Global trade faces negative record and structural shift

- Plummeting shares of logistics companies indicate that global goods trade will contract by a whopping 3.2% mom in March. This would be the largest monthly contraction since the GFC. Subsequently, our model suggests an almost flat monthly growth in April and a marginal recovery in May.

- Based on DB’s GDP forecast (base scenario), annual global goods trade will shrink by 13.6% in 2020 and will recover by only 7.5% in 2021. In the COVID-19 crisis, global goods trade is set to fall much heavier than during the financial crisis.

- Moreover, while the service exports were a shock absorber during the GFC, services exports are likely to drop at a similar rate as goods exports this time.

- Another difference between the COVID-19 shock and the GFC shock is the temporal distribution. The GFC was a synchronous economic shock whereas the COVID-19 crisis spread in “continental waves”. At the beginning, this helped to manage the crisis. But during the recovery it increases the risk of repeated disruptions of global supply chains.

- The COVID-19 crisis might result in a reorganization of global value chains, at least in some sectors. For instance, there are requests to repatriate the provision of medicines and medical devices back to developed markets. However, a more balanced approach between today’s global value chains and a complete repatriation could be continental production close to developed markets.
High-frequency indicators point to a sharp drop in goods trade

The latest available monthly data of real global goods trade (CPB) is January and February 2020. In both months global trade contracted by roughly 1.5% month on month. The COVID-19 crisis escalated in China towards the end of January and the WHO declared the crisis a pandemic on March 11. Hence, the first two months of 2020 only reflect the beginning of the COVID-19 impact on global trade. Based on the average share performance of large logistics corporations, we estimate the decline of real global trade in March, April and May. We calibrate a linear regression model using 12 months before and after the Lehman collapse in 2008. In January, global stock markets ignored the COVID-19 crisis in China by and large. Hence, the model clearly underestimated the development in January (-1.5% vs. model -0.1%). However, in February the minus of 1.2% is close to the released data point of -1.5%. Based on this model, we estimate that global trade contracted by 3.2% mom in March (a ~1%-percentile in the period from 2000 to 2020 with 242 monthly observations). The forecast in March would be the largest monthly decline excluding the GFC. This implies, for instance, that it is also bigger than the contraction in September 2001 (-1.6% vs. our model -2.2%). In April and May 2020 share prices of large logistics corporations moved on average mainly sideways. So our model implies that global trade growth was almost flat in April and moved marginally into positive territory in May. We expect that global trade bottoms in the second quarter. This is also in line with manufacturing data from Asia where leading indicators and production already surprised to the upside in March. In Europe and the US, the recent reopening of major industrial plants and the less restrictive lockdown measures should also help to revive the global economy, at least gradually.

Figure 1: 2000 to 2020 Global trade vs. logistics stocks

![Figure 1: 2000 to 2020 Global trade vs. logistics stocks](source: Bloomberg Finance LP, CPB, Deutsche Bank Research)
2020 and 2021: Goods trade growth

It seems clear that the main shock to the global economy materializes in Q2 2020. In our Special Report “World Outlook Update: Turning Gloomier”\(^1\) we assume in our base case a heavy loss of economic activity in the second quarter and subsequently a gradual economic recovery. To assess the impact on global trade for the full year 2020 and 2021, we apply DB’s current GDP forecasts in our base scenario and the historic relationship between global trade and German GDP. We forecast German GDP to drop by -14% in the second quarter in 2020. Our calculations imply that global trade will collapse by 21% quarter on quarter in the second quarter and will be back at the pre-crisis level late in 2022. The quarterly loss in Q2 is clearly larger than during the GFC where global trade nosedived by 10% qoq in Q1 2009. The assumed recovery in the second half of 2020 will result in an annual decline of -13.6% in 2020 and an annual expansion of 7.5% in 2021. Therefore, both from peak-to-trough as well as in annual terms, the COVID-19 shock is bigger than the GFC shock in 2008/09, at least in our scenario where we assume only a gradual recovery. In DB’s protracted scenario, an even more severe drop in German GDP of -16% is assumed in the second quarter of 2020 and subsequently only a fairly muted, rather L-shaped recovery. As a consequence, the annual decline in global trade would be almost -20% in 2020 and remain just about flat in 2021. This would be clearly worse than the GFC shock and only surpassed by the Great Depression or WWII. In its April economic outlook the IMF forecasts a decline in global trade of -11% in 2020 and a recovery of 8.4% in 2021. So even our base scenario foresees a heavier contraction than the IMF scenario.

![Figure 2: 2020/21: German GDP vs. global trade](image1)

![Figure 3: 1991 to 2021 Global trade vs. German GDP](image2)

**COVID-19 shock with continental time lags**

The COVID-19 shock is expected to be deeper than the GFC shock. However, there are also at least two major structural differences. First, in 2006 and 2007 the global economy expanded rapidly fueled by very strong credit growth, resulting in an annual global goods trade growth of 9.6% and 6%. By contrast, pre-COVID-19 there was already high uncertainty due to Brexit, the re-calibration of the US trade policy and a generally perceived higher political uncertainty in many countries. In 2018, global trade increased by only 3.1% annually and was already contracting slightly (-0.4%) in 2019. Second, in the GFC the world faced a synchronous shock. While

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\(^1\) Peter Hooper et al. „Special report: World Outlook Update: Turning Gloomier”, 7 May 2020
there was already a simmering financial crisis before autumn 2008, it was the Lehman collapse that led to an unexpected simultaneous global economic collapse. In the summer of 2008 global trade continued to expand rapidly and 2008 annual global trade was still positive despite the collapse in Q4. The COVID-19 crisis is different, as it gradually infected the global economy. The lockdown of the Hubei Province grabbed the global headlines already in January. The European COVID-19 crisis reached its peak end-March/early April and the climax of the US crisis seems to be in May. Therefore, these time lags allowed learning from relative successful countries and avoiding an even heavier loss of economic activity. Accordingly, goods trade in Asian EMs already declined sharply in January and where still negative in February. By contrast goods trade in advanced economies was almost unscathed by the COVID-19 crisis in the first two months of 2020. The recovery is also expected to be non-synchronous. Most Asian and some European countries already loosened the most restrictive social distancing measures, and other European countries are likely to follow soon as the number of infected persons has started to decline in nearly all European countries. Finally, the experiences in Asia and Europe led us to assume that the US will also likely overcome the crisis in the coming weeks. Although it is more uncertain that the number of infections will peak soon, and the planned reopening of the US economy might be riskier than in other countries with flatter epi curves. In our base scenario, we expect all major economies to experience a gradual recovery in the second half of 2020. Therefore, global trade should also gain ground. However, there are at least two major challenges for a more rapid recovery and that is the grim side of a non-synchronous shock. First, global value chains might be impaired for an extended period of time as some countries may choose to loosen social distancing measures relatively slowly. Second, the unlocking of the economy could unleash a second COVID-19 wave. Both factors could undermine the economic normalization. Therefore, we expect a fairly muted recovery in global trade.

This time is different – service exports are in the doldrums

In the GFC, service exports closely related to the manufacturing sector also nosedived. However, many other services were hardly affected in the financial crisis. By contrast, currently many services have been severely restricted. It seems clear that the tourism industry and airlines bear the bore of the burden. However, even small businesses like catering services and hairdressers were forced to temporarily close their business for the public. As a consequence, densely populated regions with soft borders to their neighbor countries should be hard hit. This is particularly important as for services, a broader export definition is applied in global statistics than for goods. For instance, service exports will increase if a consumer of one country goes to the neighboring country to buy a haircut, at least if the transaction is registered.\(^2\) By contrast, if the consumer purchases a pair of scissors it will not be defined in statistical terms as a goods exports until it crosses borders. A prime location where service exports should have crashed is the EU where the Schengen agreement enacted in 1985 tore down traditional borders, as during the COVID-19 crisis many EU countries unilaterally abandoned the agreement. Many non-European countries also closed their borders. Therefore, service exports are rather an additional liability than a stabilizing factor for global trade. This view is also corroborated by global PMIs where services hit a new all-time low of 24 (GFC minimum in Nov 2008: 37.8) in April 2020 whereas the manufacturing PMI declined less sharply and stands at 39.8 (Dec 2008: 33.8).


The reshaping of global value chains

In our view, there is another noteworthy difference between the COVID-19 crisis and the GFC. The structure of global export markets was only slightly adjusted in the aftermath of the financial crisis. The production hubs in the manufacturing sector remained China, Germany and the US. The global division of labor and global value chains were not questioned. By contrast, they were further enhanced to reap the benefits of low production costs in emerging markets. This time is likely to be different. The COVID-19 crisis taught us a lesson. Efficient markets are very vulnerable to unforeseen occurrences. Some even argue that the provision of goods that are essential for a well-functioning society should remain under national control and be domestically produced. In the aftermath of the COVID-19 crisis, important production lines, probably not only in the medical sector, might be repatriated or at least relocated close to national borders of developed economies. Moreover, there might be much more sophisticated industrial emergency plans which guarantee a smooth production even in the case of a pandemic or another major global disaster which cripples at least some important sections or regions of the global economy. We think that a balanced approach between today’s global value chains and a complete repatriation of production lines could be continental value chains combined with higher inventory levels which may guarantee a good balance between efficiency and the newly increasing demand for safety. Such a shift of production lines would also reduce the potential economic fallout of global trade disputes and is likely to reduce our global CO₂ footprint. Hence, the foundations for continental value chains were already laid before the COVID-19 crisis.
Appendix 1

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