Box 10

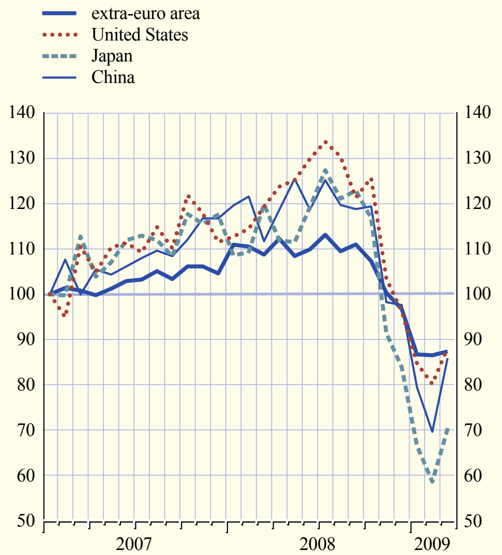
THE DOWNTURN IN EURO AREA TRADE

World trade fell abruptly following the intensification of the global financial turmoil in September 2008 (see Chart A).[1] The downturn in global trade has been unparalleled since at least the Second World War in terms of its suddenness, severity and cross-country synchronisation.[2] Against this background, this box discusses a number of possible determinants of the recent retrenchment in euro area trade. While the assessment focuses on developments affecting the euro area, the explanatory factors are also likely to be relevant for global trade.

In line with the sharp contraction in global trade, import and export volumes of extra-euro area goods decreased by 11% and 21%, respectively, between September 2008 and February 2009. Overall, the contraction in euro area trade in goods has affected trade with all partners, yet it has not been uniform across

Chart A Sum of imports and exports of goods for selected economies

(values; index: January 2007 = 100; seasonally adjusted; three-month moving averages)



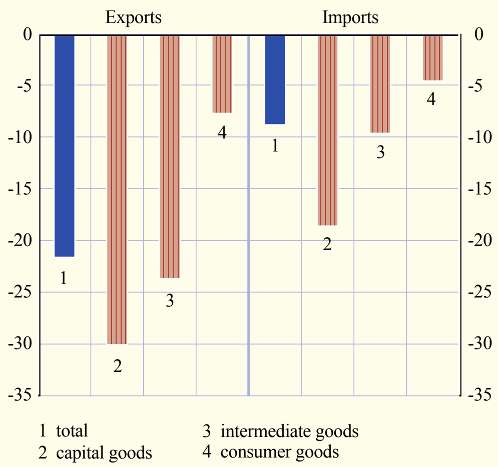
Sources: Eurostat and Haver Analytics.
Note: The last observations refer to March 2009.

1 See Box 1, entitled “The recent sharp contraction in world trade from a historical perspective”, in the March 2009 issue of the Monthly Bulletin.
2 See Baldwin and Evenett (2009), “Introduction and recommendations for the G20”, in Baldwin, R. and S. J. Evenett (editors), *The collapse of global trade, murky protectionism, and the crisis: Recommendations for the G20*, CEPR.

categories of goods. Trade in capital and intermediate goods – accounting for about 70% of extra-euro area goods trade – contracted to a much greater extent than trade in consumer goods (see Chart B).

Chart B Change in extra-euro area import and export volumes of goods between September 2008 and February 2009

(percentage; seasonally adjusted)



Source: Eurostat.

The sharp deterioration in global demand conditions is the most important factor behind the fall in extra-euro area trade. However, the general climate of uncertainty and its impact on business confidence, shortage of trade credit and a more restrictive access to the financing of business activities in some regions of the world may have exacerbated the contraction of both activity and trade. Furthermore the predominance of internationally fragmented vertical production chains may have acted as a powerful multiplier and synchroniser of these effects.

In greater detail, the intensification of the global financial crisis may have led to a subdued investment climate and exceptional uncertainty over the global economic outlook. According to survey-based evidence, these factors depressed business confidence, leading producers to reduce investment and production. The revision to investment and production plans may have contributed to amplify the downsizing of euro area imports and exports.

A more limited availability of trade credit and financing – instruments especially designed to finance import and export activities – has often been cited as an important determinant of the downturn in global trade. The difficulties in financing shipments of goods have been found to be very relevant in the current crisis to trade involving emerging and less-developed countries.[3] However, prima-facie evidence suggests that their power to explain euro area trade developments is rather limited. Euro-area trade with emerging economies has fared somewhat better than it has with advanced economies, even when different demand conditions are taken into account. Nevertheless, a more restrictive formal and informal access to the financing of business activities in some regions of the world may have still had a negative impact on euro area producers, for instance by impairing the functioning of international production networks – an important mode of production in today's economy.

The existence of complex and interdependent international production networks may help to explain not only the severity but also the unusually sudden fall in euro area trade and the synchronised nature of the global downturn. Since firms within international supply chains are in continuous communication to align the flow of parts and components with final demand, a decline in the latter and uncertainty over future demand developments can prompt a fast adjustment along the entire supply chain, with sizeable repercussions for all countries involved. Moreover, since euro area producers often depend on highly specific imported parts and components and supply intermediate and capital goods to foreign firms, bottlenecks in international production

3 See International Chamber of Commerce (2009), "Rethinking Trade Finance 2009: An ICC Global Survey".

networks may have harmed production and cash flow and, consequently, euro area trade flows. Such mechanisms would explain the particularly sharp deterioration of euro area trade in intermediate and capital goods.

Looking ahead, a rebound in global demand remains the single most important condition for a recovery of euro area trade. At the same time, a normalisation of business sentiment, resilient production networks and the avoidance of protectionist policies are likely to be necessary for trade to return to its pre-turmoil path.