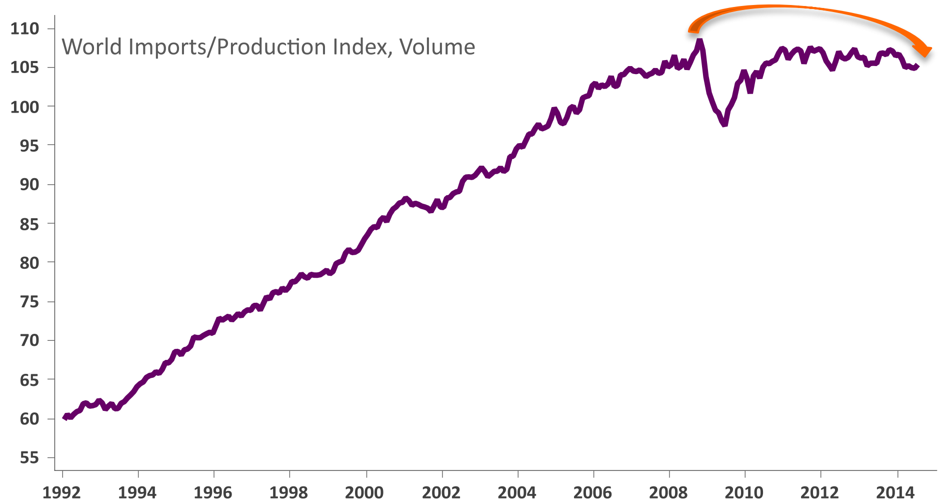
September 26, 2014

GLOBAL MACRO

When globalization is thrown in reverse

One of the most striking illustrations of the changes that have occurred since the 2008 crisis is the 180° turn that international trade has made. Once discounted as a one-off phenomenon, reverse globalization has taken an increasingly permanent turn in the past two years. The paradigm shift in the Chinese economy is the main factor behind the trend. The consequences of this sea change are sizeable for global growth, corporate valuations and geopolitical risk.

Import Contents of World Industrial Production



Sources: RichesFlores Research, Macrobond

1990-2008: explosion in international trade

Between 1990 and 2008, the volume of global trade was multiplied by nearly two, which was 1.8x greater than the expansion of global production. Free-trade policy, the emergence of Asian countries, relocating production to low-cost countries and current account imbalances are the main reasons that drove this trend. Economic and financial globalization ensued in the 2000s. Few countries did not increase their exports at exceptional rates during the first decade of the new century. Even the worst performers' sales volumes increased in absolute terms. For the losers, slower growth compared with the rest of the world was euphemistically coined "loss in market share". In France, export volumes rocketed by a multiple of 2.5x between 1990 and 2008, whereas industrial production increased by less than 15%.

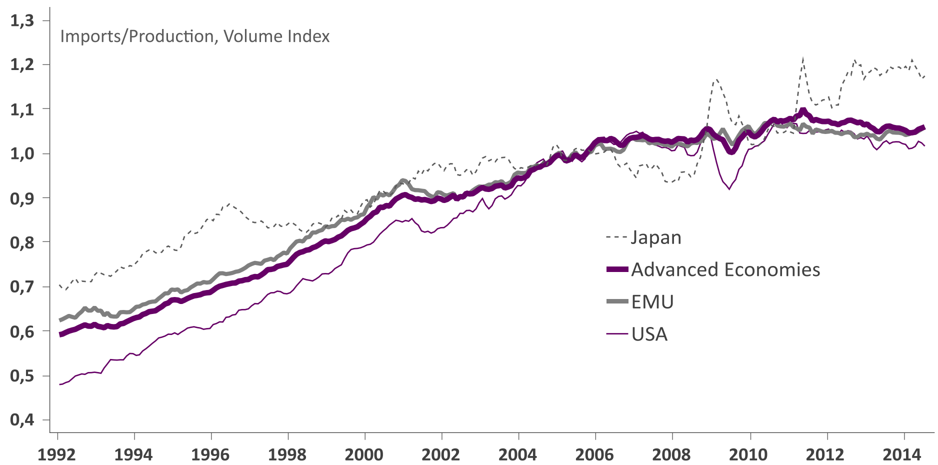
The development of trade did in fact have an immeasurable impact on global growth in the twenty years leading up to the crisis, which enabled both poorer countries to build an industrial foundation for economic development and richer nations to rejuvenate themselves after two mediocre decades in the wake of the oil crises of 1973 and 1981. Globalization ensued and changed the face of the world. Trade in goods was followed by global investment flows. Financial flows were followed by waves of labor mobility and global tourism. Corporate strategy could be summed up in two words: Go Global.

2009-2014 – globalization in reverse

International trade never really recovered from the economic and financial crisis of 2008. Trade flows returned to pre-crisis levels in 2009 but have been stagnant ever since. Idling since 2011, imports as a percentage of global growth have fallen back in recent months and may have begun a sustained downturn.

In the short run, weak economic growth against a backdrop of international geopolitical tension should continue to drive the trend, especially given soft trade numbers since the start of the year. The elasticity of U.S. imports vis-à-vis growth has declined markedly in recent years and imports' ability to ride the broader economic trend, which happens to be brighter currently, has undisputedly deteriorated. In addition, the current account imbalance in the euro area speaks for itself, whereas the recent change leaves no doubt as to what is going on with international trade. The uptick in Japanese imports since the Fukushima disaster is not of a nature to boost trade, excluding trade in commodities.

Import Content of industrial Production-Advanced Economies

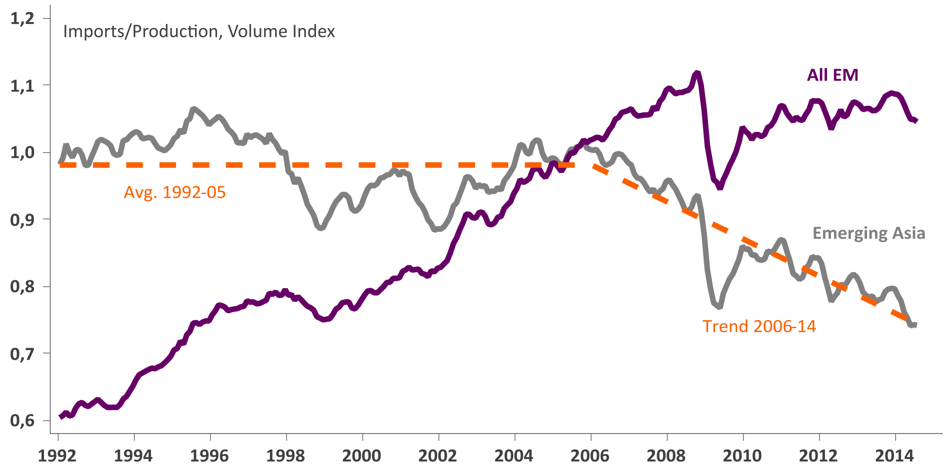


Sources: RichesFlores Research, Macrobond

Whether the current trend can be reversed largely depends, in the longer run, on China. After having been the world's biggest globalization driver, the Chinese have turned inward, which has led to declining trade since 2011. The country is less reliant on imports, as foreign companies have set up business on Chinese soil but there are other reasons why the Chinese economy has closed to the outside world:

- economic times are not as good,
- economic policy has made a big push for domestic development, including in sectors the authorities believe are too dependent on the outside world (e.g. capital goods, especially advanced technology),
-export markets that have been struggling.

Import Contents of Industrial Production-Emerging Countries



Sources : RichesFlores Research, Macrobond

Under such conditions, most Chinese imports have stagnated in the past 2+ years. These factors have also reduced the role of imports in fuelling economic growth in China and Asia at large.

Before the environment for international trade becomes more propitious, it would seem that Chinese imports would have to pick up again. By the best of accounts, this will take time. First, Chinese growth will have to recover. At present, it has been hit by the correction of the investment follies of the past whether in production capacity or real estate. Secondly, public and private debt will have to return to more bearable levels. Lastly, there will have to be political acceptance that some of the profits made from the rest of the global economy in the past twenty years will have to be redistributed...

Let's not hold our breath.

What are the repercussions?

This break with the past has weighty consequences on the global economic mechanism and explains recurring economic struggles in the last several years.

-By removing one of the main cogs in the global growth wheel, sluggish trade not only reduces the world's potential to expand economically but also worsens disparities, which are themselves sources of instability and imbalances, particularly on the forex markets.

- Emerging markets, whose development has been contingent on export growth (i.e. their revenue source has been critical to ensuring their domestic development), are currently suffering backlash from the decline in one of their biggest growth drivers.

-Such an environment is not conducive to risk taking. This automatically harms business investment and foreign direct investment, which is likely to prolong slow trade and dim chances of a robust recovery in global growth.

-These trends lead to the inevitable question: What will be the price tag for increasingly globalized companies whose recent development has been largely built on the story that their export markets would continue to grow indefinitely? Have these trends been priced into current corporate valuations?

Slumping international trade is, understandably, an important issue that could alter the global economic and financial situation...and whose effects will mark global trends for the foreseeable future.

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