QNB Economics
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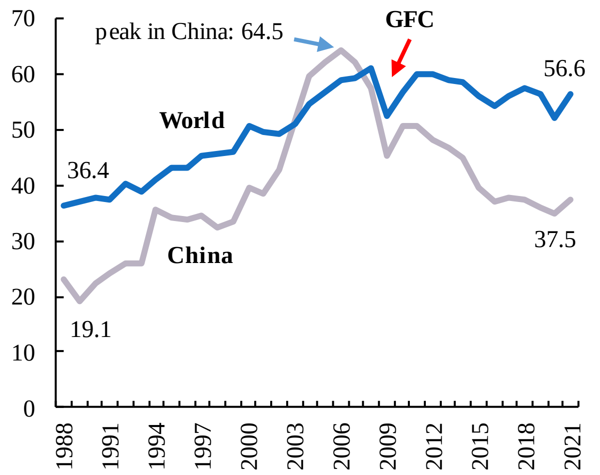
Has global trade in goods peaked?

The significant expansion of international trade in goods has been one of the pillars of the global economy during the last fifty years. This was a vital engine of growth that resulted in significant economic gains in terms of lower prices for consumers and increased productivity around the world. However, when considered as a percentage of global GDP, trade progress seems to have stalled since the Global Financial Crisis in 2008-09. Has global trade in goods peaked?

In this piece, we argue that the period of favourable structural tailwinds for global trade growth is far behind us and new factors are pointing to more headwinds in the near future.

Trade in Goods as a Proportion to GDP (%)

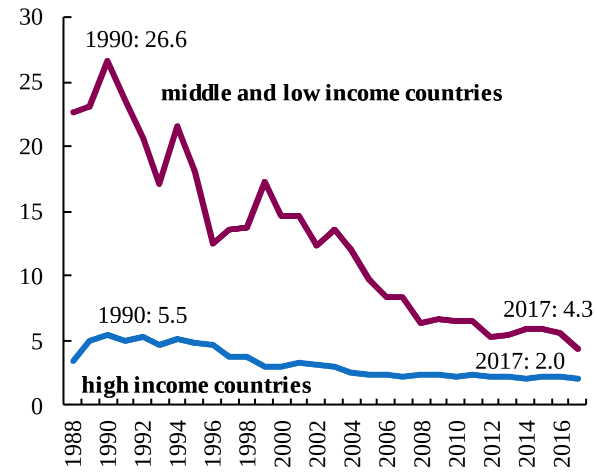


Source: World Bank, QNB analysis

The robust growth in the international trade of goods pre-GFC was boosted by different factors. First, there has been significant progress in terms of trade liberalization. Several regional trade agreements were established in the 1990s, including the North American Free Trade Association (NAFTA), the European Union (EU), the Southern Common Market (Mercosur), and the Association of Southeaset Asian Economies (ASEAN). Due to these agreements, and in addition to multilateral negotiations and unilateral trade reforms of countries opening up, trade barriers have decreased significantly. In fact, the average applied tariff rate for goods in middle and low income countries was lowered from 23% in 1989 to below 5% in recent years.

Second, the process of economic development in different countries was another contributing element to trade growth. Countries like China, India and other frontier markets from Southeast Asia set up more aggressive goals of diminishing poverty levels, moving up the value chain from agriculture to manufacturing and integrating into the global economy. In fact, China's "catch-up" to higher levels of income per capita was led by an intense process of industrialization and produced an abundance of goods for export. Similarly, India increased the volume of trade relative to GDP from 16% in 1990 to 56% in 2012, and even higher growth was shown by many countries in South East Asia, such as Vietnam, Indonesia, and Thailand.

Average Applied Tariff Rates
(weighted, %, latest available)



Source: WTO, World Bank, QNB analysis

Third, technological progress has had a positive impact on international trade through different channels. It improved communications and reduced its costs, allowing for better coordination of firms and suppliers, including the implementation of just-in-time manufacturing processes at scale, with lower trade-cycle times. The development of electronic payment systems have reduced transaction costs of international trade, making participation in global markets more affordable for firms. Additionally, it has enhanced access to information, making it easier to reach longer-distance markets and suppliers.

With these developments, global value chains (GVC) emerged as production started to take place in stages across different countries. GVC have a multiplying effect on trade volumes since each unit of product exported requires inputs and semi-finished products to cross borders numerous times. As a typical example, the iPhone requires components from suppliers in 43 countries, which in turn require intermediate inputs from different sources.

However, headwinds are now dominating the long-term picture for trade growth.

On trade liberalization, there is now more limited room for additional reductions in tariffs. While tariff reduction was an important driver of trade growth in the past, particularly by integrating middle and low income countries into the global economy, the applied tariffs rate is currently low on average, in both advanced economies and emerging markets. In addition, there is a lack of political interest to further reduce the currently low tariffs, as they mostly apply to sensitive sectors, such as agriculture and national security related segments.

Furthermore, the process of integration of previous decades is now threatened by geopolitical tensions as well as by more trade protectionism. Ongoing disputes between the US and China that started in 2018, and later the Russo-Ukrainian conflict are leading to ever more trade barriers, sanctions, and technology bans. As an example, in late 2022, the US Commerce Department issued an exceptionally broad set of prohibitions on exports to China of semiconductor chips and other high-tech equipment.

Moreover, protectionism has appeared on the scene even when it comes to trade amongst allies. The US Inflation Reduction Act (IRA) approved mid- last year, for instance, contains direct subsidies to industries where the competition with European companies is intense, creating *de facto* barriers against external players in the US market.

On factors related to economic development, change also favours a slowdown in the relative importance of trade. A distinctive feature of growth is the structural transformation that increases the share of services in the economy relative to manufacturing and agriculture. This process naturally reduces the weight of trade in the economy. Trade levels in China, which accounted for 64% of its GDP at the peak in 2006, are now already below 40%, and on their way to converging to that of "mega economies" like the US, which stands at around 25%. As China rebalances its growth model towards more domestic consumption, rather than on exports, this process can only deepen.

All in all, while trade will continue to be a key feature of the global landscape, the period of robust trade expansion is behind us. New headwinds coming from an exhaustion of tariff-based liberalization, geopolitical tensions, and the new development dynamics in China are set to lead to a marked slowdown in trade growth.

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