World trade: No strong recovery in sight yet

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Summary

Causes for the recent slowdown of world trade

- Declining value of world trade since 2014; no surprise, given the commodity price crash
- The sluggish growth in trade volumes, however, needs explanation. We see three causes:
  1. Slowdown of the world economy. This has a disproportionate effect on world trade, because (cyclically sensitive) durable goods are overrepresented in trade
  2. Slower growth of greenfield FDI and trade in intermediates, indicating a slowdown in the expansion of global value chains
  3. Increasing protectionism

2016-18: Prospects for world trade remain bleak

- Trade to grow at around world GDP growth (2.3-2.9%); no acceleration, because:
  1. Low growth of the world economy means no stimulus from the economic cycle
  2. Free trade is at risk (protectionism, Brexit, TPP not ratified and TTIP uncertain)
  3. Expansion of global value chains shows no sign of acceleration
  4. Chinese import ratio keeps declining, as rebalancing of Chinese economy continues

Content

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2. Causes of sluggish trade growth

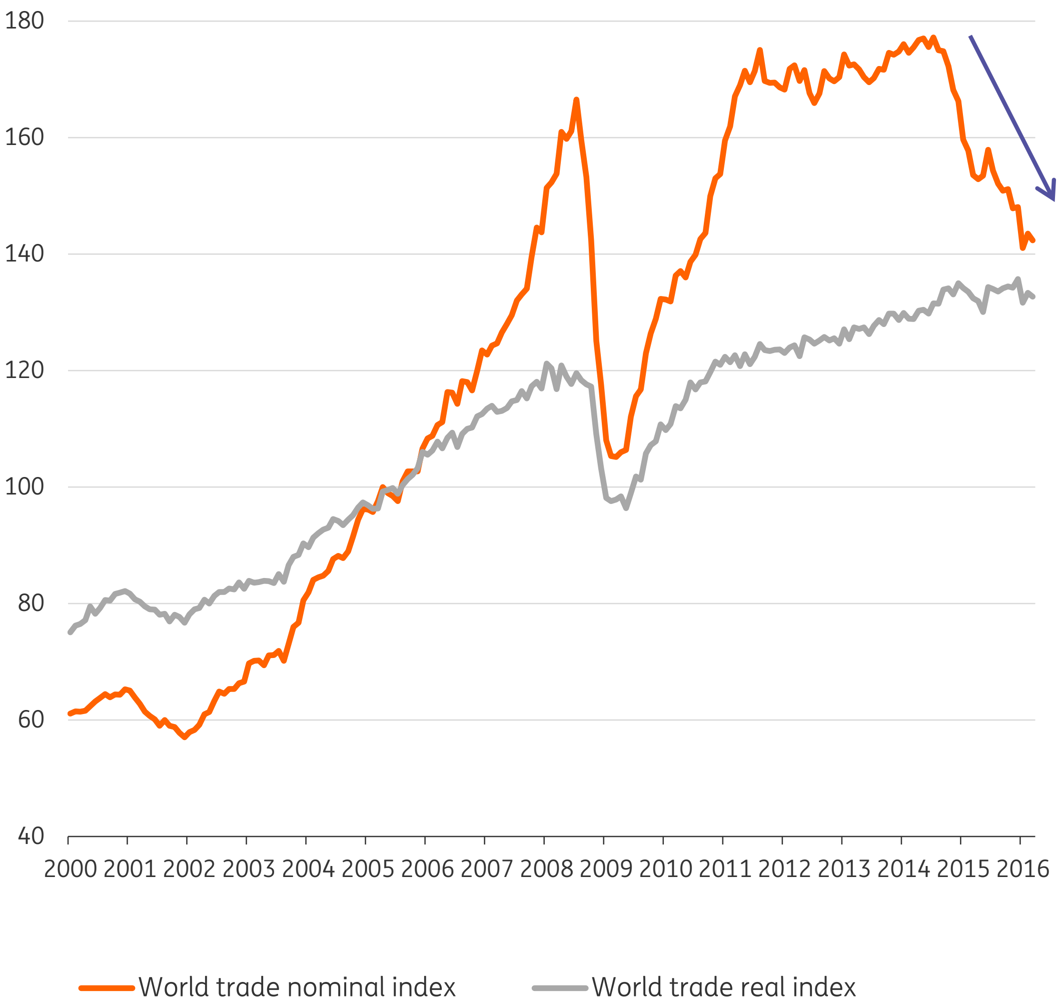
3. Prospects for trade in years to come

State of play:

Where does world trade stand?

Declining value of world trade in goods

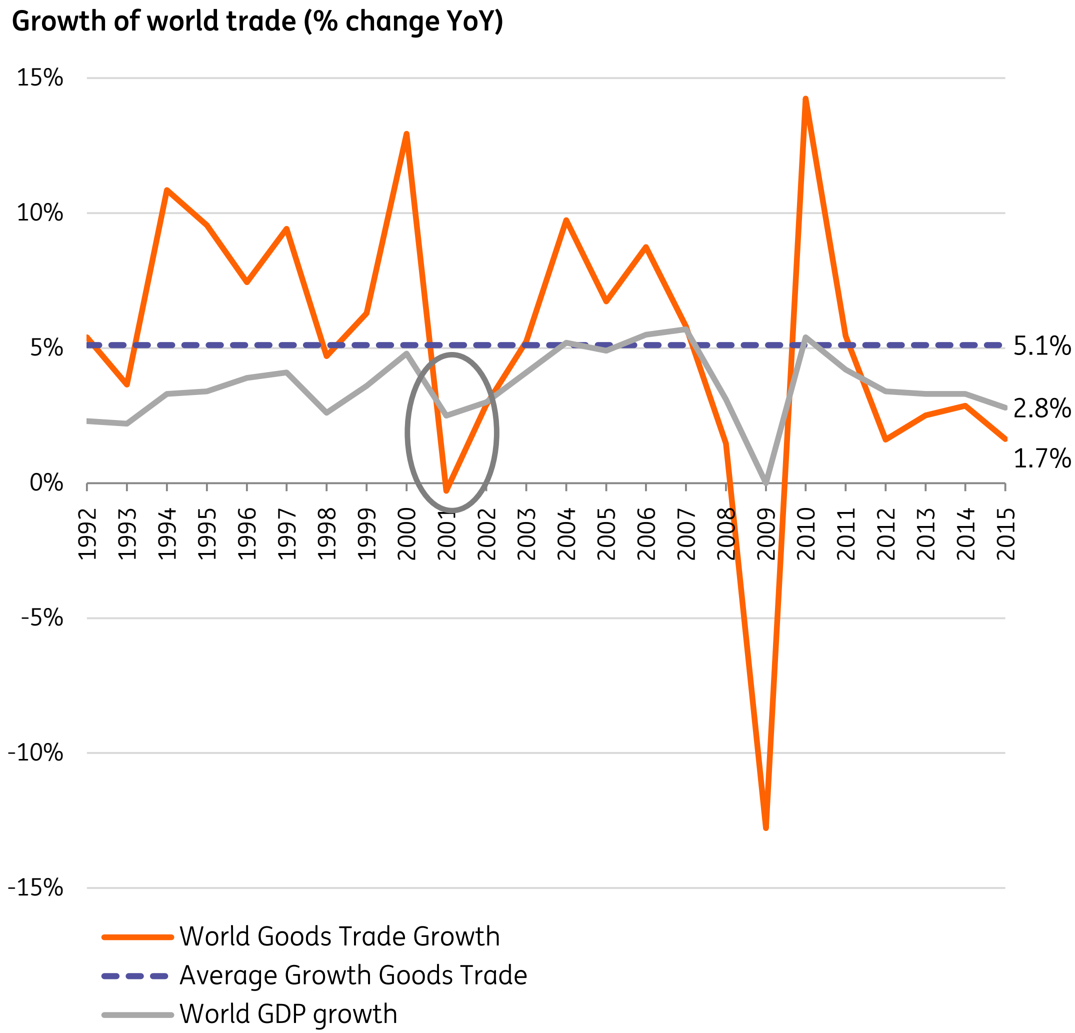
World Trade: nominal and real indices (2005=100)



- The decline in the value of world trade is primarily caused by the plunge in commodity prices, especially the oil price crash that started in the summer of 2014.
- By volume (real index), world trade declined in 1H15 and again in 1Q16, but has, on balance, increased somewhat over the last couple of years.

Source: Netherlands Bureau for Policy Analyses (CPB) Calculations: ING Global Markets Research

Goods trade by volume: Positive, but weak growth

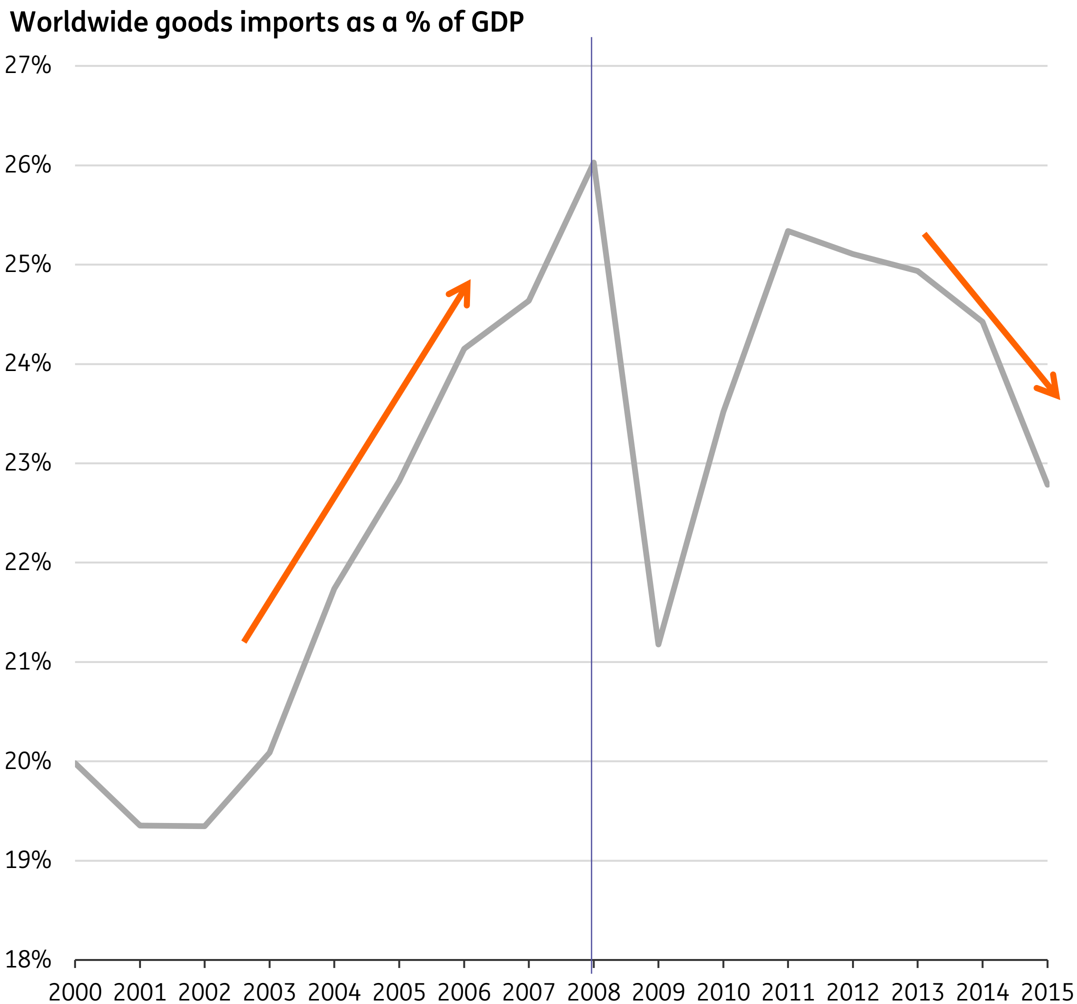


- Trade volume growth is positive, but very weak compared to:
  - The fifteen years running up to the crisis
  - World GDP growth
- In 2015, volumes grew only 1.7%, far behind world GDP growth (2.8%). Including services, trade growth is higher, but still lagging that of GDP
- Worrisome is that after a recovery in 2H15, trade volumes started to decline again in 1Q16: -1.7% QoQ

Source: Netherlands Bureau for Policy Analyses (CPB)

Calculations: ING Global Markets Research

Globalisation in reverse



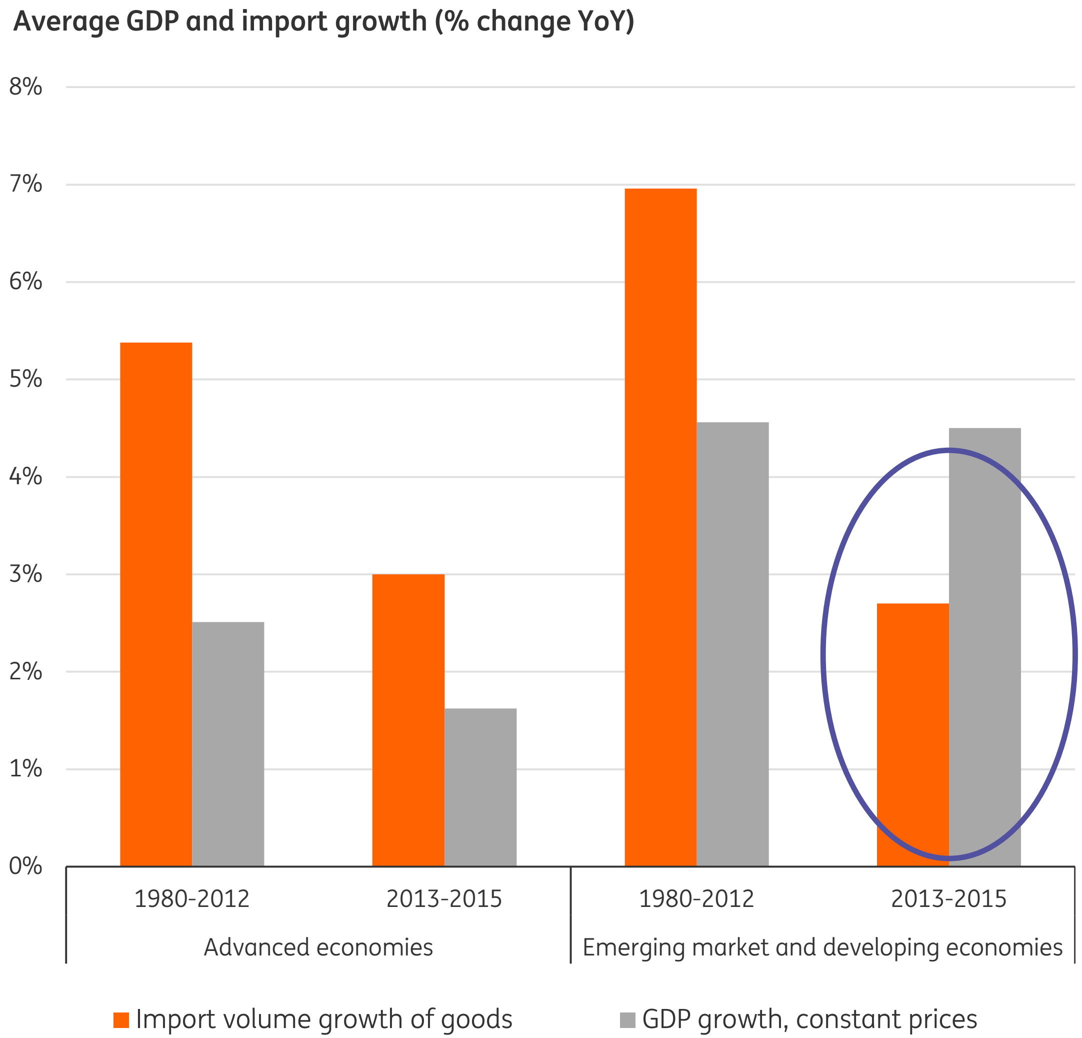
- Pre-2008:
  A steep rise of import ratios in many countries
- 2008–11:
  A steep decline and subsequent recovery of import ratios
- Post-2011:
  A decline in import ratios, which accelerated in 2015
- This shows that the 'openness' of the world economy is actually in reverse

Source: IMF WEO & WTO

Calculations: ING Global Markets Research

Causes of the slowdown in trade

1. Emerging markets to blame

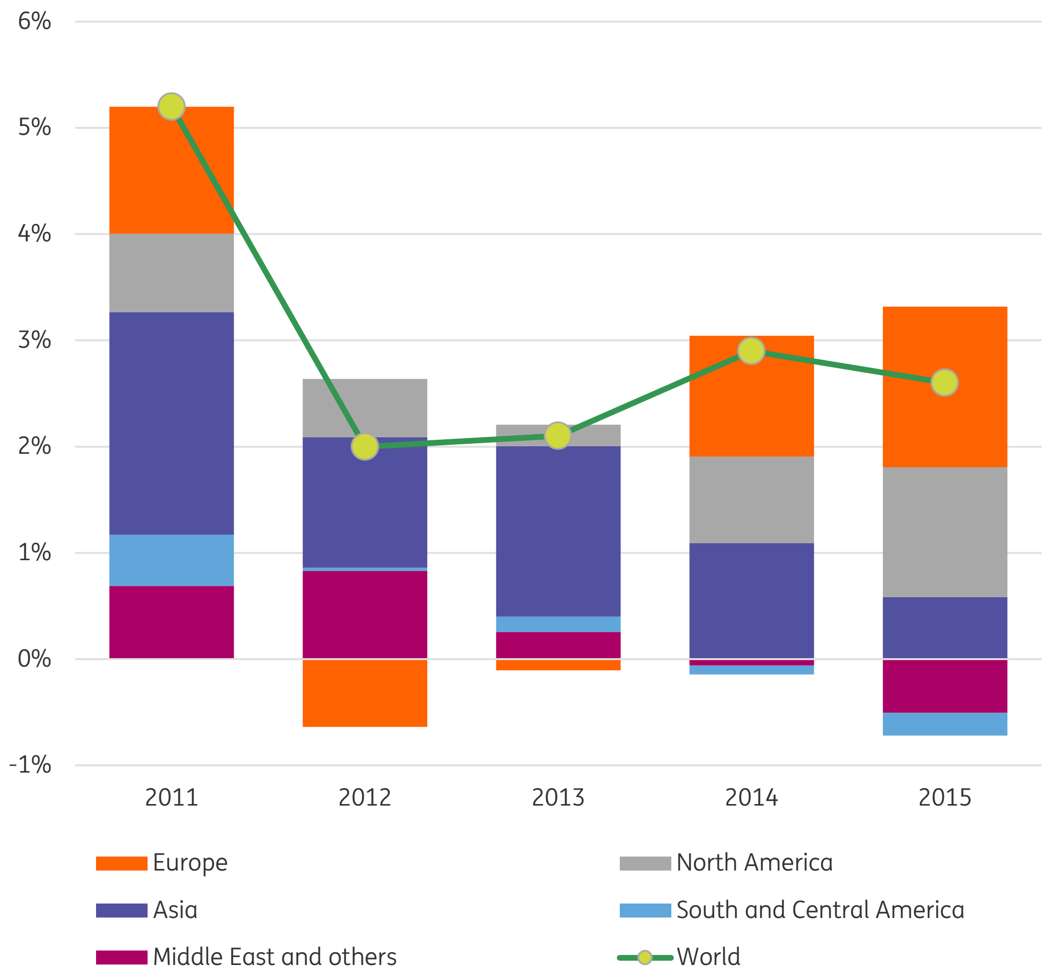


- Compared to 1980-2012, the average growth of imports in advanced economies is much lower.
- However, growth of imports still outpaces GDP growth.
- In Emerging Markets (EMs) we observe the contrary; trade in goods is now growing less than GDP.
- This also holds for the most recent figures (1Q16). Thus, EMs remain the leading cause of the decline of world trade.

Source: IMF WEO

Asian trade in lower gear

Regional contributions to world import growth

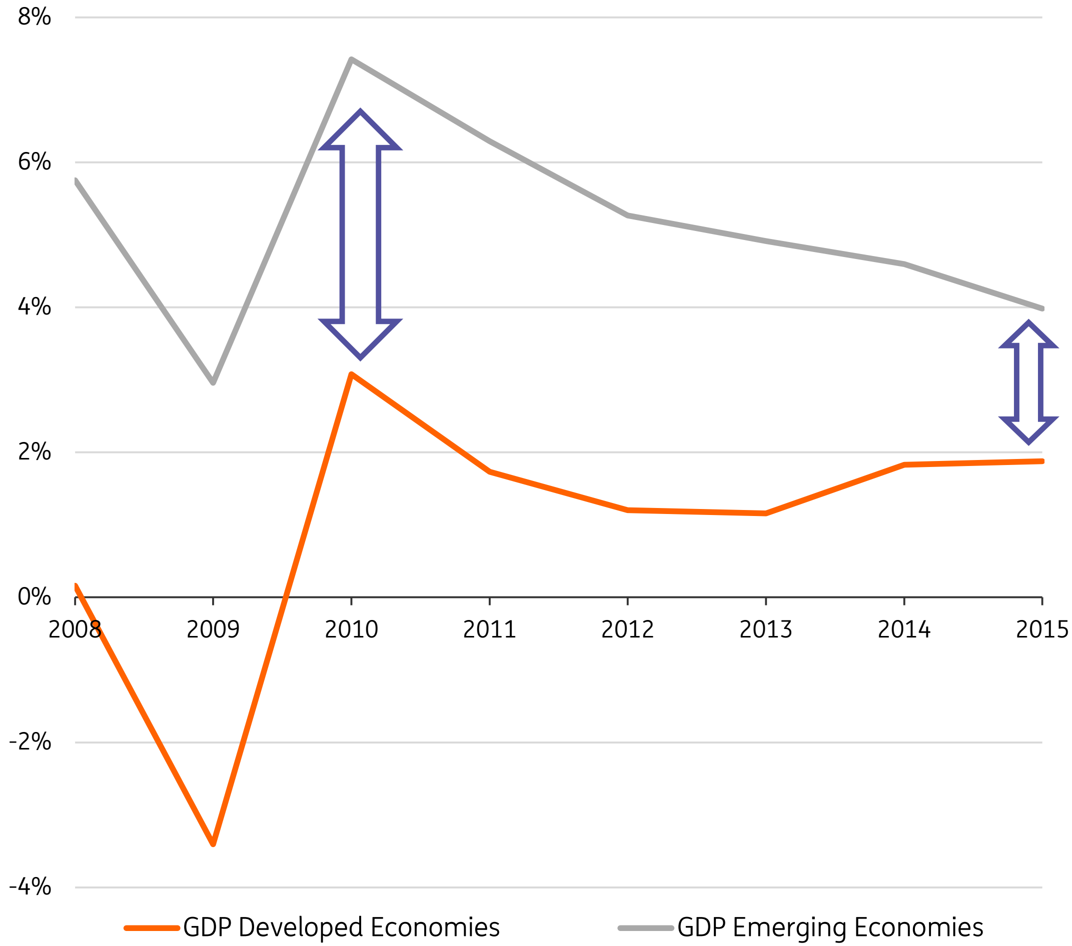


Source: WTO

- In 2014 and 2015, Europe and the US showed healthy demand for imports.
- South America and the Middle East have made negative contributions to growth of imports globally.
- Though the contribution of Asia was positive during 2014-15, it has decreased steeply. In 2013, Asia was responsible for 75% of the growth in world trade, versus 20% in 2015.
- During 2015 and 1Q16, emerging Asian economies were the most dominant factor behind the declining volumes of world trade.

EMs: from lifebuoy to a drag on world GDP growth

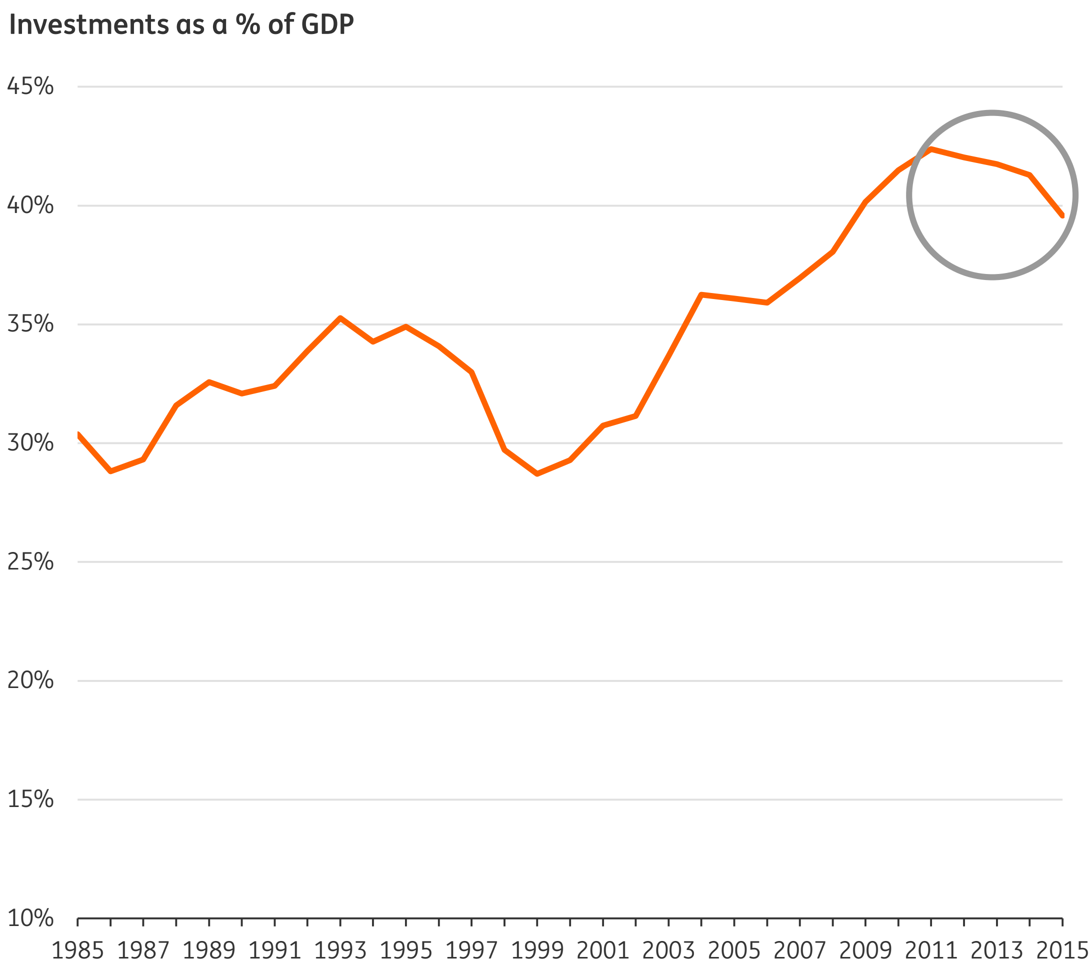
Real GDP growth (% change YoY)



- The difference between real GDP growth in Emerging Markets (EMs) and Developed Markets (DMs) has declined sharply.
- DMs are no longer supressing world GDP growth. Nowadays, EMs have taken up that role; GDP growth rates are declining.
- Hence, EMs are no longer the 'lifebuoy' of world GDP growth.

Source: Netherlands Bureau for Policy Analyses (CPB)

Investments in emerging Asia, especially, are curbing imports…

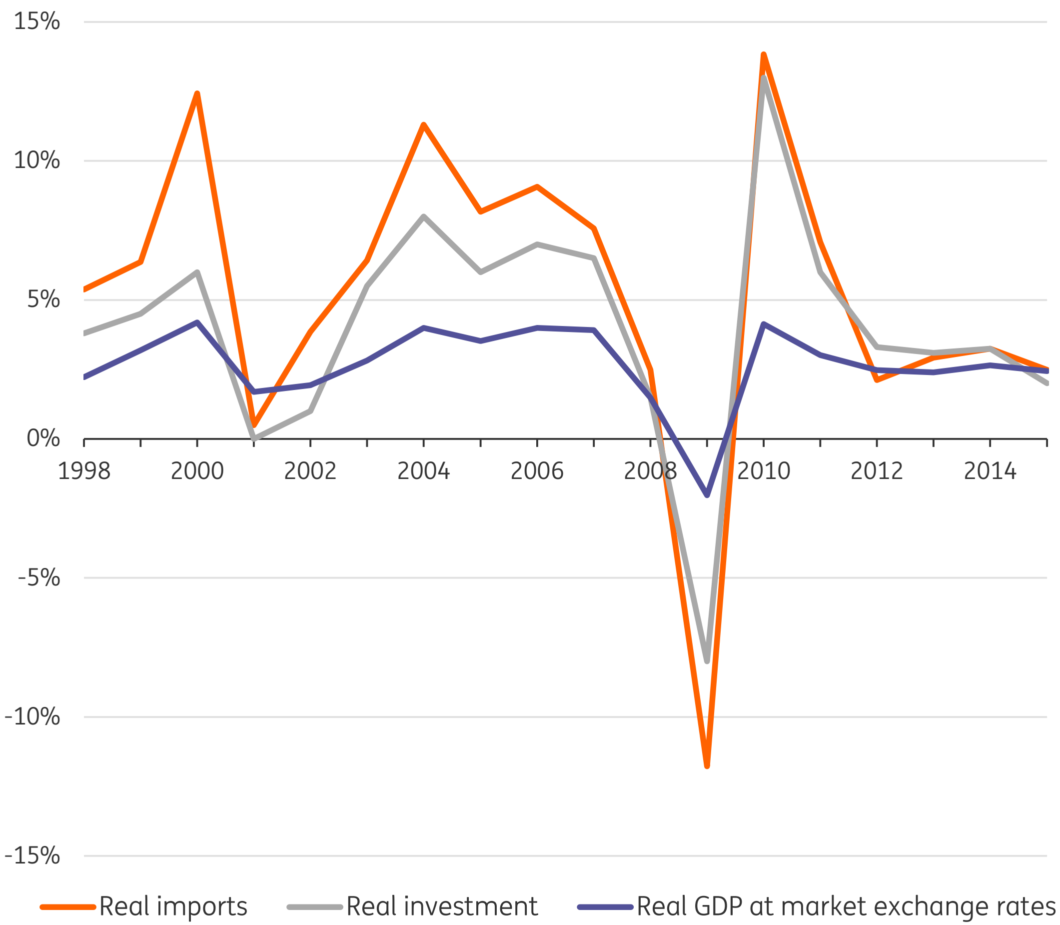


- The decline of GDP growth in EMs is an important reason for the slowdown in world import demand.
- Especially worrisome is that the investment ratio in emerging Asia is declining.

Source: IMF WEO

…because imports are strongly related to investments

World growth of real imports, real investment and real GDP (% change YoY)

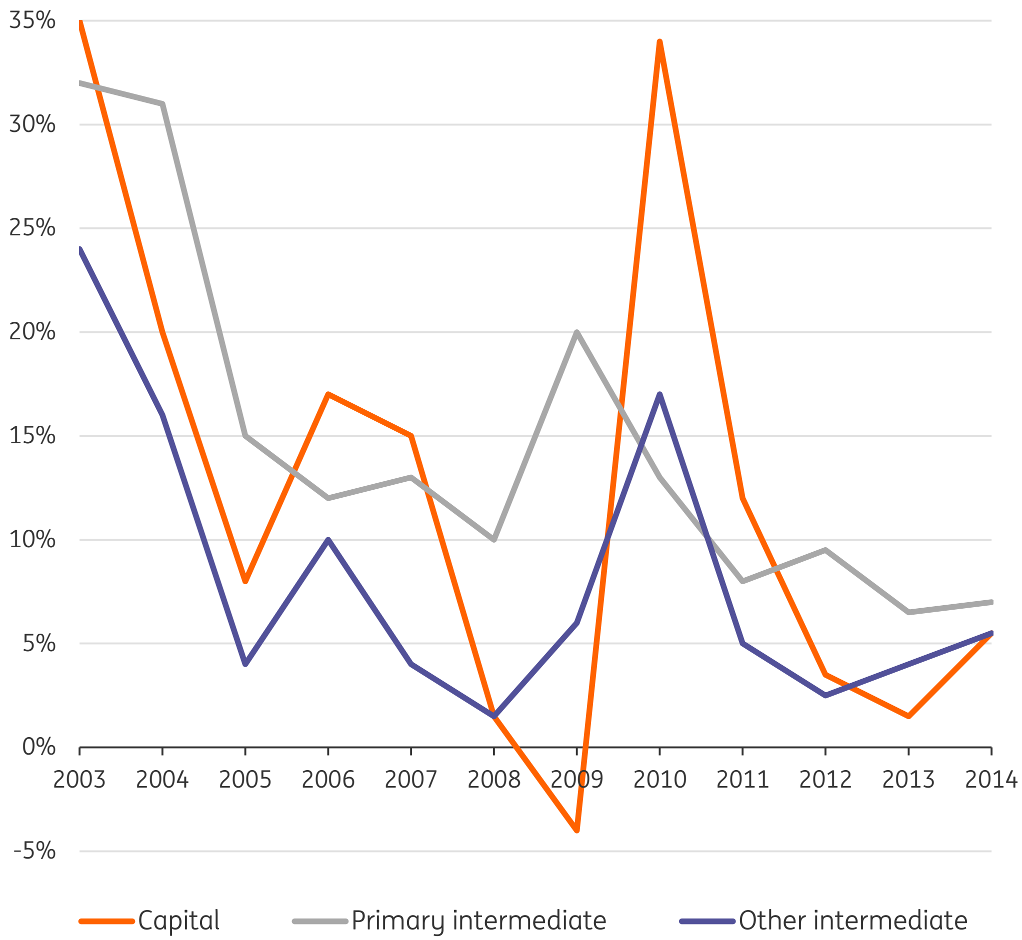


- The chart shows that trade is more closely related to investments than to GDP.
- This is because 70% of (non-energy) world trade consists of trade in durable goods. Capital goods for investments make up a significant part of trade in durable goods.
- China is one of the EMs where imports are declining.

Source: IMF WEO

Less Chinese imports of intermediates and capital goods

Chinese import growth (% change YoY)

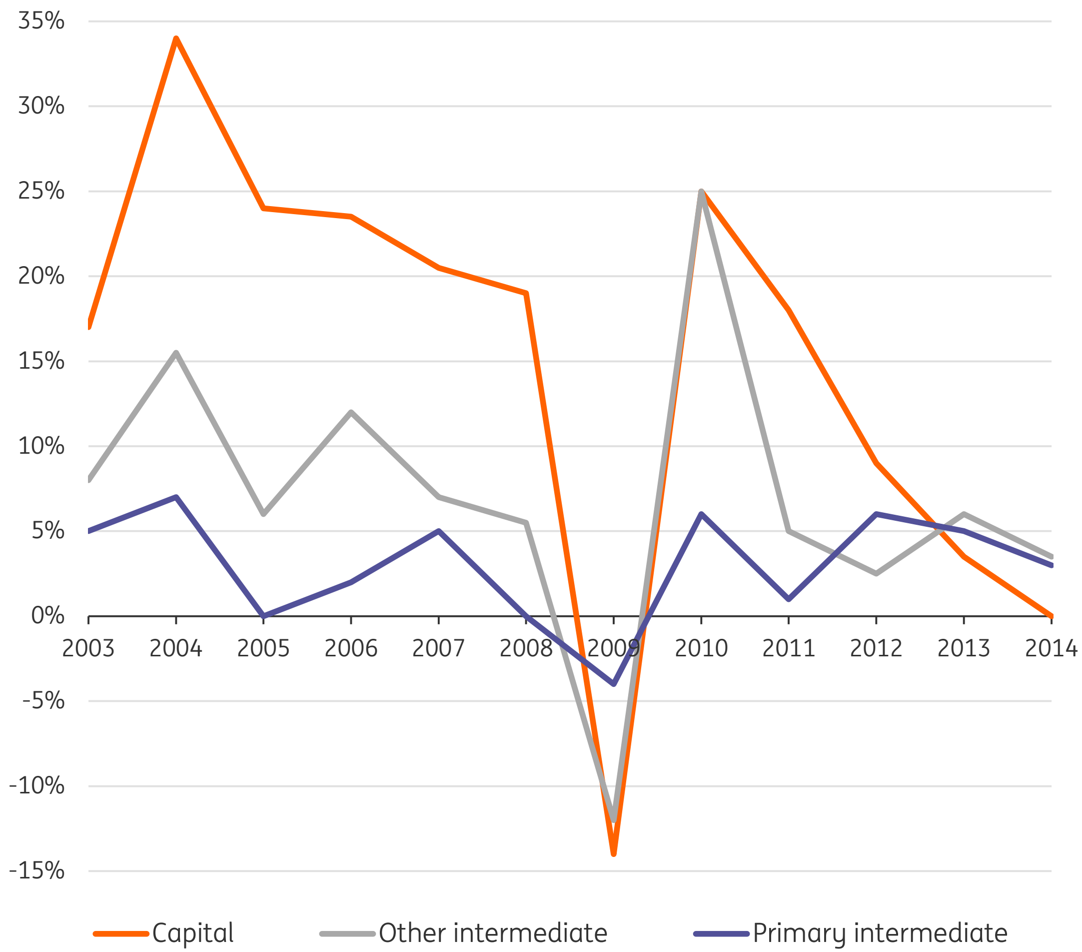


Source: IMF WEO & UNCTAD

- Much lower growth in Chinese demand for capital goods and intermediates since 2010.
- The Chinese import slowdown is not only cyclical, because:
  - A structural shift to domestic suppliers for intermediates.
  - Rebalancing of the economy away from exports and investments, towards consumption, meaning a shift from the high import content of exports and investments towards the lower import intensity of consumption. (Consumption goods account for only 5% of imports).

Other emerging markets show the same pattern…

Emerging market import growth, excluding China (% change YoY)

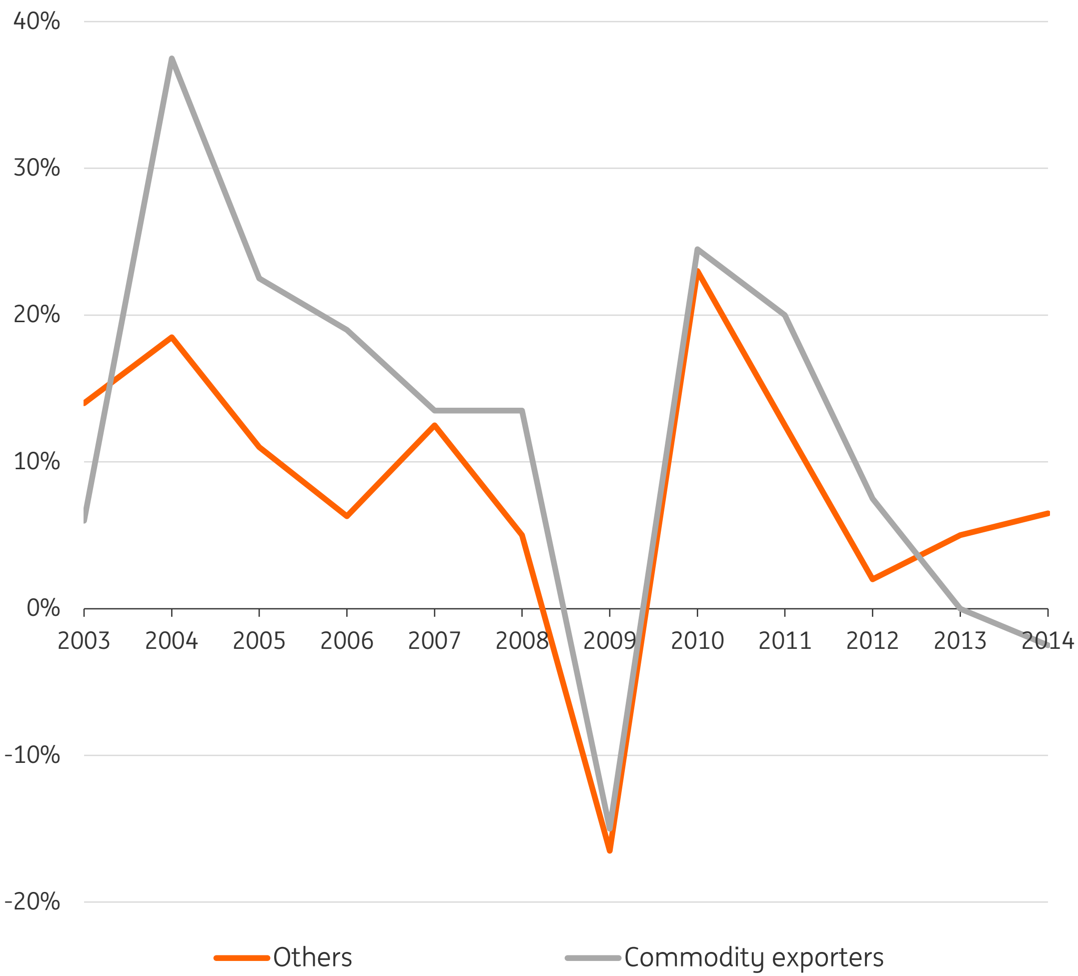


- Imports of capital goods, in particular, have taken an even bigger hit in EMs other than China.

Source: IMF WEO & UNCTAD

...partly due to the crisis faced by commodity exporters

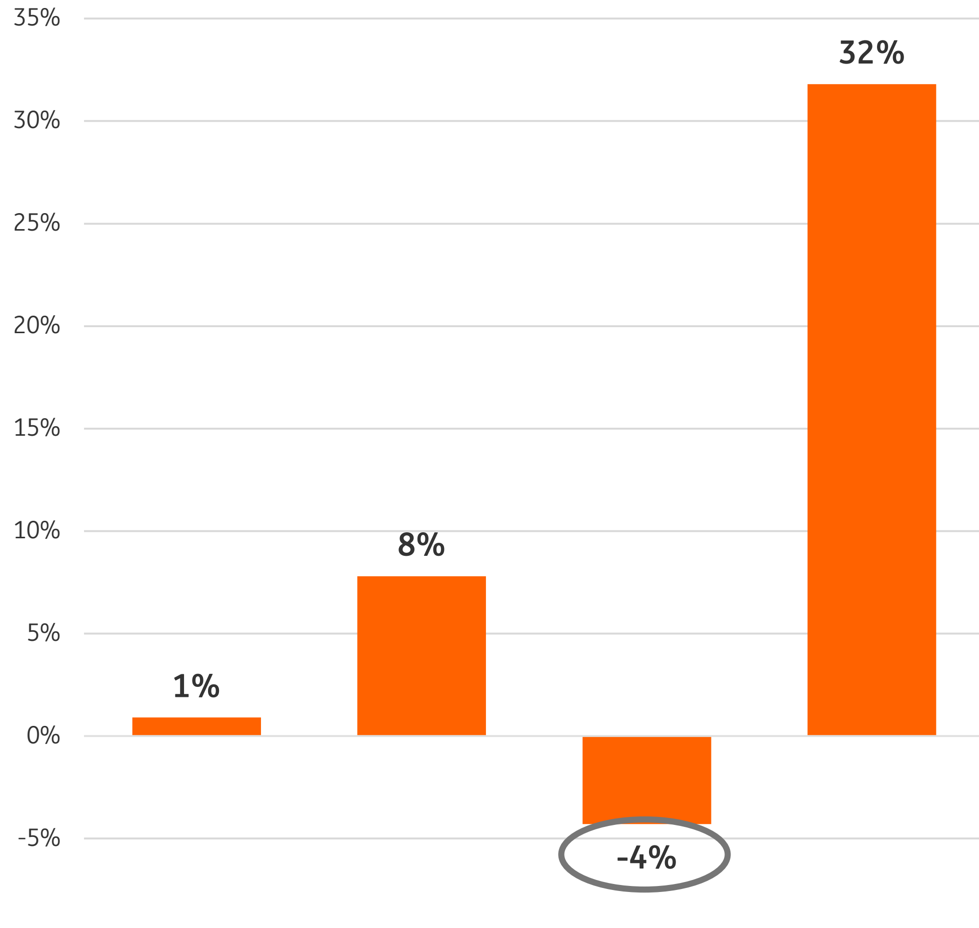
Capital goods import volume index (% change YoY)



Source: UN Comtrade, IMF & World Bank

- Within these other EMs, commodity-exporting countries are playing a significant role in the slowdown of import growth of capital goods.
- The commodity price crunch has led to less import demand for capital goods from oil-exporting countries.
- But it's not only commodity exporters that are importing less.
- Other EMs, like Asian economies outside of China, are also importing less.
- So, what else is going on?

2. Global value chains: Lower greenfield FDI…



World	Developed Economies	Developing Economies	Transition economies
1%	8%	-4%	32%

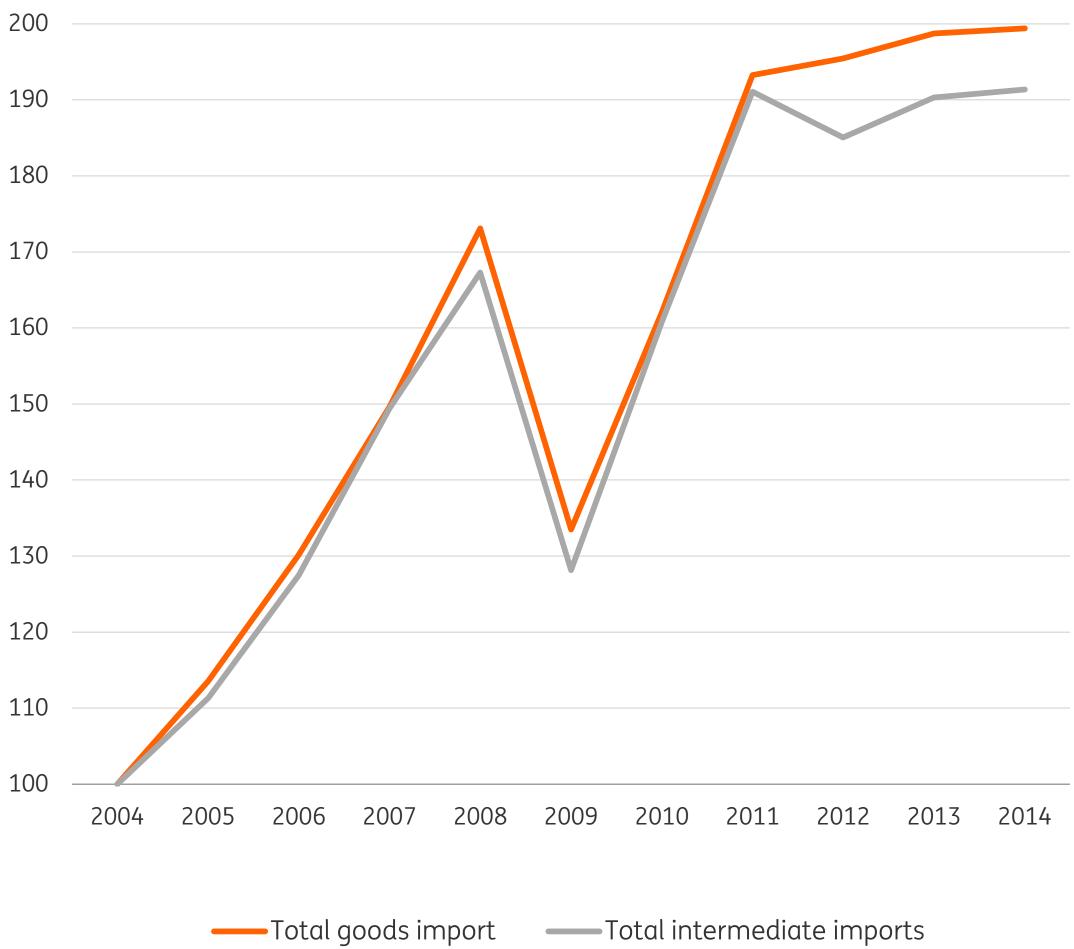
Source: UNCTAD

- Could it be that the expansion of global value chains is slowing down? Is offshoring losing ground to re-shoring?
- Diminishing greenfield FDI flows to developing economies in 2015 seem to indicate this.
- But, greenfield FDI is a blurred indicator of global value chains. Greenfield FDIs, with the purpose of setting up new offshoring locations to take care of part of the production process, lead to a lot of imports and exports of intermediates.

But, greenfield FDIs are also made to sell products in the local market. If so, these can be substitutes for exports instead of being a stimulus.

...lagging trade in intermediate products

World imports of intermediate products and all imports (2004=100)

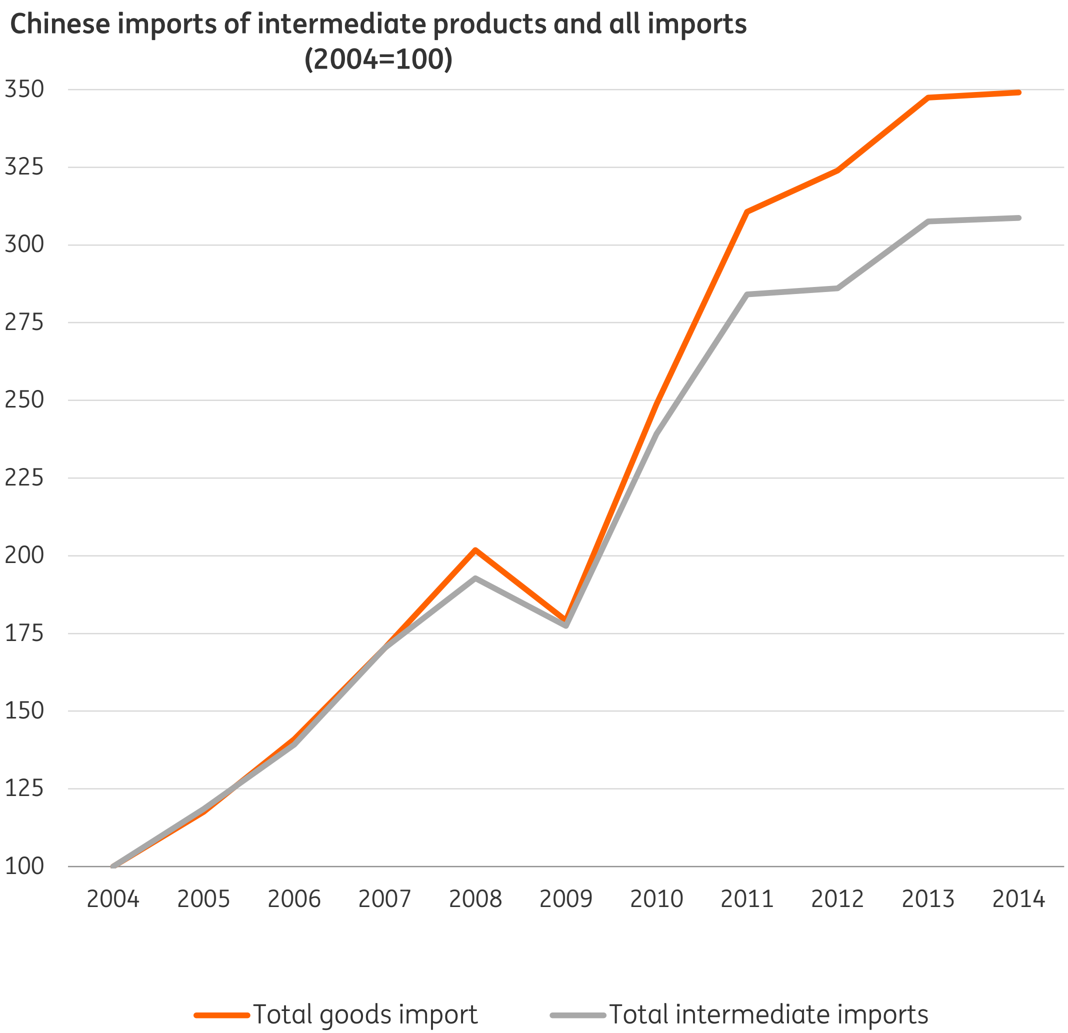


- The worldwide slowdown in the growth of imports of intermediates also suggests that the expansion of global value chains is slowing down.

Source: WTO

Calculations: ING Global Markets Research

China leads the way in this slowdown



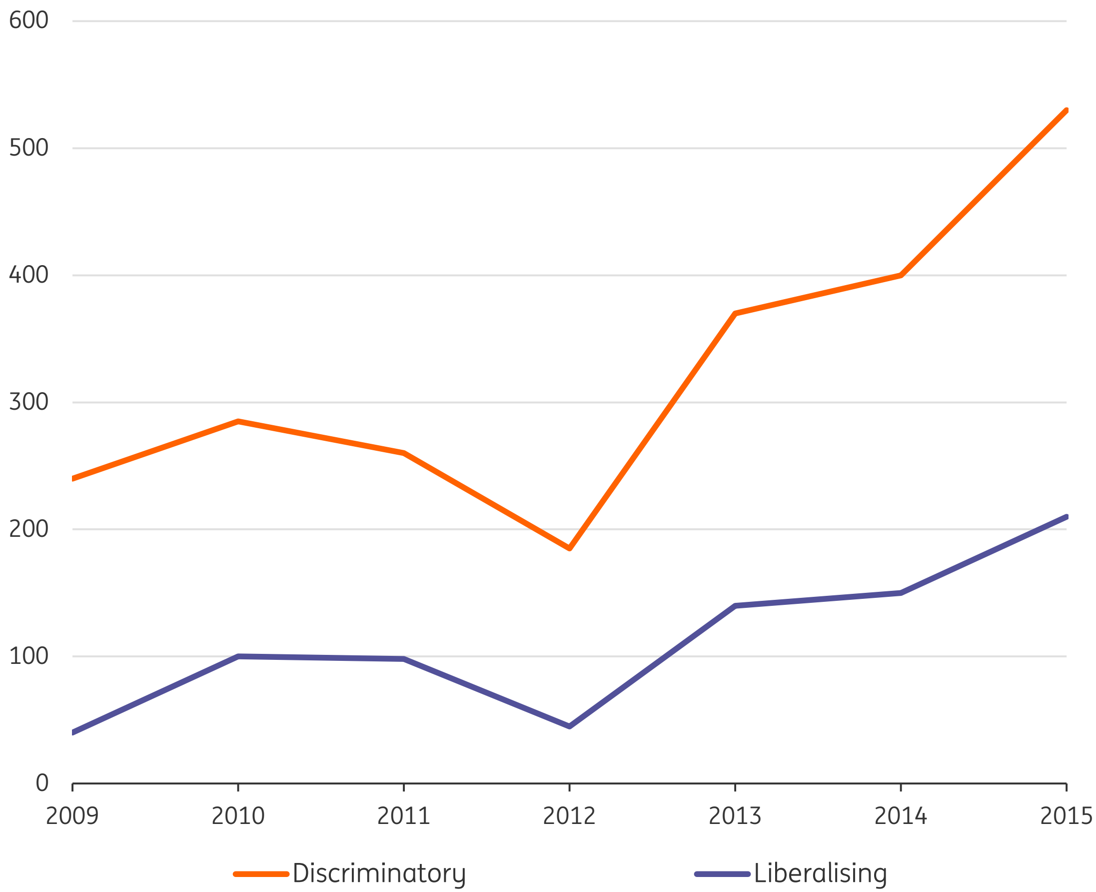
- Chinese import demand for intermediates is slowing.
- This is not only because China is increasingly using domestic suppliers.
- The rebalancing of the Chinese economy away from exports/industry, towards consumption/services, means reduced imports of intermediates.

Source: WTO

Calculations: ING Global Markets Research

3. Trade liberalisation losing out to protectionism

Number of implemented trade measures

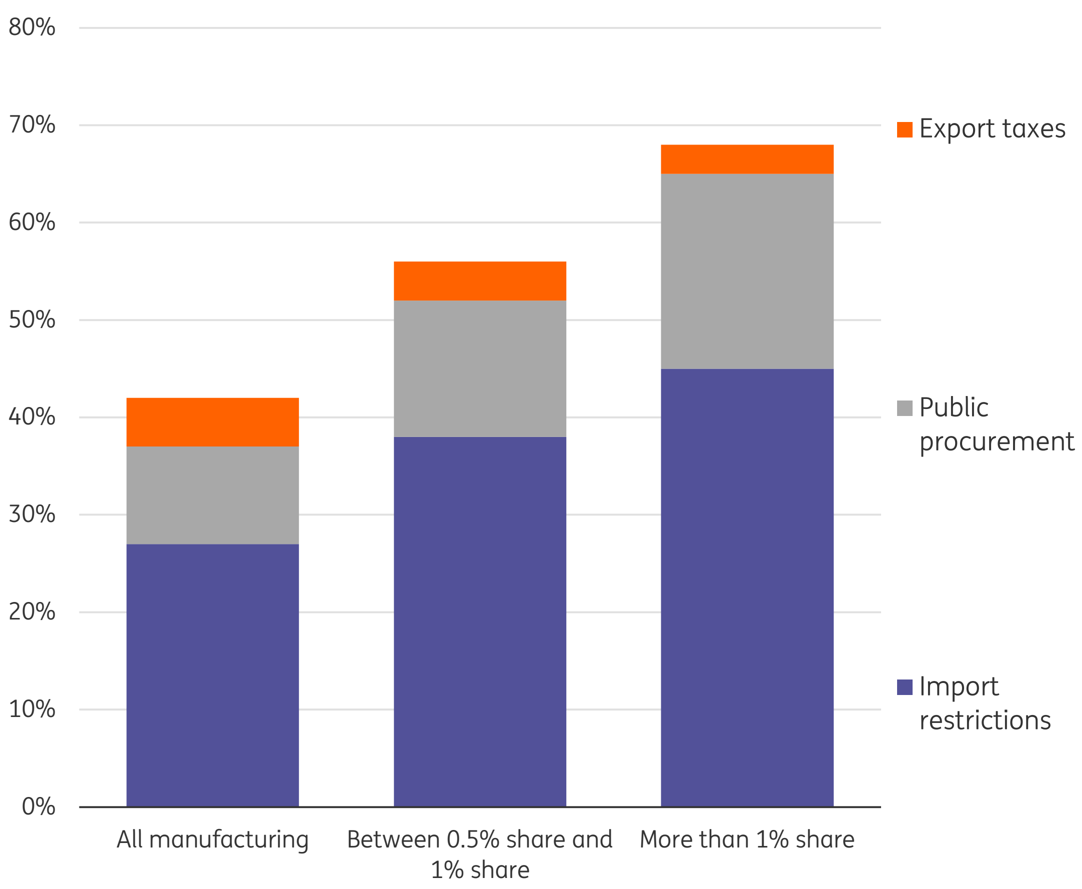


- Another reason for the slowdown in trade is: Protectionism.
- Over 500 protectionist measures have been implemented in 2015, compared to just 200 liberalising trade measures.
- This does not only hold true for 2015. In each year since the start of the financial crisis in 2008, protectionist measures have outpaced liberalising measures.

Source: Global Trade Alert

Products responsible for trade fall hit by protectionism

Trade measures that are protectionist (as a % of total)

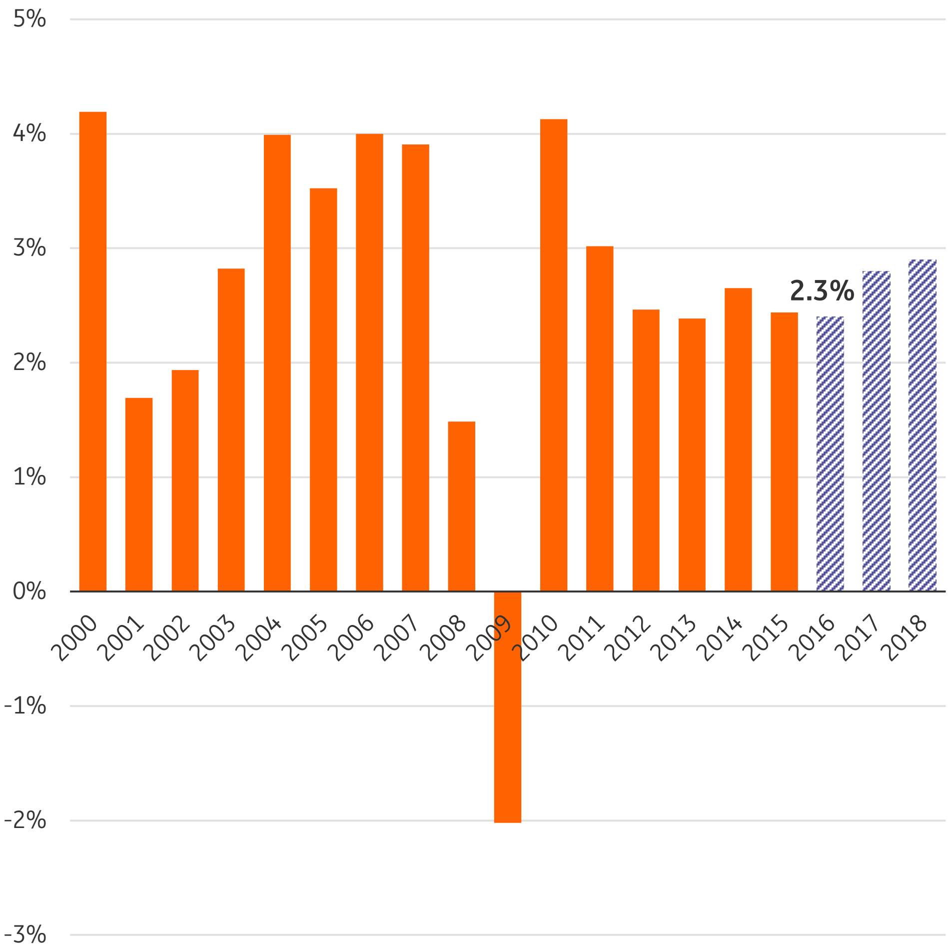


- There is a clear relationship between product groups that contributed most to the fall in trade in 2015 and those hit most by protectionism.
- Product groups (excluding commodities) that are each responsible for at least 1% of the decline in trade (by volume) from 2014 to 2015 are hit almost twice as hard by protectionism than the average for manufacturing goods.

Source: Global Trade Alert

Where is world trade heading?
Cyclical and structural drivers look weak

Cyclical: Trade suffers from economic weakness



Low economic growth has a disproportionate negative effect on trade

ING forecasts slower 2016 GDP growth in:

- The US: 2.4% in 2015 to 1.6% in 2016
- China: 6.9% to 6.5%
- UK: 2.3% to 1.8%
- Japan: still-low growth (0.5%)
- The Eurozone hardly compensates: 1.4% to 1.6%
- Russia exerts less drag on the world economy, but is still shrinking (-1.7%)

Investment picture looks rather bad

- Negative investment growth in the US/UK
- Only modest recovery in the Eurozone
- Flat investment profile in Japan
- China: negative structural trend

Source: IMF & ING

Calculations: ING Global Markets Research

Structural: Unfavourable tide, but one bright spot

Many negative factors for trade:

1. Free trade at risk
2. No signs of accelerating expansion in global value chains
3. China's shift away from investments to continue

A positive one:

- Rising commodity prices push up import values and volumes of commodity exporters

1. Free trade at risk: EU under pressure

BREXIT:

- Vote to leave EU can hurt British and EU trade and creates risk of more EU countries leaving the EU

TPP/TTIP/Bali:

- TTIP: Little public support makes closing any deal with the US difficult
- TPP: Positions taken by US presidential candidates make ratification of TPP uncertain
- Bali: 31 countries yet to ratify, before Bali agreement can be implemented

Refugee crisis:

- Reestablishment of border controls

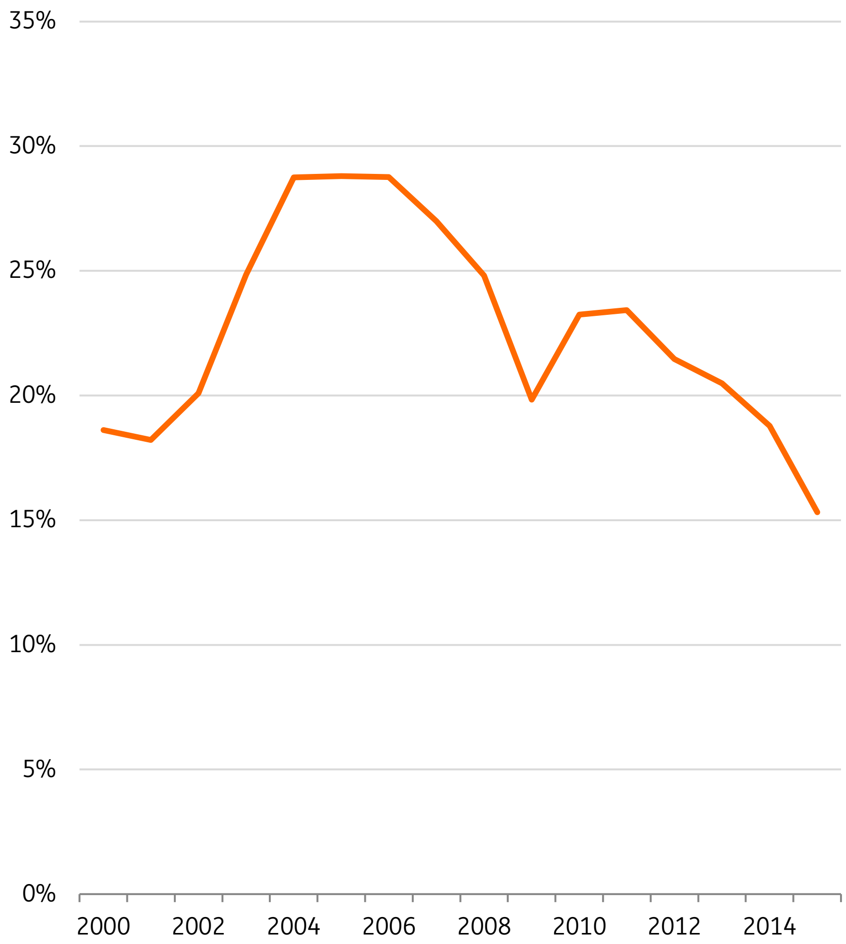
2. No signs of renewed momentum for global value chains

Greenfield FDI in EMs may continue, but not accelerate, due to:

- Subdued investment activity of enterprises in developed markets
- Threat of barriers due to political instability/protectionism

3. Chinese imports: Growth will not return to pre-crisis levels

Development of Chinese goods imports as a % of GDP



Source: IMF & WTO

Calculations: ING Global Markets Research

- The shift away from export- and investment-led growth in China, towards consumption-led growth, had already started to reduce the import intensity far before the start of the financial crisis. The export industry uses many imported intermediates, while consumption is less dependent on imports

ING's baseline expectations for world trade

1. World trade (in goods) will grow at around the world GDP growth rate (2.3-2.9%) during 2016-18

2. Nominal trade will grow a bit faster, especially from 2017 onwards

3. But, no sign of a return to trade growth outpacing production by any significant amount

Risks to the baseline scenario: Mainly downward

Downside risks

- Political (Brexit, European refugee crisis, Grexit and US politics)
- Stronger slowdown of the world economy
- Return of volatility in financial markets
- Another drop in commodity prices

Upside risks

- European growth
- Recovery in China
- Trade agreements going ahead
- Recovery of commodity prices

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