Why has world trade slowed?

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World trade grew for decades considerably faster than global GDP. In recent years, the growth of international trade has slowed to the level of the GDP growth rate. Is the most hectic phase of globalisation already history? It would seem that, in the latter part of the first post-millennium decade, it was for the most part permanent structural factors that took centre stage, while transitory cyclical factors played only a minor role. Forecasts suggest world trade growth relative to global GDP is not likely to gain significant momentum in the immediate years ahead.

World trade growth relative to global GDP growth has already been weak for nearly ten years, but trade growth has been particularly muted since 2010. Is this a passing phenomenon? The subsiding of world trade is related in part to cyclically-driven, in part to structural and other factors.

The cyclical factors can be considered to include the fading of intra-EU trade, the deceleration of Chinese growth, the sluggishness of investment activity in the advanced economies and the low level of commodity prices. Structural factors encompass, among other things, the end of the most frenetic phase of integration of China and Eastern and Central European countries, the end of the fastest growth phase in the fragmentation of production, expansion in digitalisation and, additionally, various governments' increased action to safeguard domestic production.

Why is trade growth desirable?

The relationship between world trade and global GDP can be seen as representing a measure of specialisation of production: the more trade relative to production, the more division of labour and specialisation. Division of labour and specialisation of production are desirable, as these enhance the spreading of knowhow, lead to an efficient use of resources in accordance with the principle of relative advantage and, by extension, also to stronger growth in both the economy and wellbeing.

In Finland, for example, the heyday of electronics and forest industries in the 1990s would not have been possible without brisk international trade. Trade growth has also added to equality between countries by helping to reduce poverty in emerging economies, boost average per capita income and upgrade skills. Moreover, from the perspective of shorter-term economic activity, world trade growth outstripping GDP growth contributes to higher levels of employment and income for small, open economies, in particular.

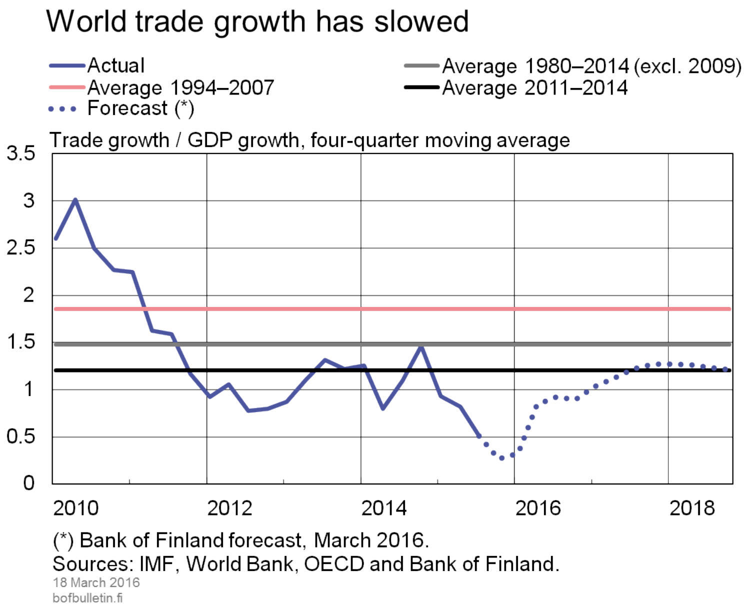
Decades of growth

World trade expanded very strongly from 1986 to 2007. During this period, the global economy was affected by two geopolitical developments and one economic trend: 1) the integration of Eastern and Central European countries into Western Europe, 2) China's integration into the global economy and 3) the fragmentation of production (i.e. the rapid expansion of value chains) in the economy. Against the backdrop of these factors, world trade increased by substantially more than global GDP. However, world trade growth has been slack since the onset of the financial crisis in 2007 (Chart 1).

Chart 1

World trade grew on average about twice as rapidly as global GDP in 1980–2007. Trade growth was only slightly faster than GDP growth in 2011–2014, and trade has recently evolved at the same pace as GDP. The easing of world trade growth reflects, in part, temporary cyclical factors, but also more permanent structural factors.

Chart 2



Temporary cyclical factors

Consumption and investment in the advanced economies have been sluggish to recover since the 2007–2008 financial crisis. Deleveraging has weighed on households' purchasing power and balance sheet repair has eroded non-financial corporations' investment appetite, notably in Europe. On the other hand, the moderation of the rate of growth in the emerging economies, particularly China, has been instrumental in depressing the improvement in world trade.

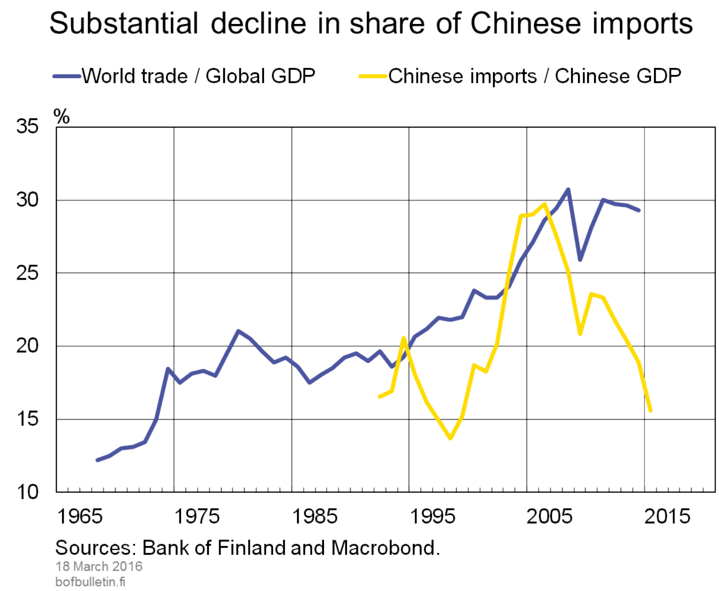
Forecasts by international organisations foresee more lively consumption and investment activity in the advanced economies in the immediate years ahead. This will support world trade growth in the near term, but the pick-up in trade will nevertheless remain considerably more muted than in 1980–2007, due to a variety of permanent structural factors that lie behind trade growth (Chart 2).

Permanent structural factors

The share of industrial goods in world trade is contracting, while the share of services is increasing. The manufacture of industrial goods, capital goods and consumer durables is highly trade-intensive, partly on account of the expansion of value chains, whereas service production is less trade-intensive. With demand growth increasingly focusing on services, world trade relative to GDP is not expanding with the same vigour as before.

The second and most important permanent structural factor is the maturing of the integration process of Eastern and Central European countries, and particularly of China. The shift in China's growth model from exports to domestic demand means a decline in the country's propensity to import. Imports accounted for about 30% of China's GDP in 2006, but the share halved to approximately 15% in 2015. This is the largest single factor in explaining why the world trade growth rate has converged towards global GDP growth (Chart 3).

Chart 3



The third more permanent structural factor relates to the slackening pace of expansion of production value chains. A fourth factor that in part supports the third is economic policy aimed at promoting domestic production and employment, while digitalisation ranks fifth. Although no reliable statistical evidence on factors four and five is available, tax reliefs and other subsidies for domestic production are widely used economic policy tools in many countries, and digitalisation is indisputable.

Is the slowing of trade a passing phenomenon?

On the basis of forecasts by international organisations, slower growth in international trade than witnessed in 1986–2007 is not a passing phenomenon, although the sharpest downtrend in world trade growth is already over.

The cyclical situation will improve on the back of a predicted boost in domestic demand – consumption and investment – in the advanced economies. Even so, the structural factors underlying slower trade growth do not appear to be dissipating. The shift in China's growth model is permanent. More significant trade growth would require, among other things, that India and African countries experience a strong upswing and such integration into the world economy as seen in China.

Tags

globalisation, gross domestic product, world trade