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Globalessation

As the twenty-first century dawned, it seemed nothing would stop the march of trade globalisation. But fast forward a decade and growth in global trade has reached a plateau. So, why has globalisation come to a standstill? Was a stronger global trade growth relative to global production really sustainable in the long-run?

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What cannot go on forever, doesn't. Take globalisation of trade. As countries reduced their trade restrictions, and transport and technology made supply chains more complicated, trade growth exploded. More and more goods (and services) were produced in one country and sold in another. More and more products had different stages of production in different countries. Throughout the 1990s and early 2000s it looked like nothing could stop the ever-increasing path of globalisation.

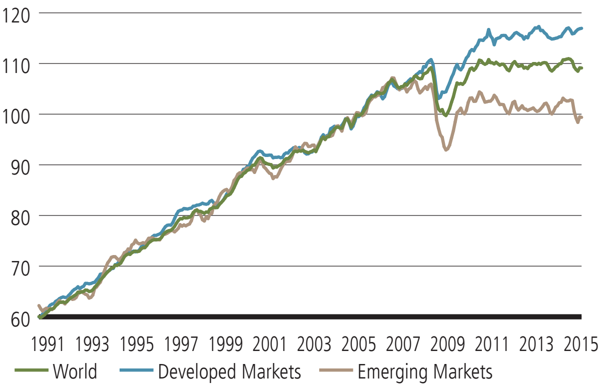
But then the global financial crisis put a stop to many trends that looked un-stoppable, global trade being no exception. Global trade volume dropped by almost a fifth when the crisis hit. It bounced back, but since then trade growth has been more moderate than in the past. The pace of globalisation has stalled as well. The globalisation of goods markets could be witnessed by the consistent rise of export volumes relative to industrial production (chart 1). From the 1990s through to 2008 a higher proportion of the goods being produced found their way into exports. But once trade recovered, export growth has only kept pace with industrial production. In short, globalisation has reached a plateau.

What this global picture disguises though is the fact that the countries that seemed to benefit most from globalisation:- emerging markets (EM) - actually suffered an outright reversal in globalisation following the financial crisis. The ratio of exports to industrial production in EM stabilised well below its pre-crisis peak. Industrial production still grew in EM, and in fact grew faster than in developed markets (DM), but more of it was oriented to domestic consumption rather than foreign consumption. In DM, however, the globalisation of goods markets plateaued at a higher level than before the crisis.

This pattern reflects the difference in growth following the financial crisis. EM continued to experience strong domestic demand growth, supporting exports from DM. Conversely, weak domestic demand growth in DM made it harder for EM to export to DM. Yet although DM benefited more from the export bounce-back than EM, the story of the last few years is the same: the rate of globalisation levelled off.

Chart 1: Plateaued

Ratio of export volume to industrial production, 2005=100

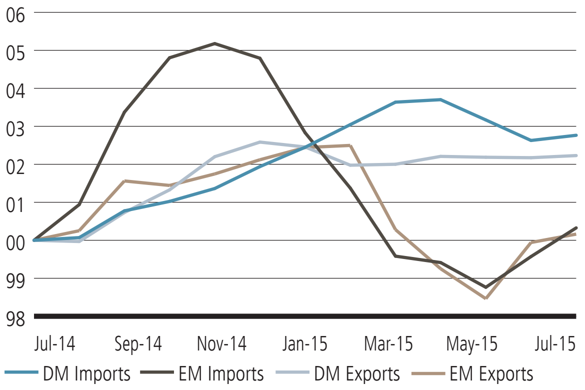


Source: CPB World Trade Monitor

On top of this structural change, there is a cyclical swing. Recently, exports from emerging markets, especially in Asia, have seen precipitous reversals (see *Economist Insights*, Trading Down, 20 July 2015). This weakness is hard to blame on domestic demand weakness in DM. The drop in EM exports has been matched by a drop in EM imports (chart 2). DM imports and exports have both been steadier (although not rising much). The decline is concentrated on trade within EM, rather than from EM to DM. This makes the decline in trade feel much more like the 1998 Asia crisis than any of the recent recessions.

Chart 2: EM and DMs

Import and export volume in EM and DM, July 2014=100, 3m moving average



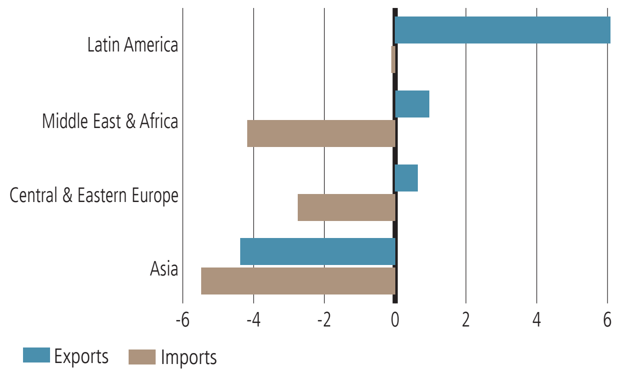
Source: CPB World Trade Monitor

The recent EM trade weakness has also been concentrated in Asia, which has seen the biggest drop in both exports and imports (chart 3). Asia makes up over half of EM trade volumes, so this is the decline that matters. A slowdown in China would in turn explain most of this decline, complete with a knock on effect.

The Middle East and Africa has seen export volumes rise, but not import volumes. The drop in oil prices explains this: prices are low precisely because OPEC is pumping out, and exporting, a lot more oil. But the low oil price reduces the spending power of oil producers, so they cannot afford to import as much. The drop in imports for Central and Eastern Europe is dominated by the same phenomenon hitting Russia. Meanwhile Latin America has done even better on its exports, perhaps because the strong USD increased the purchasing power of their largest trading partner.

Chart 3: Asian flu

Change in trade volumes by EM region, year to date up to July 2015, %



Source: CPB World Trade Monitor

Some countries, such as China, that previously dominated in the low cost segment of the market may be trying to move up the value chain. So rather than simply assembling a computer, for example, they are manufacturing rather than importing the components. As this happens, there is less trade volume, for the same volume of end product (e.g. computers) because the components are not imported and then re-exported.

But on its own this factor is unlikely to explain why globalisation has stalled. More likely it is just that much of the increase in trade over the last two decades was catch-up – markets trying to get trade up to the level where it should have been historically if countries had been less protectionist. Once that catch-up was achieved, the growth slowed. This was inevitable at some point: if trade had continued to grow faster than GDP permanently, eventually you would have had to pick up your morning coffee in person from another country. But now that the rapid gains from globalisation have already been realised, EM will not be able to rely on trade to save them from their current troubles.