Small States:
Faltering Recovery, Multiplying Challenges

M. Ayhan Kose
April 2022

Two Questions

1. What are near-term growth prospects for small states? A lagging recovery from the pandemic is being further held back by global supply shocks. Geopolitical tensions associated with the war amplify risks, including financial stress, inflation, supply disruptions, food insecurity, social tensions, fragmentation of trade, investment, and financial networks.

2. What are the policy priorities? Supporting the vulnerable through the period of high food and energy prices; facilitating trade; mitigating debt vulnerabilities; accelerating vaccinations; preparing for climate change and natural disasters; addressing structural barriers to growth.

* EMDEs = Emerging Market and Developing Economies
Two Questions

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Global Economic Environment

High Uncertainty; Rising Inflation; Tightening Financial Conditions

Sources: Bloomberg; Caldara and Iacoviello (2021); Haver Analytics, World Bank.

- Left Panel: VIX refers to 30-day expectation of U.S. equity volatility. End-month data are presented. Global geopolitical risk is represented by the benchmark index developed in Caldara and Iacoviello (2021). Monthly averages of daily data are presented. Last observation is March 2022. Center Panel: Year-on-year group median inflation for 81 countries, of which 51 are advanced economies, 50 are EMDEs and 15 small states (a geographically selected sample of small states). Last observation is February 2022 except for small states, which is January 2022. Right Panel: Market expected interest rates, based on overnight interest rate swaps. Data from April 6, 2022.
Growth Forecasts
Downgraded for 2022

Sources: World Bank.
Left Panel. Sample includes 34 EMDE small states and 146 EMDEs. Small states include those for which the World Bank produces a growth forecast and which are eligible for WBG lending. The small states aggregates exclude Guyana, which is in a growth boom due to rapid offshore oil industry development. Right Panel. FCS is fragile and conflict-affected. Sample includes 22 tourism-reliant, 11 commodity-reliant, and 7 FCS small states. Guyana is excluded. Tourism-reliant countries are those with inbound tourism expenditure as a share of GDP in the top quartile among 146 EMDEs. Commodity-reliant economies are those where, on average in 2017-19, either (i) total commodities exports accounted for 30 percent or more of total exports or (ii) exports of any single commodity accounted for 20 percent or more of total exports. Economies that meet these thresholds as a result of re-exports are excluded.

Scars of the Pandemic
Still Depressed Tourism; Large Output Losses

Sources: Haver Analytics; national sources; UNWTO; World Development Indicators; World Bank.
Left Panel. Averages. Range refers to the interquartile range for people vaccinated. Last observation is March 27, 2022. Center Panel. Data is seasonally adjusted. Caribbean includes Antigua and Barbuda, Bahamas, Barbados, Beliz, Dominica, Grenada, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines. Indian Ocean islands include Maldives, Mauritius, Palau and Seychelles. Last observation is December 2021 for Caribbean and World, and January 2022 for Indian Ocean islands. Right Panel. Losses represent sum of real GDP losses for 2020, 2021 and 2022 versus pre-pandemic growth projections as percent of 2019 real GDP. Values for 2022 are World Bank current estimate for this year. Small states is EMDE small states excluding Guyana.
**Supply Shocks**

*Rising Commodity Prices and Shipping Costs; Reliance on Food and Fuel Imports*

<table>
<thead>
<tr>
<th>Commodity Prices and Shipping Costs (Index, 100 = Jan 2020)</th>
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<tbody>
<tr>
<td>Energy</td>
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<td>Jan-20</td>
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<th>Food and Fuel Imports (Percent of GDP)</th>
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<td>Small states</td>
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<td>Food</td>
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<th>Shipping Intensity of GDP (Multiples of global shipping intensity)</th>
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<td>Small states</td>
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Sources: Bloomberg, World Bank.

Left Panel: Energy, metals, and food price indices are World Bank Group commodity indices. Shipping is the Baltic Dry Exchange, an index of freight rates paid for sea transport of dry bulk materials across major global routes. Last observation for the Baltic Dry Index is March 2022 and for Energy, Food and Metals February 2022. Center Panel: Simple averages for 2019. Samples includes 109 EMDEs, 35 AEs, and 20 small states. Right Panel: Pacific refers to Pacific island small states, Caribbean refers to Caribbean small states. Data are for 2019. Values are ratios of port container traffic (20-ft equivalent units) to real 2019 GDP, normalized by world ratio.

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**Natural Disasters and Fiscal Risks**

*Large Costs of Disasters; Elevated Fiscal Vulnerabilities*

<table>
<thead>
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<th>Damages from natural disasters, 1990-2019 (Percent of GDP, per year)</th>
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<td>Small states</td>
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<th>Fiscal balance (Percent of GDP)</th>
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<td>All</td>
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<th>Government debt (Percent of GDP)</th>
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<td>All</td>
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Sources: EM-DAT; International Monetary Fund; Kose et al. (2021); World Bank.

Left Panel: Bars are calculated by summing the damages in each country in each year, dividing by nominal GDP, then weighting by nominal GDP. Damage comprises both property damage and economic losses (e.g., foregone income from tourism) and is calculated from estimates. Center and Right Panels: Aggregates are computed with nominal GDP in U.S. dollars as weights, based on 37 small-state EMDEs, including 14 commodity-reliant and 23 tourism-reliant small states, and 155 EMDEs in the center panel, and 24 small-state EMDEs, including 14 commodity-reliant and 21 tourism-reliant small states, and 154 EMDEs in the right panel.
Risks - 1
Before the War: Multiple Risks

- Financial stress
- Inflation
- Supply disruptions
- COVID-19 outbreaks
- Weaker longer-term growth prospects
- Climate-related disasters

Risks - 2
After the War: Multiplying and Mutually Amplifying Risks

- Geopolitical tensions
- Financial stress
- Inflation
- Supply disruptions
- COVID-19 outbreaks
- Weaker longer-term growth prospects
- Energy and food insecurity
- Social tensions
- Cyber-security risks
- Climate-related disasters
- Fragmentation of trade, investment, and financial networks
Two Questions

2. What are the policy priorities? Supporting the vulnerable through the period of high food and energy prices; facilitating trade; mitigating debt vulnerabilities; accelerating vaccinations; preparing for climate change and natural disasters; addressing structural barriers to growth.

Policy Priorities

Bolstering Resilience to Short-term Shocks and Boosting Long-term Growth

**Bolstering resilience to shocks**

- Limit immediate impact of food and fuel inflation on vulnerable groups through targeted transfers
- Balance need for macroeconomic support with fiscal sustainability and price / financial stability
- Increase support for disaster risk-pooling mechanisms to enable rapid response financing
- Accelerate vaccination; address hesitancy problem
- Support investment in renewable energy sources to reduce reliance on imported fossil fuels
- Coordinate policies globally to reduce debt burdens and enhance debt transparency
- Coordinate policies to address global challenges related to climate change

**Boosting long-term growth prospects**

- Enhance digital infrastructure and inclusion to leverage new economic opportunities
- Invest in education and healthcare to build human capital and remediate pandemic-related scarring
- Enhance infrastructure, logistical capacity and policies to reduce trade costs
- Pursue economic diversification and foster new sectors to reduce growth volatility (“work-from-anywhere” economy; sustainable “blue-economy” industries)
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Questions & Comments

Thank you!

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