Trade in flux

By Jean-Francois Lambert, Founder and Managing Partner at Lambert Commodities

The globalised world economy we saw building up over the past 50 years is in a state of flux. New dynamics have emerged, are gathering momentum and the picture gradually shaping up does not look particularly pretty. The World Trade Organisation hitherto undisputed aegis is being weakened; a large web of global supply chains is under duress; long lasting alliances and trade partnerships are being reassessed. The trade scene has become starker and polarised. It is increasingly framed by sanctions, tariffs, and protectionism. Optimists might believe in a transitionary state, and that by democratically electing new leaders, the picture could and will improve. That is far from certain however, as the rationale for the shift may finds its roots deep in societies and be a direct, albeit unexpected, consequence of the great financial crisis of 2008. A new order is probably in the making, unleashing new, complex dynamics and it is wise to heed.

Until a few years ago, there was a vast consensus about how the world should be led. Fukuyama wrote about the 'end of history', whereby post war ideologies were bygone, and liberalism and free markets would eventually spread across the world. Economic dynamics were shaping policies and an unwritten consensus was that globalisation – with trade as its engine – would bring progress and prosperity. With few boundaries, global supply chains helped spreading wealth and development in many parts of the world as products are designed, built, assembled and sold over and across tens of different countries. Globalisation was the norm. But is it still?


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In the long aftermath of the great crisis of 2008, the effects of which we are likely to feel for many years to come, the old economic order has been increasingly challenged. If globalisation on a macro level has been an undeniable success, it is not so perceived everywhere on a micro level: Over 50 years, vast populations reached a middle-class status in developing economies. Yet, in the developed world, social progress has not been seen as particularly vigorous in the same period. A view that globalisation left many on the side, grew progressively in developed democracies and has gathered momentum as it became a centrepiece of the political discourse in several countries, from eastern to western Europe and to America.

In these countries, the belief that globalisation has to be ring-fenced is growing. Concerns about unfair competition from distant countries where the environment is discarded and social laws still basic; de-industrialisation and its consequences on employment; uncontrolled immigration; and unacceptable trade deficits are shaping many politicians' manifestos. In short, the global economic agenda is superseded by new priorities, whereby politics should be conducted with country's self-interest at heart, surfing on a wave

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of discontentment and worries. Hence sanctions, tariffs, Brexit, a more complicated diplomatic scene. Hence, also an increasingly worrisome economic outlook.

On the face of it, as evidenced by facts and figures, the world economy has been extremely robust. Global GDP has been growing on average at almost 3.5 percent per annum since 1980[1]. In 2019, the IMF forecast 3.2 percent growth[2], which might look somehow tepid. Yet, and even at that pace, the world economy measured by its GDP would double in 24 years!

Or will it, really? Growth over the past 30 years or so has been driven by trade. For most of a period extending from the late 1980's to the mid-2000's, real global trade flows expanded twice as fast as real GDP growth[3]. Between 2008 and 2018, world trade and GDP have grown in tandem[4]. However, trade as monitored by the WTO through the Goods Trade Barometer, has been losing momentum for many months now. According to the WTO, the world merchandise trade, is showing 1.2 percent year-on-year growth on the first quarter of 2019[5], much below world GDP growth. The next two quarters are expected to show a similar trend. As further evidence, economies which are trade-dependent are suffering. Singapore's economy experiences its slowest growth in decades[6] in the first half of the year with an annual growth rate, so far this year, barely above zero. Why is trade faltering? And could the world economy remain as robust if trade, the engine of growth, was to lose significant momentum durably?

To be sure, we have, in the past, witnessed periods where trade has receded. The last significant occurrence was 2009, amid the great financial crisis. Yet trade growth quickly resumed. So why could it be different this time? Precisely because the global trading system is under assault. Trade agreements are being challenged (TPP, Nafta); the US has threatened to leave the WTO and is hampering its ability to rule on trade disputes; economic nationalism has become the centrepiece of the political agenda in the world's largest economy. In reaction, US trading partners are considering or taking countermeasures (through tariffs, currency depreciation or else), the consequence of which likely leads to escalation rather than a truce.

However tense the relations between trading partners may have become, common sense and reason could still prevail and new agreements may eventually be found. After all, it would be in everybody's interest to recreate a stabilised marketplace for business to thrive. An encouraging thought, but one which discard the fact that the trade dispute involves the two largest economy in the world, representing over 37pct. of the word GDP[7]: the US and its immediate challenger, China. Without a prompt settlement, disruption could be pervasive.

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Despite the fact that both economies are intertwined – China is the US' third largest destination for exports, and its top supplier – the rivalry between the two juggernauts was bound to deepen. Graham Allison described in the Thucydides Trap the inevitable confrontation between a rising power and already dominant one. In these columns one year ago, we ruled out that a fully fledge trade war could occur. The rationale was the sheer interwoven relationship between the two countries and that economic logic would prevail. Well, it has not, and this shows that the economic decoupling between the United States and China, that we are witnessing is probably a pure geopolitical play finding its roots deeper than in the current administration's agenda. Trade has been weaponized as a mean, not as an end by one America, increasingly worried about the growing influence of China, beyond sheer trade imbalances. If so, there is no coming back, at least for several years, and the magnitude of potential disruption would be long-lasting, possibly triggering further tensions between the two countries. The geopolitical environment will thus be increasingly difficult to navigate for corporates, banks and risk takers. To quote

Henry Paulson a former US Secretary of the Treasury, "that is why I see more clearly than ever the prospect of an Economic Iron Curtain—one that throws up new walls on each side and un-makes the global economy, as we have known it[8]".

This tells us volumes about how the world has changed and how political influence has grown over economic rationale since 2008. Bill Clinton, to epitomise what the drivers for his victory over GHW Bush were in the 90's talked about "the economy, stupid". Amid the rise of protectionism and ultra-polarisation, the main drivers have become geopolitical ones. How can trade not be durably disrupted in that context? and if it is, could the world economy continue to grow at the current pace? Those are very stark concerns and answers are not easily found in recent history.

Business is nimble and always adapts. What make the challenge quite formidable this time, lies both in the magnitude of the disruption and with the uncertainty of the outcome. Before stating the obvious, i.e. they cannot be winners in the long run as everybody will be affected eventually, whether directly or indirectly, let's explore a few likely consequences of a more polarized trade scene.

First, and most obviously, the supply chain realignments. How long will it take to large supply chain managers to reconsider their sourcing strategy? Empirical evidence shows this has started already, notably for large US companies. But not only them. Consider British groups sourcing in a hard-Brexit context? Could China remain a priority market for US companies? Would China maintain its reliance on America supply of raw materials?

At a macro level, the decoupling between China and the US might foster tighter relationship between China and Europe. This has been on top of the Chinese leaders' agenda for many years. In hindsight, the Belt and Road Initiative, under way for a few years was quite timely. How Europe will respond though is uncertain as the worries about the rise of the Chinese giant are shared, amongst advanced economies, beyond Washington. Yet and since the European trade corridor has become more critical for China, European companies could have a potentially interesting bargaining stand.

The Middle East in its unique position between Europe and Asia could also take advantage of Asia's thirst for energy and become a large investor in the region. We might also expect China to reinforce its African strategy both to develop cheap manufacturing and to optimise its strategic raw material sourcing.

Existing tensions between Europe and Russia have already triggered the drift of the largest Eurasian country towards the East, a trend that would probably accelerate as China relies more on Russian oil and gas. Last but not least, a closer partnership is likely to be found between South American countries and China to compensate for US food and agri commodities supply, but also for key mining products thus complementing the key supplies coming from Australia.

It remains to be seen whether the curtailing by the US of the relationship with China could generate a recoupling with Europe. So far Washington seems oblivious of its European partners but that might change if the US economy starts to slowdown as trade flows less freely elsewhere. In the meantime, some suppliers to the US and notably Mexico, South Korea, Taiwan and Japan may also witness an additional flow of activity. Large US supply chain managers have most of their supply chains reaching China in a way or another. They are bound to revisit their sourcing strategy. Technology companies will probably shift part of their production out of China into South East Asian countries.

Access to the Chinese market may prove increasingly challenging for American companies, however significant their investment in China may have been. Banks, hotel chains or consumer product companies

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might find a more hostile environment, for instance. Similarly, the ability of US major trading houses to keep feeding the Chinese consumers might be hampered. That might benefit non-US trading companies, enjoying easier access to China. Some form of partnership between Chinese companies and non-US large trading houses from Switzerland and Singapore notably could even formalise. Incidentally, commodity trading houses may find themselves in a long foregone sweet spot yet again as the dislocation for supply and demand may offer an interesting playground to companies whose DNA is precisely built around the ability to react swiftly to market changes and provide key commodities sourcing alternative in whatever circumstances.

If we now take a broader view, let's ponder how trade could develop in a polarized world in the long run. It is likely that large and widespread supply chains find increasingly difficult to navigate in a volatile world where tariffs are more widely raised, one where trade regulations are increasingly set on a bi-lateral basis rather than through a global rule book. A likely consequence therefore could be, where possible, the curtailing of the chains with a closer-to-home strategy.

Amid the polarisation policies of various countries, it is likely that priority will be given to sourcing and selling amongst close partners. This may not be triggered by laws or regulation, but merely through the additional constraints imposed by more difficult country-to-country international relations. This could foster shorter supply chains, when feasible increasingly at a regional scale. Post-Brexit UK may remain an oddity in that respect where the aim is to rebalance the trade flows with the European neighbours with renewed partnership with afar former British empire countries.

Re-onshoring may also be accelerated when possible. Thanks to the help of technology, this prospect has become more plausible. Robotics, allowing 24/7 production, 3D printing made available for an increasing number of products. If energy prices are contained – the new energy mix as the big transition has started should keep price in check, then we might witness the emergence of a new form of industrialisation closer to the consumer centres.

Trade as we know it would therefore be significantly affected as the world gets less global. If supply chains get shorter, this means that the flow of semi-finished products which today constitute a large part of the container freight, following hitherto the global supply chains, might eventually shrink.

Of course, "predictions are difficult, especially when they involve the future[9]" and as such, all of the above may prove totally wrong. However, as geopolitics trump economics, one thing remains likely. Alliances and partnerships will be more than ever dictated through the prism of relative strategic importance and tangible benefits to be obtained as a quid pro quo. In that respect, the weaponization of trade is likely to remain the norm rather than the exception and the availability of commodities, be them food and agri, energy, precious metals or rare earth will remain on top of the world leaders' agenda. The journey towards a new economic order has started and the road is already be bumpy for supply chain managers, their clients, and financiers. ■

Notes

1 Source IMF, real GDP growth from 1980 to 2018
2 Source IMF, World Economic Outlook July 2019
3 The Falling Elasticity of Global Trade to Economic Activity, Marc Auboin and Floriana Borino, CESIFO, Sept 2018
4 Source World Tarde Statistical Review, 2019, World Trade Organisation
5 Source WTO Goods Trade Barometer August 2019
6 Sources FT July 2019
7 Source Pocket World in Figures 2019 – The Economist
8 Paulson Institute, Feb 2019
9 Attributed to Mark Twain

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