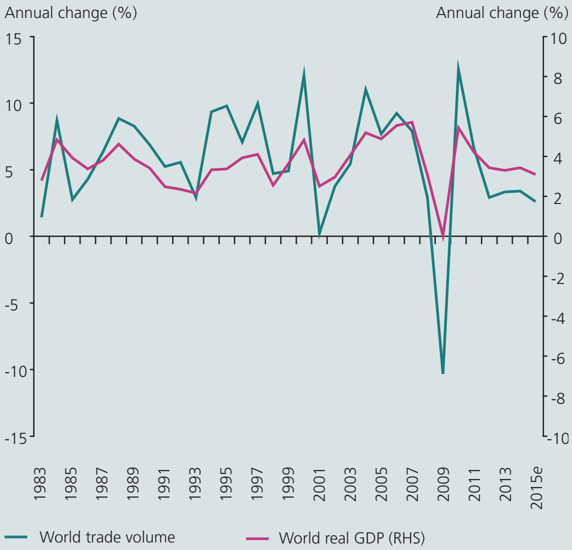
Recent Slowdown in Global Trade: Cyclical Bane or Structural Shift?

Introduction

Global trade growth experienced a sharp deceleration in 2015, registering its slowest pace of expansion since the 2008 Global Financial Crisis (GFC) (Chart 1). The underperformance of global trade compared to global economic activity is, however, not a recent phenomenon. Global trade elasticity, calculated as the ratio of world trade growth to GDP growth, has been on a declining trend even prior to the GFC (Chart 2), suggesting that the recent trend of subdued growth in global demand only partly explains the modest trade performance in recent years. Several structural shifts could be contributing to a change in the dynamics between global trade and global growth. This article aims to provide possible explanations regarding the cyclical and structural factors that may be weighing on global trade growth and the potential impact of these trends on Asia.

Chart 1

Global Trade in 2015 Expanded at its Slowest Pace Since the Crisis

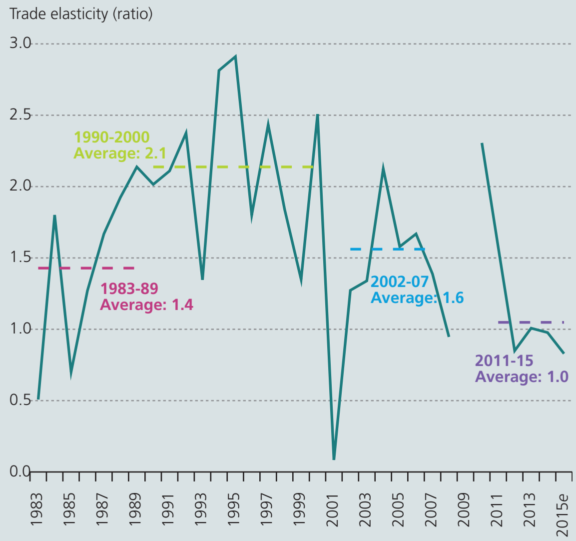


e Estimates

Source: International Monetary Fund (IMF)

Chart 2

Trade Elasticity Has Been on a Declining Trend in the Recent Decade



e Estimates

Source: International Monetary Fund (IMF)

Cyclical and Structural Factors

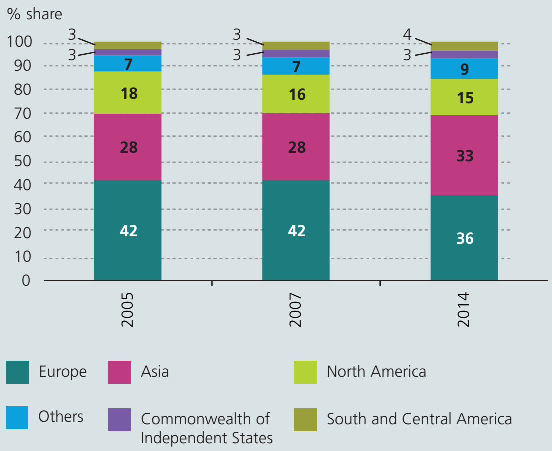
Persistent economic weakness, particularly in several of the major advanced economies is likely to be the key factor in explaining the modest performance of world trade after the GFC.

In the pre-GFC period, the advanced economies collectively accounted for almost two-thirds of total global imports (Chart 3) and almost 60% of global import growth. However, the sharp growth contraction and the impairment of the financial systems experienced by these economies during the crisis resulted in a protracted compression in demand, which constrained the pace of expansion in global trade (Chart 4).

In particular, the weak recovery in investment growth has major implications for global trade activity given that investment goods typically have higher import content relative to consumption goods (Constantinescu et al., 2015). In the advanced economies, while consumer spending has been on a recovering trend, investment growth has remained weak. In Europe, domestic demand has been further weakened by the implementation of fiscal austerity measures and weak investor sentiments amid prolonged concerns surrounding the European sovereign debt crisis.

Chart 3

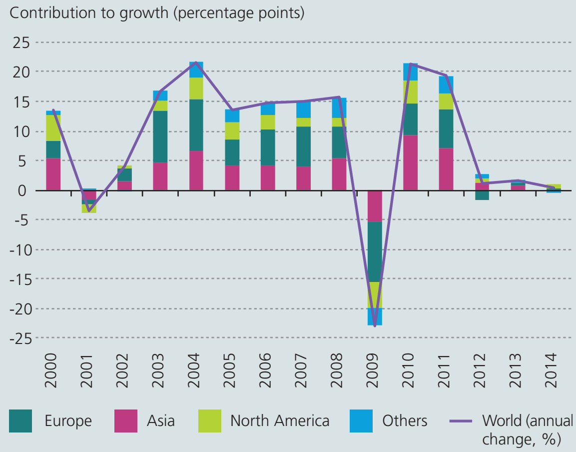
Pre-GFC, Advanced Regions Had a Higher Share of Global Trade



Source: World Trade Organization (WTO)

Chart 4

Post-GFC Import Demand From the Advanced Economies Has Remained Weak



Source: World Trade Organization (WTO)

It should be highlighted that despite persistent demand weakness in the advanced economies, global trade activity in the post-GFC period did not experience a collapse. A key supporting factor of global trade growth was the recovery in trade in the emerging economies (Marinov and Marinova, 2013), amid a strong growth rebound in these economies in the period immediately after the crisis. Between 2010 - 2011, the emerging economies accounted for almost four-fifths of global GDP growth. More recently, however, global trade is facing stronger headwinds. In 2015, several large emerging economies experienced a moderation in growth due to a confluence of factors. This included the significant decline in commodity prices, on-going structural reform measures and country-specific factors, which weighed on both the domestic and external demand of these economies. Heightened uncertainty during the year, arising from policy shifts and financial market adjustments in several major economies also adversely affected global sentiments, contributing to a further weakness in global trade, which continued to grow but only at a modest pace.

Beyond these cyclical weaknesses, there are also structural factors at play, in particular the diminishing impact of major catalytic factors that were important drivers of the high global trade growth observed in the 1990s and early 2000s. First, the proliferation of global value chains (GVCs) catalysed a rapid increase in global trade of intermediate goods (WTO, 2011). This was in part spurred by the information and communication technology (ICT) revolution, which greatly reduced the cost of managing, transacting and coordinating production across borders (WTO, 2011). As a result, firms were better able to leverage on the comparative advantages of different countries through outsourcing and dispersing the different stages of production internationally.

Second, major trade liberalisation breakthroughs, including the formation of the European Union (EU)[1] and the World Trade Organisation (WTO) resulted in the lowering of tariffs and regulatory barriers. This provided further impetus to the expansion of GVCs. For Europe, the more liberalised trade environment between the EU members has contributed to a tripling of intra-European trade from EUR800 billion in 1992 to EUR2.9 trillion in 2014.

Third, the accession of PR China into the WTO in 2001 marked a major shift in the global trade landscape. The opening up of the Chinese economy facilitated a rapid expansion of its manufacturing

[1] The European Union (EU) was formed in 1992 upon the signing of the Maastricht Treaty. To date, the EU has 28 member states with Croatia being the latest addition to the union in 2013.

sector amid large inflows of foreign direct investment. The offshoring phenomenon accelerated as firms became better at maximising the economies of scale offered by the GVCs. This was further supported by low production costs in the host country as they became increasingly adept in manufacturing processes. Subsequently, PR China's share of world merchandise exports to global trade more than doubled, from 5.8% in 2003 to 12.7% in 2014.

It is hypothesised that the catalytic effects of these factors may have peaked, resulting in a lower elasticity of global trade with respect to global growth. Of late, there are signs of an emerging trend towards more onshoring or re-shoring of manufacturing activity. Anecdotal evidence suggests that multi-national corporations are increasingly relocating production back to the US and Europe[2].

Asia's Experience

In the past few decades, given its long history of global orientation and trade openness, Asia has benefitted tremendously from the rapid expansion of international trade activity. The diversity of resources in the region enabled each economy to specialise at different stages of both regional and global production networks[3]. This inherent strength of the region was further reinforced by the close geographical proximity of Asian economies to fast-growing PR China amid continued deepening of trade linkages with the Chinese economy (Chart 5). Intra-regional trade rose from 32% of total trade in 1990 to 43% in 2007, while Asia's merchandise trade grew at an annual average rate of 8.9% in 1990 - 2000 and 16.3% in 2002 - 2007.

As with the advanced economies, trade activity in Asia was adversely affected during the GFC. Nevertheless, the Asian economies experienced a swift rebound in demand in the few years following the GFC. The strong economic recovery could be attributed in part to increasing trade within the Asian region and between Asia and the other emerging economies that also registered favourable growth following the crisis. For example, Asia's trade with Latin America, the Middle East and Africa increased from 12% in 2007 to 15% of its total trade in 2014. Nevertheless, most recently, a confluence of headwinds, including the persistent demand weakness in the advanced economies, as well as structural factors, such as maturing GVCs, have contributed to a continued moderation in trade growth in the region.

Furthermore, PR China's economic transition is posing an additional challenge for Asian economies, in particular for the exporters of raw materials and intermediate goods. The slowdown in PR China's final demand will affect the export performance of its trade partners. Additionally, PR China's structural transformation process amid increasingly competitive domestic firms have led to import substitution of some of the parts and components that are usually sourced from other economies, including from those in Asia (Kee and Tang, 2015). This is evidenced by the moderation in PR China's imports of intermediate goods from a pre-crisis average growth of 26.5% to just 3.5% from 2012 to 2014 (Chart 6).

Asia's Prospects

With the effect of past trends diminishing, the future direction of global trade will depend on the interplay between the various ongoing and emerging structural shifts in the global economy and trade landscape. These include PR China's economic transition towards a more consumption-based growth, a rising middle income population in the emerging economies and new multilateral trade agreements. To successfully adapt to this fast evolving environment requires agility. This in turns necessitates economies to have strong institutions, sufficient policy flexibility as well as diversified sources of trade and growth.

Following the Asian Financial Crisis, policymakers in Asia undertook wide-ranging structural reforms to strengthen economic resilience and improve their growth prospects. In particular, policymakers

[2] A BCG survey of senior US-based manufacturing executives showed that more manufacturers are planning to add production capacity in the US, compared to any other country. The share of manufacturers that are in the process of reshoring producton back to the US is also increasing (Boston Consulting Group, 2015).

[3] The varying stages of development among the Asian nations enable each of them to take advantage of its distinctiveness to develop a supportive ecosystem, as explained by the ``flying geese model" (Kojima, 2000).

Chart 5

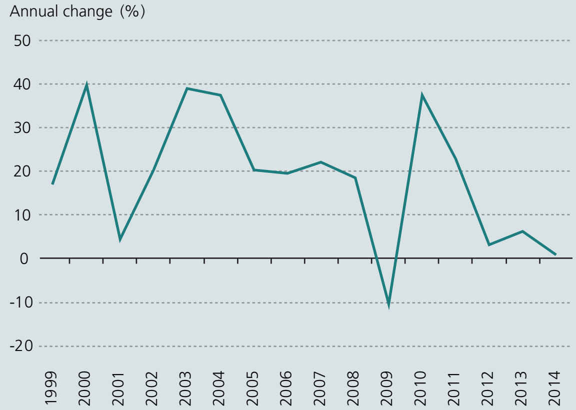
PR China's Importance as a Source of Final Demand for Asia Has Increased

Note: 2014 final demand for the region estimated based on 2011 figures available on OECD TiVA

Source: OECD Trade in Value Added (TiVA) - October 2015 database and Bank Negara Malaysia estimates

Chart 6

PR China's Imports of Intermediate Goods Have Declined



Source: UN COMTRADE

embarked on efforts to develop a vibrant manufacturing base, to move up the value chain and to improve efficiency and competitiveness. At the same time, measures were also implemented to strengthen domestic demand in the region, including increasing labour market flexibility and enhancing social safety nets.

Conclusion

This article puts forth cyclical and structural factors that have caused the global trade growth and the intensity of trade to decline in recent years. At this point, with the global economy still undergoing some critical transitions, it is difficult to conclude whether these trends in global trade will continue. Nevertheless, it is imperative for economies to continuously embark on policy initiatives geared towards enhancing their competitiveness, in order to benefit from the more globalised world and to position the economy to confront the increasingly challenging global environment.

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