Charting The Great World Trade Collapse

Submitted by Tyler Durden on 12/02/2009 12:03 -0500

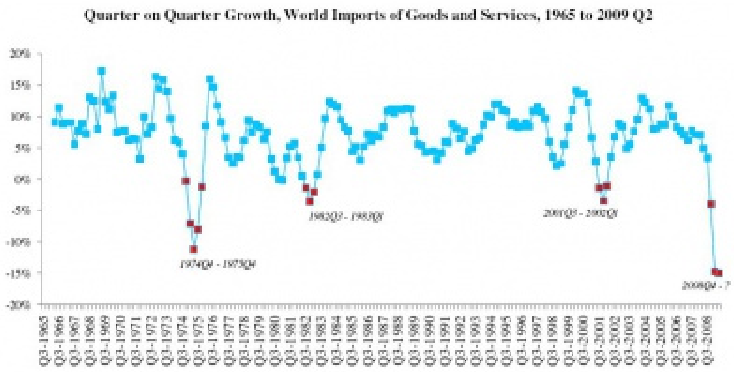
A new report by VoxEU provides some detailed perspectives on just how bad the collapse in world trade has been as a result of the last year's events. In a nutshell: the current Great Recession/Depression has plunged the world into an unprecedented collapse of global trade, with the resultant blowing of liquidity bubbles having been the only way for individual governments to respond to this massive loss of GDP. And while drops in world trade are nothing new, with a 5% drop in the 1982 and 2001 periods, as well as a more severe 11% contraction in the 1970s, the current plunge of over 15% YoY is truly unprecedented and demonstrates the fragile nature of "globalization." What the outcome of this fact will be, depends entirely on the traditional dynamo of world economic growth - the US consumer, and unfortunately he is still down for the count.

From the VoxEU report:

Global trade has dropped before ? three times since WWII ? but this is by far the largest. As Figure 1 shows, global trade fell for at least three quarters during three of the worldwide recessions that have occurred since 1965 ? the oil-shock recession of 1974-75, the inflation-defeating recession of 1982-83, and the Tech-Wreck recession of 2001-02. Specifically:

- *The 1982 and 2001 drops were comparatively mild, with growth from the previous year’s quarter reaching -5% at the most.*
- *The 1970s event was twice that size, with growth stumbling to -11%.*
- *Today's collapse is much worse; for two quarters in a row, world trade flows have been 15% below their previous year levels.*

Figure 1 The great trade collapses in historical perspective, 1965 - 2009

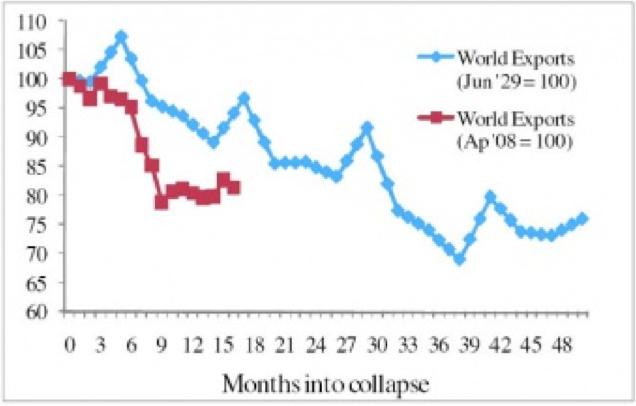


Source: OECD Quarterly real trade data.

On the steepness of the current collapse:

The great trade collapse is not as large as that of the Great Depression, but it is much steeper. It took 24 months in the Great Depression for world trade to fall as far as it fell in the 9 months from November 2008.

Figure 2 The great trade collapses vs. the Great Depression

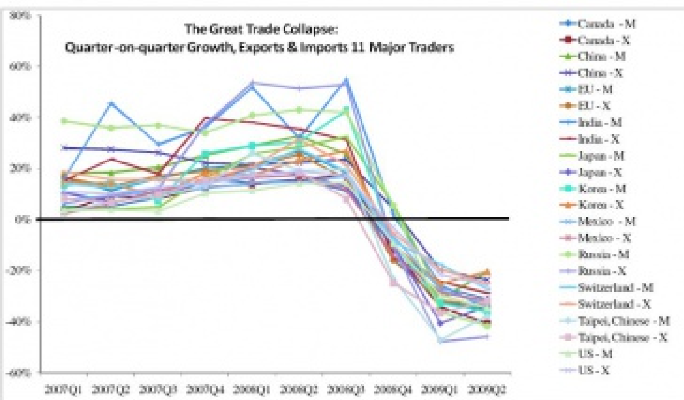


Source: Eichengreen and O'Rourke (2009).

On the **synchronicity** of the collapse, which is most troubling, as while the benefits of globalization have been widely extolled previously, this is one of the most troubling adverse side-effects:

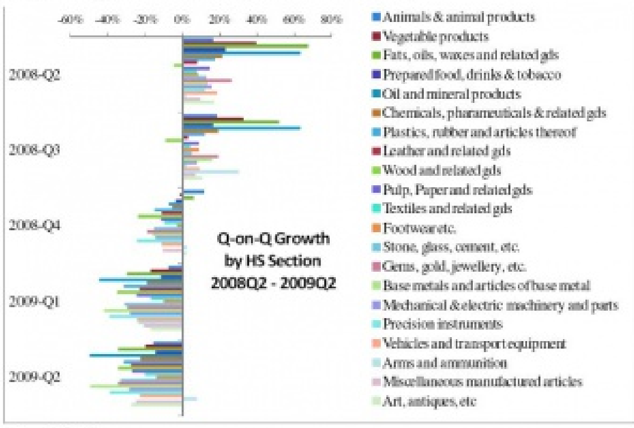
- *All 104 nations on which the WTO reports data experienced a drop in both imports and exports during the second half of 2008 and the first half of 2009.*
- *?Figure 3 shows how imports and exports collapsed for the EU27 and 10 other nations that together account for three-quarters of world trade; each of these trade flows dropped by more than 20% from 2008Q2 to 2009Q2; many fell 30%*
  or more.
- *?World trade in almost every product category was positive in 2008Q2, almost all were negative in 2008Q4 and all where negative in 2009Q1 (Figure 4).*

Figure 3 The great trade collapse, 2008 Q2 to 2009 Q2



Source: Eichengreen and O'Rourke (2009).

Figure 4 All types of goods trade collapsed simultaneously



Source: Comtrade database

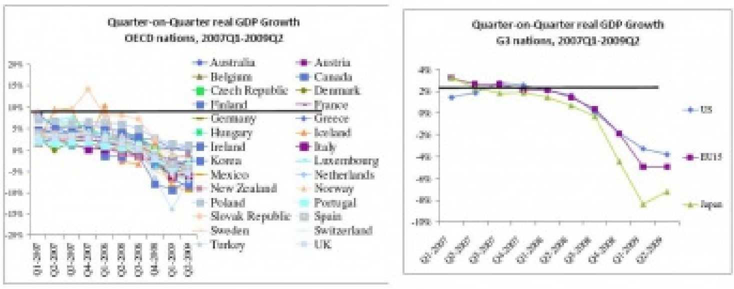
On the causes of the "Great Trade Collapse":

The great trade collapse was triggered by ? and helped spread ? the global economic slump that has come to be called

"The Great Recession."

As the left panel of Figure 7 shows, the OECD nations slipped into recession in this period, with the largest importing markets ? the US, EU and Japan (the G3) ? seeing their GDP growth plummet more or less in synch. The US and Europe saw negative GDP growth rates of 3 to 4%; Japan was hit far worse.

Figure 7. The current recession, OECD nations and G3, 2007Q1 - 2009Q2



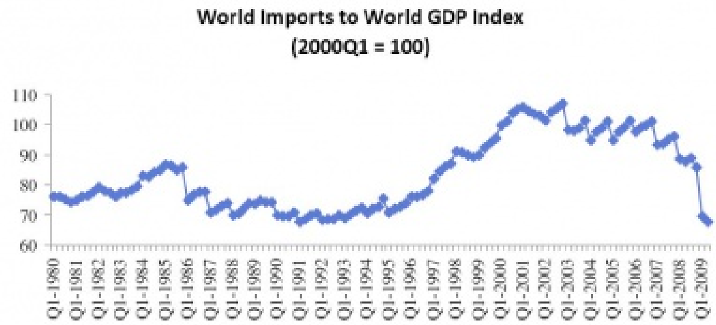
Note: G3 is US, EU and Japan.
Source: OECD online data base.

Another very relevant topic: why have GDPs not followed the trade collapse to the same degree:

Given the global recession, a drop in global trade is unsurprising. The question is: Why so big? The chapter by Caroline Freund shows that during the four large, postwar recessions (1975, 1982, 1991, and 2001) world trade dropped 4.8 times more than GDP (also see Freund 2009).

This time the drop was far, far larger. From an historical perspective (Figure 8), the drop is astonishing. The figure shows the trade-to-GDP ratio rising steeply in the late 1990s before stagnating in the new century right up to the great trade collapse in 2008.

Figure 8. World trade to world GDP ratio, 1980Q1 to 2009Q2



Source: World imports from OECD online data base; World GDP based on IMF data.

The rise in the 1990s is explained by a number of factors including trade liberalisation. A key driver, however, was the establishment of international supply chains (manufacturing was geographically unbundled with various slices of the value-added process being placed in nearby nations). This unbundling meant that the same valueadded crossed borders several times. In a simple international supply chain, imported parts would be transformed into exported components which were in turn assembled into final goods and exported again, so the trade figures counted the final value added several times.

As we shall see, the presences of these highly integrated and tightly synchronised production networks plays an important role in the nature of the great trade collapse.

As for the implications of the collapse:

What does the great trade collapse mean for the world economy? The authors of this Ebook present a remarkable consensus on this. Three points are repeatedly stressed:

- *Global trade imbalances are a problem that needs to be tackled.*

One group of authors (see the chapters by Fred Bergsten, by Anne Krueger, and by Jeff Frieden) sees them as one the root causes of the Subprime crisis. They worry that allowing them to continue is setting up the world for another global economic crisis. Fred Bergsten in particular argues that the US must get its federal budget deficit in order to avoid laying the carpet for the next crisis.

Another group points to the combination of Asian trade surpluses and persistent high unemployment in the US and Europe as a source of protectionist pressures (see the chapters by Caroline Freund, by Simon Evenett, and by Richard Baldwin and Daria Taglioni). The chapter by O'Rourke notes that avoiding a protectionist backlash will require that i) the slump ends soon, and ii) severe exchange rate misalignments at a time of rising unemployment are avoided.

- *Governments should guard against compliancy in their vigil against protectionism.*

Most authors mention the point that while new protectionism to date has had a modest trade effect, things need not stay that way. The chapter by Simon Evenett is particularly clear on this point.

There is much work to be done before economists fully understand the great trade collapse, but the chapters in this Ebook constitute a first draft of the consensus that will undoubtedly emerge from the pages of scientific journals in two or three years time.

One simple way to look at the globalized chain of events is that even as trade has collapsed, CBs have turned on the liquidity spigot, and the resulting rush to risky assets has moderated to a large extent a collapse in GDP which would have certainly resulted in a global depression of unprecedented proportions. It is early to say if this consequence has so far been avoided. Yet with excess liquidity being a presumably transient phenomenon, the traditional driver of economic growth, end user consumption and purchasing, has to resume. Alas, as Obama himself has pointed out, the US consumer will be out for the count for an indefinite period, and without that critical cog in the global economy, all other measures are merely band aid temporary solutions. The major debate in the economic community right now is whether the temporary fixes will be sufficient to get the consumer out of hiding. Yet with wage deflation and unemployment still surging, the likelihood of a favorable outcome grows dimmer by the month. And with systemic shocks like Dubai threatening to destabilize the fragile state of the world economy as we saw so vividly last week, a global economy priced to perfection may be just taking the policy of "hope" one step too far.