Global trade takes a beating — and with it the global economy

International trade tends to be a good barometer of how the world economy is doing and where it is headed. This is why twists and turns in the U.S.-China trade war, and other developments in world trade, receive so much attention.

What do recent trade data portend? The news is not good, and suggests that not only is the world economy weaker than it was earlier this year but that more weakness lies ahead. Still, it may be premature to call a worldwide global recession. Much will, of course, depend on U.S. trade policy and whether the Trump administration chooses to tamp down or further escalate its trade disputes, not just with China but also with other major U.S. trading partners such as the European Union. Otherwise, trade will drag down rather than boost growth.

First, what do the data show? International trade volumes usually tend to grow at the same rate or faster than global GDP growth. The World Trade Organization, which monitors world trade, recently slashed its forecast for global trade growth in 2019 from 2.6 percent to just 1.2 percent. For 2020, the forecast has been cut from 3 percent to 2.7 percent, which still suggests a rebound.

But other indicators paint a less promising picture. The Baltic Dry Index, a closely-watched indicator based on bulk commodities shipping that serves as a reliable indicator of future trade activity, has fallen by nearly 50 percent since August (after doubling in the first eight months of the year), squelching hopes for a rebound in global trade.

To better understand some of these trade dynamics, I draw upon the DHL Global Trade Barometer. (Full disclosure: I have assisted DHL in interpreting its GTB index data.)

The index is based on highly disaggregated trade data for different product categories, covering both air and ocean freight, for seven major economies. An index value above 50 indicates growth in trade and a value below 50 denotes a contraction.

The latest GTB update shows that trade flows have been adversely affected in nearly all major economies. The indexes for China and the U.S., the two main drivers of global growth, are below 50 and have been falling. The indexes for other major advanced economies have also declined, reflecting the broad-based nature of the slowdown in trade as well as GDP growth. The low and declining index for Germany, the main driver of growth in Europe, points to an economy that is flirting with recession, as it has experienced virtually zero growth in recent quarters.

While there are domestic factors and geopolitical tensions hurting growth, trade developments are playing a major role as well. Trade tensions between the U.S. and its major trading partners, including China, continue to fester and are likely to remain a drag on growth. Rising trade tensions in other parts of the world, including between Japan and Korea, and the prospect of a messy Brexit are likely to have an increasingly disruptive effect on world trade volumes.

The level of uncertainty about macroeconomic growth prospects, exacerbated by trade tensions, has driven down business investment around the world, with adverse effects on cross-border trade of machinery and equipment. Household consumption has remained strong in most major economies but the stagnation of trade in consumer durables, reflected in the GTB component indexes, portends weakening in this key driver of GDP growth.

These developments are consistent with other macroeconomic data, such as overall GDP and investment growth, that indicate further troubles ahead. The world economy appears to be entering a phase of stagnation, reflecting weak and slowing growth in some major economies and essentially no growth or mild contraction in others.

Fears of a worldwide recession might seem overblown as most major economies are still growing. But the risks have risen as policymakers have little room for maneuver with monetary and fiscal policies, and they seem unwilling to undertake significant structural reforms to product, labor, and financial markets that are essential to revive productivity growth.

Slowing trade growth is adding to economic woes around the world. What is worse, trade tensions and the uncertainty they have spawned are likely to leave a long-lasting scar on the world economy if they continue affecting business confidence and, therefore, investment growth.

Dealing with the growth stagnation requires a judicious mix of tough government policies that are not easy to implement. Resolving trade tensions might well be the tonic that is easiest for policymakers to administer and could provide a much-needed boost to global growth in these perilous times.

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