

The Covid-19 drop in world trade, and what's on the other side

In our baseline scenario, world trade falls 9% this year, but in a 'worst case' scenario, the fall is 34%. Maintaining global value chains is likely to become more challenging and costly as protectionism increases, but is also a way of managing risks



Source: Shutterstock

The hit to world trade

World trade is falling sharply as Covid-19 puts investment and consumer spending on hold as well as disrupting production and credit markets. China's exports fell 6.6% year-on-year [in March](#) and may get worse in April and May. Global port throughput was down 10% on the month in [February](#), mainly due to lower activity at Chinese ports. Services trade is also showing sharp falls, with the distances travelled by air passengers falling 15% in [February](#). The goods that are still moving are facing higher frictions. Europe and the US are experiencing shortages of empty containers, having received fewer shipments from China. Ports worldwide are enforcing delays before ships from China are unloaded.

In the global financial crisis, the total fall in world trade in goods and services was roughly four times that in GDP. The collapse in trade was mostly due to falling demand for durable goods, with major purchases and investments being put off when economies slowed. This stopped the many cross-border flows of durable intermediate goods within global value chains. Supply side effects

due to credit constraints for producers, and disruptions to trade finance, also played a role.

Scenarios

World trade is likely to fall by more than GDP again in the wake of Covid-19. In our base-case scenario, countries experience a more severe contraction of economic activity than during the financial crisis. This time, supply chains may be disrupted by production outages and workforce absences, as well as the knock-on effects of lower demand for durable goods. Lockdown measures in many countries are sharply reducing services activity, including travel and tourism, but also non-traded services, so the falls in trade and GDP – while drastic – may be more evenly matched than in 2008-09.

In our base case [scenario](#), lockdown measures begin to be relaxed across all countries toward the end of this quarter. If policy measures to support business have been effective, production and investment resumes, and there is a ‘U shaped’ recovery. In another scenario where lockdowns resume this winter, the hit to demand lasts through 2Q 2021, and recovery to pre-crisis levels of activity takes a further year. A ‘best case’ scenario sees lockdown measures lifted for good by the end of this quarter, allowing activity to bounce back strongly. A ‘worst case’ scenario involves a deeper recession this year and recovery taking until 2023.

Percentage annual growth in GDP and world trade under ING scenarios

	GDP		Total trade	
	2020	2021	2020	2021
Base case	-3.6	3.7	-9.0	9.2
Winter lockdown	-5.1	1.8	-15.4	5.5
'Best' case	-1.2	3.6	-3.1	9.1
'Worst' case	-11.3	1.8	-33.9	5.4

In the scenarios where the recovery is delayed until 2022 or beyond, investment is likely to suffer and with it, demand for durable goods. Trade policy may also become less supportive of globalisation, with longer term implications for trend growth in world trade. Export restrictions on medical supplies may be extended to other goods, and, once the crisis has passed, there may be a lack of political will to pursue trade liberalisation. Trade negotiations may be halted indefinitely, including EU and China efforts to stave off further increases in US import tariffs.

Protectionism doesn't protect

Covid-19 has made it clearer than ever that global value chains make production and livelihoods in one country vulnerable to shocks in others. Increasing protectionism was already a threat to global value chains before the Covid-19 outbreak, and countries' responses to the virus have included protectionist actions. Some US-China trade war tariffs have been lifted, but only as part of the same rush to secure supplies of medical products that has seen many countries implement export [restrictions](#), which are allowed within the WTO rules.

Countries are exposed to value chains to different [degrees](#), but vulnerability follows from how readily available substitutes are – whether for an imported component or a buyer for a product. To manage the risks, firms could hold larger inventories to help them bridge disruptions to the supply

of their inputs. They could also source from multiple suppliers (and sell to multiple markets), decreasing the chances of suppliers (markets) all facing shocks at the same time.

Holding more inventories and finding backup suppliers will push costs up for firms, and beyond a temporary effect from building up inventories, will not provide any boost to world trade. Trade costs will also go up if protectionism persists, whether in the form of increased frictions, export controls, or damaged relations between countries. Higher costs erode the efficiency of global value chains and with it, the benefits to consumers of international trade.

There are profound challenges ahead for global value chains and world trade as Covid-19 hits the world economy and seems likely to leave an increase in protectionism behind. The spread of the virus has made it clearer than ever that global value chains make production and livelihoods in one country vulnerable to shocks in others. But managing these risks does not have to involve abandoning globalisation.

Author

Raoul Leering

Senior Macro Economist

raoul.leering@ing.com