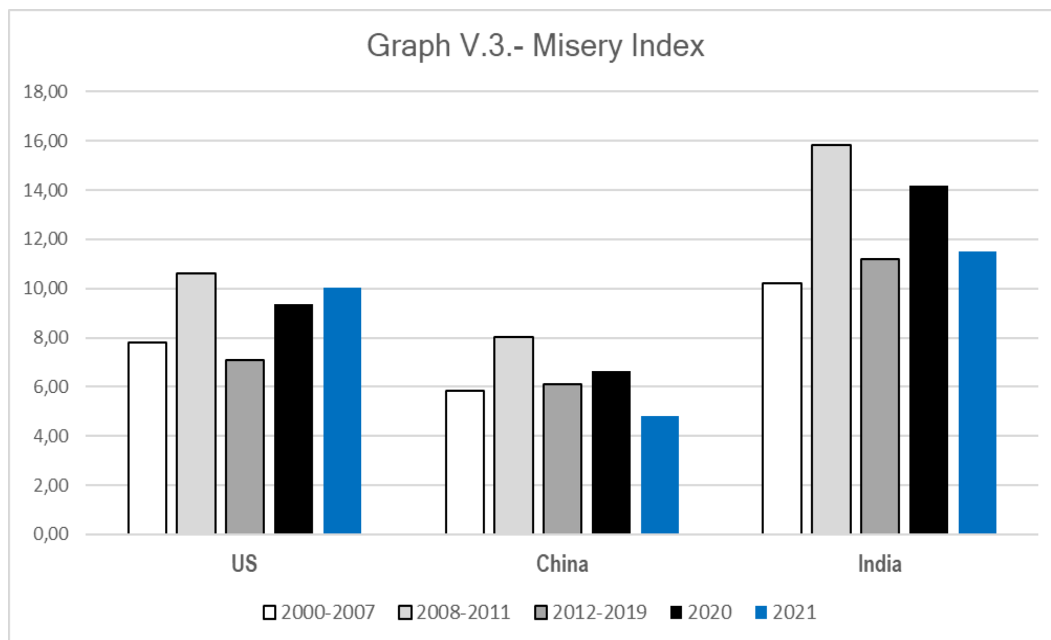
Thirdly, stands out the ostensible reduction over the twenty years in the indicator's progress in the emerging countries, something very reasonable in the case of China,

bearing in mind the very high initial growth and the progressive maturing of its economy, but less justifiable for the other nine countries as a whole (an aggregation which, of course, hides important differences between, for example, the high dynamism of Indonesia and the poor performance of Brazil and Mexico).

Fourth, and non-exhaustively, outstanding is the strength, relative to the rest of the world, of the intensity of the economic recovery in the West, particularly in the United States, in 2021. Apart from the rebound effect from a larger decline in the previous year, the greater extent and speed of the inoculation of the vaccines designed against COVID-19, and the greater size of the support introduced by macroeconomic policies, explain this evolution.

V.2.- THE MISERY INDEX EVOLUTION

The following two graphs refer to the joint evolution of unemployment and inflation (absolute value in our case), i.e. the Misery Index.

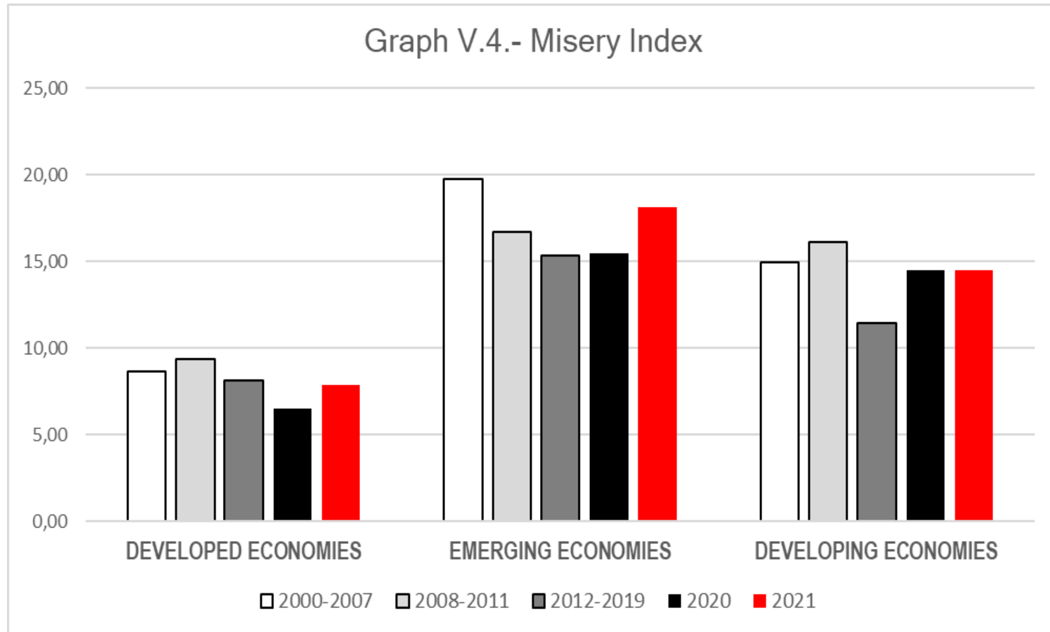


Source: Own elaboration. Data: International Monetary Fund.

Again, referring only to some of the insights suggested by this evolution, we would highlight: first, predictably, the fact that the aggregation of both negative economic processes is more favourable in the West than in the rest of the world... although more unfavourable in the United States than in China. Perhaps surprisingly, this indicator is systematically better in the developing world than in the emerging world (once China's clear advantage over India is presented separately). The high inflation rates in several countries in the second bloc and the dubiously (very) low official unemployment data (collected by the IMF and the World Bank) in more than a few developing countries explain this partial surprise.

Second, cyclical upturns outperform downturns, implying that unemployment reductions in upturns have been more than offsetting inflationary pressures of economic dynamism... until 2021. The rise in inflation (already before the current peaks) was so

remarkable that its adverse impact on the indicator outweighed in all three economic blocs the favourable effect of unemployment reductions by 2020.



Source: Own elaboration. Data: International Monetary Fund; World Bank.

Third, this counter-cyclical behaviour of the indicator (the higher the growth, the lower the economic dissatisfaction) does not seem to mask a clear structural trend towards a better indicator performance, except perhaps in the emerging world.

Finally, it is noteworthy that China's Misery Index, unlike the trend for the rest of the non-developed world, has consistently outperformed those of the developed countries as a whole over the two decades analysed.

ANNEX. Selection of economies Section V

2021 Data	POPULATION (millions of habitants)	GDP-Purchasing Power Parity (% of world total)
DEVELOPED ECONOMIES		
US	**332.183**	**15.738**
Japan	125.507	3.843
Germany	83.196	3.324
United Kingdom	67.531	2.329
France	65.447	2.301
Italy	59.236	1.871
Republic of Korea	51.681	1.718
Spain	47.399	1.357
Canada	38.226	1.386
Australia	25.709	0.992
EMERGING ECONOMIES		
China	**1412.600**	**18.619**
Indonesia	272.249	2.441
Brazil	212.609	2.351
Russian Federation	145.558	3.073
Mexico	128.972	1.825
Egypt	102.612	0.950
Islamic Republic of Iran	84.981	0.983
Turkey	84.680	2.014
Thailand	69.951	0.920
South African Republic	60.143	0.593
DEVELOPING ECONOMIES		
India	**1392.012**	**6.993**
Pakistan	222.590	0.910
Nigeria	211.401	0.790
Bangladesh	166.303	0.671
Philippines	110.200	0.692
Ethiopia	99.701	0.214
Vietnam	98.321	0.776
Democratic Republic of Congo	93.751	0.077
Tanzania	59.730	0.127
Myanmar	53.550	0.163

Source: Own elaboration. Data: International Monetary Fund.