

Economics Group

Special Commentary

Jay H. Bryson, Global Economist
jay.bryson@wellsfargo.com • (704) 410-3274
Zachary Griffiths, Economic Analyst
zachary.griffiths@wellsfargo.com • (704) 410-3284

Why Is Global Trade Growing So Slowly?

Executive Summary

There is a high degree of correlation between global trade growth and growth in global economic activity but, the former, has generally grown in excess of the latter over the past few decades. The successive rounds of multi-lateral trade liberalization that occurred in the decades following the Second World War lubricated the wheels of global trade over and above growth in global economic activity by reducing the relative price of exports via tariff reduction. In addition, the fragmentation of production processes as manufacturers moved production facilities to low-cost developing economies also helped spur export growth.

Not only are global exports growing at the lackluster rate of only 3 percent or so at present, but global trade is growing more or less in line with global economic activity at present. Talks on multilateral trade liberalization have stalled over the past decade, and the fragmentation of production processes may have reached a high-water mark, at least for now, as foreign direct investment in developing economies appears to have topped out. The International Monetary Fund forecasts that global trade growth will strengthen over the next few years, but it will likely not exceed growth in global economic activity to the same extent as it did during the past few decades.

Slow Export Growth Is a Global Phenomenon

In 2010, President Obama set a goal for the United States to double its exports within a five-year period. As we wrote at the time and then subsequently restated, it would be challenging for the country to achieve 15 percent per annum growth for 5 consecutive years.¹ After surging about 12 percent in 2010, growth in real American exports of goods and services slowed to roughly 3 percent in 2012 and 2013. This slowdown continues today. On a year-ago basis, real exports were up only 3.5 percent in Q2-2014.

Furthermore, slow growth in exports is not only confined to the United States. As shown in Figure 1, the volume of exports on a global basis has grown at a slow rate over the past few years. Figure 2 shows that global exports grew at a per annum rate of 3.5 percent in 2011 through 2013, which is half the annual average rate that was achieved during the last two global expansions, but it also shows that advanced as well as developing economies have participated in the slowdown. Deceleration has been especially acute in developing Asia. Real exports from developing Asia grew 15 percent per annum between 2003 and 2007 but only 6 percent over the past three years.

Is this slowdown in global trade related to anemic global economic growth over the past few years?² Economic theory posits, and empirical evidence confirms, that growth in the volume of exports is a function of economic growth in foreign economies. Indeed, Figure 1 confirms that growth in real global exports and growth in global industrial production (IP), which we use as a monthly proxy for global economic activity, are highly correlated. Over the past two years, global

Slow growth in exports is not confined to the United States only.

¹ See “Can America Double Its Exports In Five Years?” (Feb. 14, 2011) and “Can America Achieve Stronger Export Growth?” (Oct. 21, 2013). Both reports are available upon request.

² In this report we use “global exports” and “global trade” interchangeably. At a global level the exports of one country must be the imports of another.



IP has grown less than 2 percent on an annual average basis, slower than the 3 percent per annum growth rate that was registered between 1993 and 1999 and the 4 percent growth rate that was achieved in the 2003-2007 period. Thus, deceleration in economic activity appears to be playing a role in the slowdown in global trade.

Figure 1

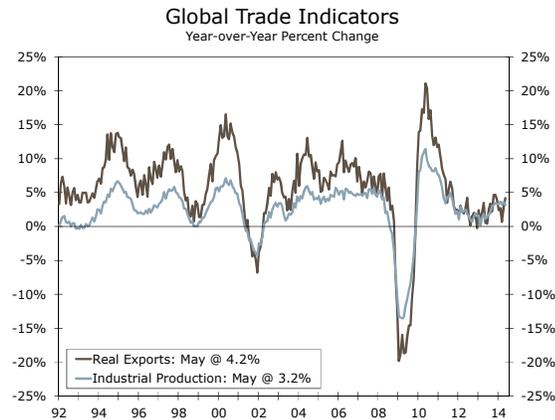
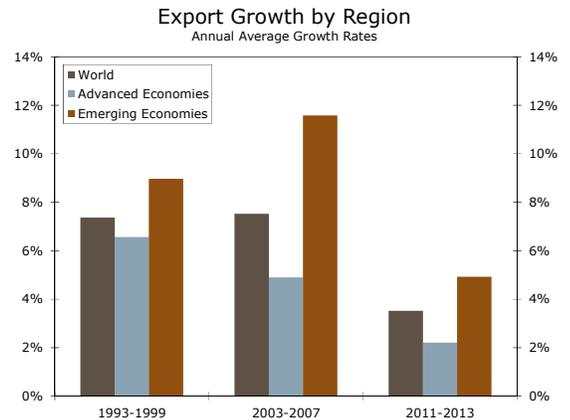


Figure 2



Source: IHS Global Insight and Wells Fargo Securities, LLC

There are likely other factors, besides slow global growth, which are restraining growth in global trade at present.

However, there appears to be something else at work as well that may be restraining global trade. As Figure 1 also makes apparent, real global exports have generally grown in excess of global IP over the past two decades. Between 1992 and 2007, global exports grew at an annual average growth rate of 7 percent, more than twice as strong as the 3 percent per annum growth rate in global IP during that period. Since 2011, however, global trade has grown more or less in line with global IP. What helped boost global export growth during the past two decades that is not at work today?

There are two factors that likely helped boost global trade in earlier decades. First, the rounds of trade liberalization that occurred in the decades after the Second World War reduced tariffs, largely among advanced economies initially and then subsequently more broadly, thereby lubricating the wheels of export growth in the world.³ As shown in Figure 3, real exports of the advanced economies grew significantly in excess of industrial production in those economies throughout the 1980s and 1990s.

Second, the fall of the Berlin Wall in 1989 and the opening of China, which started in 1979 but which really gathered steam in the 1990s, led to a fragmentation of production processes as manufacturers moved production facilities to developing economies, especially to China, to take advantage of low-cost labor in those countries. Instead of confining the production process for a specific good to one country, companies increasingly broke up the production process into multiple stages in different countries. Raw and intermediate inputs were exported to a location where they were assembled into a final product and then subsequently re-exported. This movement of production facilities to low-cost countries is illustrated by the acceleration of foreign direct investment (FDI) in developing economies during the 1990s and its subsequent explosion, especially in China, during the past decade (Figure 4).⁴

³ Wacziarg and Welch (2008) study the 1950 to 1998 period and find that countries that liberalized trade experienced a 5 percentage point increase in their trade-to-GDP ratios, on average. See Romain Wacziarg and Karen Horn Welch, "Trade Liberalization and Growth: New Evidence," *The World Bank Economic Review*, 2008 (2), p. 187-231. Buono and Lalanne (2010) find that the tariff reductions associated with the Uruguay Round accounted for between 3.4 percent and 4.7 percent of French export growth between 1993 and 2002. See Ines Buono and Guy Lalanne "The Effect of the Uruguay Round on the Intensive and Extensive Margins of Trade," *Banca d'Italia Working Paper #743*, February 2010.

⁴ In the United States, foreign affiliates of multinational companies (MNCs) accounted for \$324 billion (23 percent) of the total value added that those companies produced in 1989. By 2010, the value added of

Figure 3

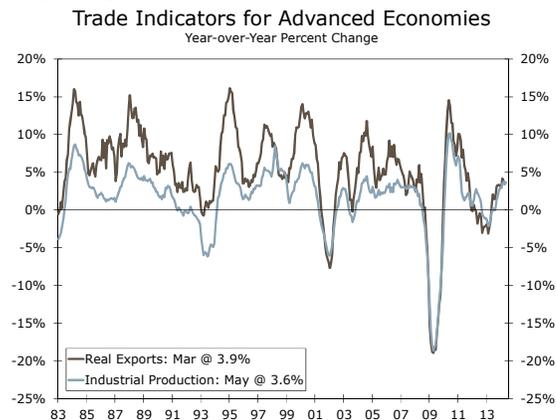
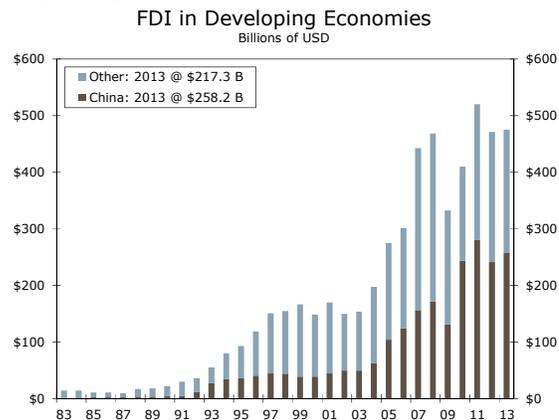


Figure 4



Source: IHS Global Insight, International Monetary Fund and Wells Fargo Securities, LLC

Will Export Growth Return to Its Pre-Crisis Rates?

The two factors that may have helped boost global export growth above global IP growth in the past few decades appear to have stalled in recent years. The Uruguay Round of multilateral trade negotiations, which launched in 1986 and came into effect in 1995, represents the last round of multilateral tariff reductions. The Doha Round, which started in 2001, has never been completed. There have been numerous bilateral free trade agreements that have been negotiated over the past two decades but, by their nature, bilateral trade pacts do not cover the breadth of countries that multilateral agreements entail. In addition, Figure 4 shows that FDI in developing economies has topped out in recent years largely because the amount of direct investment in China has stabilized after its explosive growth of the past two decades.

So what will happen to export growth in the years ahead? If, as the International Monetary Fund (IMF) forecasts, global economic growth strengthens in coming years, then export volumes should also accelerate. The bad news, however, is that the outlook for export “lubrication” via further trade liberalization is clouded. As noted above, the Doha Round of multilateral trade liberalization is stalled. Negotiators from multiple countries are currently working on the Transatlantic Trade and Investment Partnership (TTIP) and the Trans-Pacific Partnership (TPP), but it will likely be years, if ever, before those agreements are concluded.

Furthermore, it is very much an open question as to whether production processes will fragment even further, thereby providing an extra boost to export growth. The Institute of International Finance forecasts that FDI in developing economies will remain essentially flat through 2015.⁵ As shown in Figure 4, China currently accounts for roughly one-half of the FDI flows to developing economies. However, Figure 5 shows that the average wage in U.S. dollar terms for migrant workers in China, which have generally supplied the labor in the bustling factories of the country, have more than doubled since 2009. Consequently, the wage gap between China and most advanced economies has narrowed. Is there another developing country as large and as stable as China to which FDI will gravitate? Or will some production processes be “on-shored” back to advanced economies to take advantage of shorter and less complex supply chains, thereby eroding export growth?

The good news is that the IMF forecasts that growth in global trade will strengthen from about 3 percent last year to nearly 6 percent by 2016, as global economic activity accelerates somewhat (Figure 6). However, this 6 percent per annum forecasted growth rate is not quite as strong as the 7 percent annual average growth rate that characterized the 1992-2007 period, much less the

Trade negotiations are stalled and FDI in developing economies may have topped out.

Growth in global economic activity should pick up.

The IMF forecasts that export growth will strengthen, but not back to pre-crisis rates.

foreign affiliates had shot up to \$1.2 trillion, 30 percent of the total produced by American MNCs in that year.

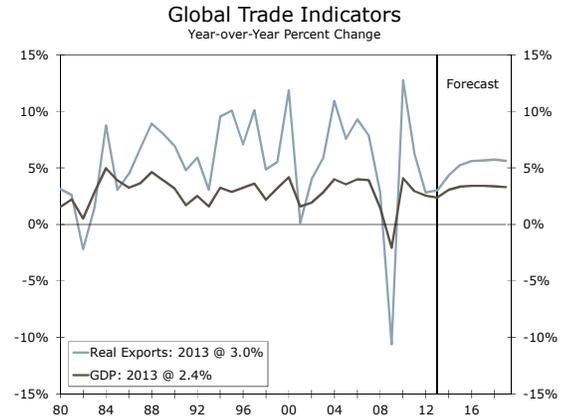
⁵ See “Capital Flows to Emerging Markets,” Institute of International Finance, May 29, 2014.

8 percent per annum growth rate between 2003 and 2007, despite the IMF’s projection that growth in global economic activity will eventually strengthen to nearly its pre-crisis norm. Implicitly, the IMF seems to be assuming that some of the factors that “lubricated” global export growth in decades past may not be as supportive in coming years.

Figure 5



Figure 6



Source: CEIC, International Monetary Fund and Wells Fargo Securities, LLC

Wells Fargo Securities, LLC Economics Group

Diane Schumaker-Krieg	Global Head of Research, Economics & Strategy	(704) 410-1801 (212) 214-5070	diane.schumaker@wellsfargo.com
John E. Silvia, Ph.D.	Chief Economist	(704) 410-3275	john.silvia@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Jay H. Bryson, Ph.D.	Global Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	Currency Strategist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Eugenio J. Alemán, Ph.D.	Senior Economist	(704) 410-3273	eugenio.j.aleman@wellsfargo.com
Anika R. Khan	Senior Economist	(704) 410-3271	anika.khan@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 410-3270	azhar.iqbal@wellsfargo.com
Tim Quinlan	Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Eric Viloría, CFA	Currency Strategist	(212) 214-5637	eric.viloria@wellsfargo.com
Sarah Watt House	Economist	(704) 410-3282	sarah.house@wellsfargo.com
Michael A. Brown	Economist	(704) 410-3278	michael.a.brown@wellsfargo.com
Michael T. Wolf	Economist	(704) 410-3286	michael.t.wolf@wellsfargo.com
Zachary Griffiths	Economic Analyst	(704) 410-3284	zachary.griffiths@wellsfargo.com
Mackenzie Miller	Economic Analyst	(704) 410-3358	mackenzie.miller@wellsfargo.com
Erik Nelson	Economic Analyst	(704) 410-3267	erik.f.nelson@wellsfargo.com
Alex Moehring	Economic Analyst	(704) 410-3247	alex.v.moehring@wellsfargo.com
Donna LaFleur	Executive Assistant	(704) 410-3279	donna.lafleur@wellsfargo.com
Cyndi Burris	Senior Admin. Assistant	(704) 410-3272	cyndi.burris@wellsfargo.com

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