

Chief economist's comment

Have we hit peak trade?

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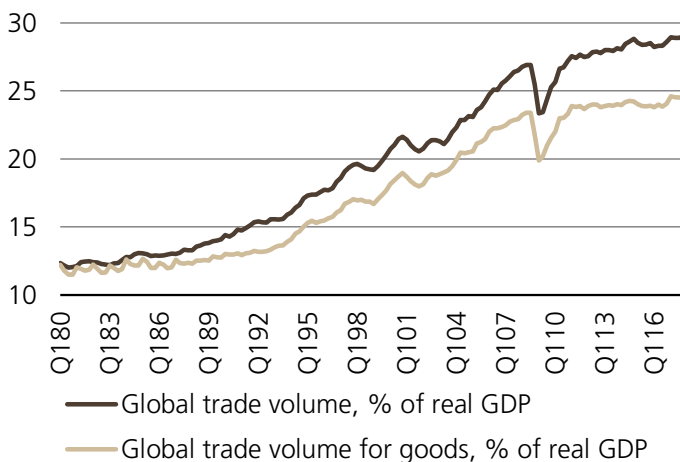
Paul Donovan, Global Chief Economist WM, paul.donovan@ubs.com

- Global trade in goods and services has grown dramatically over the past 25 years. Now the globalization of goods may have hit a peak.
- Globalization was helped by more and more complex supply chains. Outsourcing meant that more and more trade was needed to make one item.
- Technology has changed the costs and benefits of complex supply chains. Robots can replace cheap foreign labor. Digitization can replace things entirely. Trade is simpler. If supply chains become shorter, globalization of goods will reverse.
- If we have hit peak trade for goods, today's protectionist trends look out of date. Trade wars are fighting battles from the past.

Global trade has surged over the past 25 years. People are trading with one another more than ever before.

Global trade today is almost 30% of the world economy, in real terms. This measure of globalization has doubled since 1990. However, in recent years, the growth of global trade has stalled. In particular, trade in goods (rather than trade in services, like wealth management) has stalled. In fact, the world might have hit peak trade.

Global trade volumes for goods have leveled out recently



Source: Oxford Economic Forecasting, UBS

How did global trade grow?

Making things has become more complex. This helped the surge in global trade over the past 25 years. In the 1970s, products tended to be made locally. A country would import some things it could not make itself. If a country does not have oil, it has to import oil (or use other sorts of energy). Oil and other basic goods aside, countries made their own things.

Over the last 25 years, countries stopped making everything themselves. Countries now import more than basic goods like oil. Think about music. Someone wanting to buy a compact disc album by a foreign artist is really importing music from another country. However, a second country may make the compact disc. A third country may make the case, using plastics from a fourth. A fifth country may print the cover, using the paper and inks made in a sixth and a seventh country. And an eighth country assembles the whole package. Only then does the music fan get their album.

This is why a car "made in the USA" is not really "made in the USA" any more. Over one-third of a car exported by the United States comes from abroad.

Global trade will increase every time something crosses an international border. Global GDP only goes up with the final sale. If it takes more trades to make the final item, then trade as a share of GDP will go up.

Why might global trade change?

There is now evidence that the rapid growth of global trade may be coming to an end, or even moving lower. We may have hit peak trade, at least for trade in goods. It would be easy to blame protectionism for this, but that is only a part of the story.

The reason supply chains became more complex was cost. It was cheaper to make some things in some parts of the world. While it did cost money to ship parts from one place to another, lower production costs offset shipping costs.

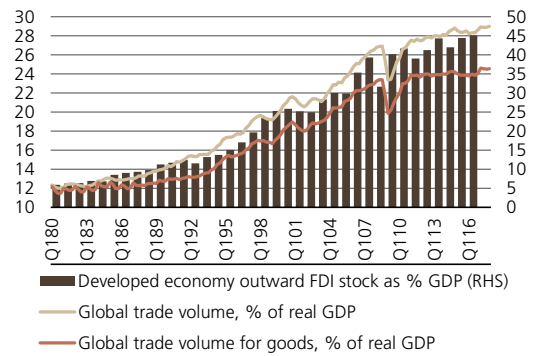
That cost story is less clear now. Local robots can replace foreign labor. The advantage of making things close to the customer is that goods can be made on demand. Rather than waiting weeks for things to travel from the other side of the world, a company can deliver things made locally within days. Making things close to the consumer reduces the risk of making too much (waste is a cost) or too little (missing a chance to make more money). Other costs may fall. It will cost less to insure expensive finished goods if they are moved over shorter distances.

Digitization cuts supply chains even more. This stops any trade in goods. In the last two years, how we listen to music has changed. The compact disc is a thing of the past. Today, most music is downloaded or streamed. There is still trade. The artist trades their intellectual property. That is, of course, not a good, but a service. The supply chain for music has become dramatically shorter.

As supply chains become shorter, trade for goods will be simpler. There are some signs that this is happening already. The trend for more foreign parts in a country's exports has stalled or reversed

Globalization grew as supply chains became more complex

Rising foreign direct investment (goods and services) as a share of the global economy is a proxy for rising supply chain complexity



Source: Oxford Economic Forecasting, UNCTAD, UBS

since the global financial crisis. With shorter supply chains and simpler trade, we may have hit peak trade.

If we have hit peak trade there are several things investors need to think about:

- Countries that have grown by becoming links in longer supply chains will need to come up with new ways of generating growth.
- Demand for transport will change. Finished products will travel over shorter distances. Raw materials may travel to new locations. Some things (like music) will not travel at all.
- Making things closer to customers should reduce stocks of goods, or inventory. Inventory can make recessions worse. If things are made closer to customers, the ups and downs of the economic cycle may be less violent.
- Services and ideas could become more important to future trade than trade in goods.

Peak trade for goods does not create lots of new jobs. Peak trade is about robots and digitization. However, peak trade might mean that, over the next 15 years or so, today's protectionist trends become less significant. Trade wars are fighting battles from the past. The future of trade is going to be different.

Appendix

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