

Box 1

THE RECENT SHARP CONTRACTION IN WORLD TRADE FROM A HISTORICAL PERSPECTIVE

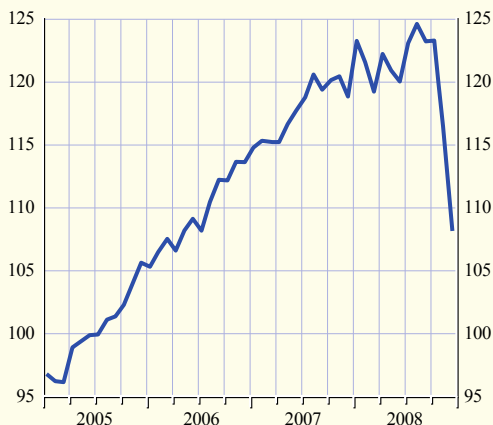
The spreading repercussions of the financial turmoil have recently precipitated a downturn in international trade transactions across the globe. According to the latest data release¹, world trade volumes of goods contracted markedly in November and December 2008, by 5.3% and 7.0% month on month respectively. Overall, world trade declined by 6.0% quarter on quarter in the fourth quarter of 2008. According to this latest information, at the end of 2008 world trade had reverted to mid-2006 levels (Chart A). Moreover, a further contraction is expected, as the February global PMI export orders index remained below its expansion-contraction threshold for the sixth consecutive month. This box considers the recent contraction in world trade from a historical perspective in order to shed light on trade prospects for the medium term.

Following a period of strong growth, world trade was gradually affected by the general slowdown in global activity that began with the US recession at the end of 2007. After the failure of Lehman Brothers, the strong adverse feedback loop between the financial turmoil and real activity

¹ Monthly data for world trade in goods are provided by the CPB Netherlands Bureau for Economic Policy Analysis (<http://www.cpb.nl/eng/research/sector2/data/trademonitor.html>).

Chart A World trade volumes in goods

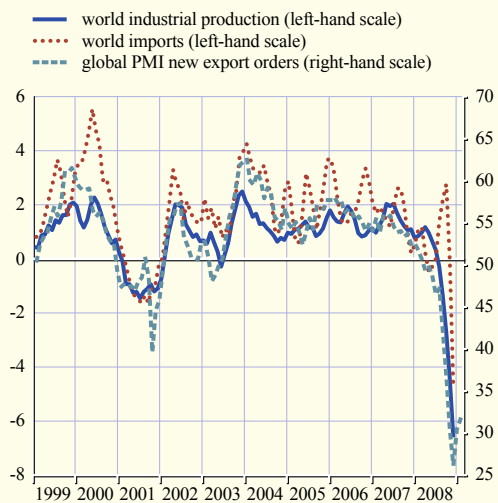
(index 2005 = 100; monthly data)



Source: CPB.

Chart B World import volumes, world industrial production and global PMI new orders

(index; percentage changes)



Sources: CPB, World Bank and ECB calculations. Note: Figures for world industrial production and world import volumes refer to three-month-on-three-month percentage changes.

led to a sharp decline in world trade. The impact of the financial turmoil on wealth and confidence, together with the associated high level of uncertainty, prompted firms and households to reduce or postpone expenditures, as shown, for instance, by the sharp fall in the global manufacturing PMI new orders index. The decline in demand for capital and consumer goods – especially durable goods – which have a relatively high import content, caused world output and trade to plummet in the final months of 2008 (Chart B).

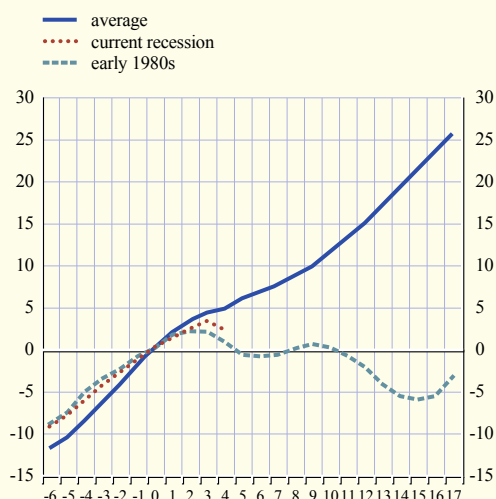
The difficulties surrounding access to trade credit have exacerbated the trade downturn. While the evidence relating to problems in trade financing remains somewhat anecdotal, it would seem that the cost of trade financing has risen across the globe and that the volume of trade credit provided by banks has fallen, especially in emerging markets (and particularly in Asia).²

From a historical perspective, the link between the US business cycle and global economic developments remains strong, and US recessions have often been associated with downturns in world trade. Although this relationship does not necessarily imply any causality, it provides a useful benchmark for gauging current developments. Based on data collected since the late 1950s, Chart C shows the average pattern of the change in world import volumes of goods and services during US recessions (with quarter “0” corresponding to the start of the US recession as dated by the National Bureau of Economic Research). In general, US economic recessions have been accompanied by a slowdown in the pace of expansion of world trade (on average, the rate of increase in world trade declines for around eight quarters after the start of a US recession). While the change in world import volumes in the current recession (quarter “0” corresponding to the fourth quarter of 2007) rather closely follows the average pattern up to the third quarter of 2008, the sharp contraction in the fourth quarter of 2008 implies a significant deviation from the average.

Looking at the past US recessions individually, the recession in the early 1980s shows similarities with the current cycle. Both are characterised by significant adverse impacts on consumption, residential investment and imports. In addition, the recession in the early 1980s was associated with difficulties in the banking sector, as is the present cycle. The impacts of that recession on world trade were particularly strong, with trade remaining below its pre-recession levels for the next four years (Chart C). Developments in the current downturn in trade have so far been relatively similar to those in the early 1980s. Therefore, using the latter as a rough benchmark, it seems legitimate to expect some further weakness in world trade for a period of time. Moreover, features particular to the current episode may give rise to downside risks to world trade prospects,

Chart C Developments in world import volumes during US recessions

(cumulative changes; percentages; four-quarter moving average; quarterly data)



Sources: IMF and ECB calculations; latest data obtained from CPB.
Notes: Quarter “0” refers to the start of the US recession. Average is based on eight US recessions since 1957.

² See, for instance, “Trade and Development Quarterly”, International Trade Department (PRMTR), The World Bank, 17th edition, January 2009. (http://siteresources.worldbank.org/INTRANETTRADE/Resources/239054-1090532971789/Trade_Quarterly_17th_edition_Jan_22_09.pdf)

such as limited access to trade credit or the emergence of global production chains that could intensify the synchronous decline in trade across the globe. However, these risks could be somewhat mitigated by the recent fall in oil prices, as the resulting decline in transportation costs might support a recovery in international trade activity.

Overall, the recent slump in world trade predominantly reflects the synchronised and severe downturn in global demand. Going forward, as policy-makers around the world take action to alleviate restrictions on the supply of credit in general, one might expect some improvement in trade financing over the course of this year. However, with little sign as yet of any material recovery in activity, it is unlikely that either global demand or trade will rebound in the near term, especially if the global economic recovery is driven mainly by fiscal expansion, which typically has a relatively low trade-intensity.

Against this background, the increasing risk of protectionism is a matter of growing concern. The Great Depression provides evidence of the fact that intensifying protectionist measures can delay recovery in world trade and aggravate the length and extent of the downturn worldwide. While the risk of Great Depression-style protectionism remains very limited, other kinds of protectionism (e.g. industrial policy leading to economic nationalism or financial protectionist measures) could prove damaging to world trade and growth. Therefore, it is in the interest of all parts of the world economy to resist any pressure to adopt protectionist measures.