A New Decade of Reform, Challenges and Opportunities: Recovery from COVID-19 – The Global Economic Outlook

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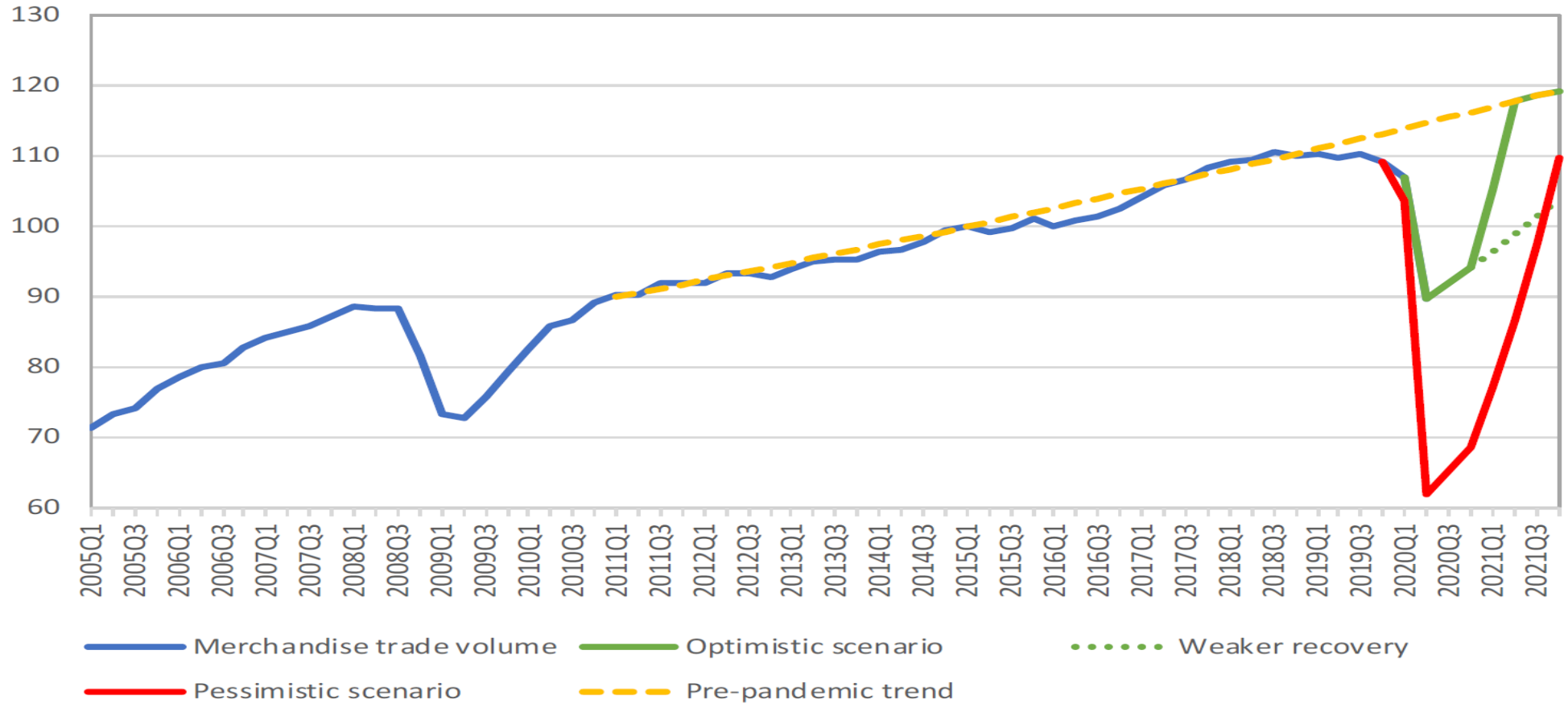
WTO EXPECTS SIGNIFICANT DECLINE IN GLOBAL TRADE FOR 2020 AND POTENTIAL FOR SLOW RECOVERY IN 2021

Chart 1: World merchandise trade volume, 2005Q1-2021Q4
(Index, 2015=100)



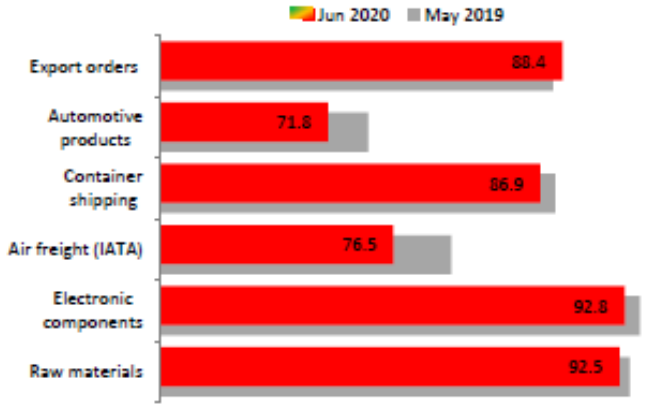
Source: WTO/UNCTAD and WTO Secretariat estimates.

Most recent WTO trade momentum update:

Goods barometer confirms steep drop in trade but hints at nascent recovery

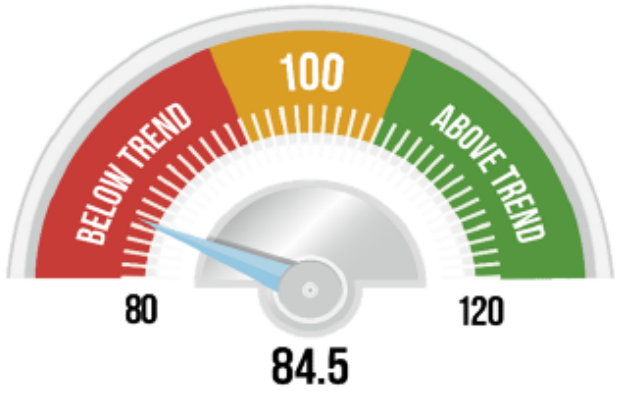
Drivers of goods trade

Component index values, trend = 100

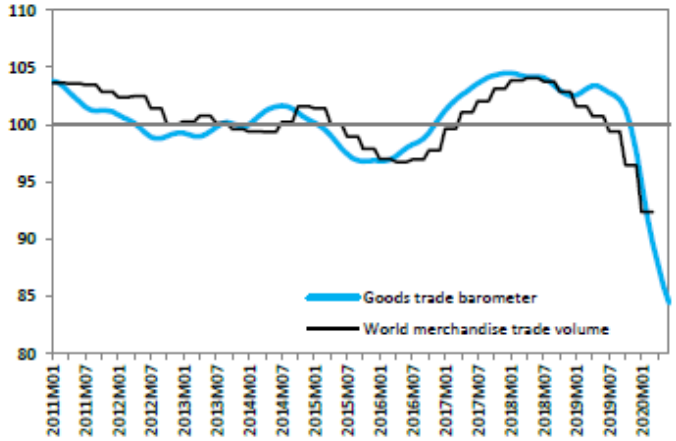


Goods trade barometer

Index value, June 2020



Index history, trend = 100



Macroeconomic developments – IMF, WBG, OECD

	Real GDP (% change)		Trade volume (% change)		Elasticity (ratio)	
	2020	2021	2020	2021	2020	2021
WTO Trade forecast (April 2020)						
- optimistic scenario	-2.5	7.4	-12.9	21.3	5.3	2.9
- pessimistic scenario	-8.8	5.9	-31.9	24.0	3.6	4.1
IMF World Economic Outlook (April 2020)	-3.0	5.8	-11.0	8.4	3.6	1.4
World Bank Global Economic Prospects (May 2020)	-5.2	4.2	-13.4	5.3	2.6	1.3
OECD Economic Outlook (June 2020)						
- single hit scenario	-6.0	5.2	-9.5	6.0	1.6	1.1
- double hit scenario	-7.6	2.8	-11.4	2.5	1.5	0.9
Memo items:						
IMF GDP at market exchange rates	-4.2	5.4	-11.0	8.4	2.6	1.6
World Bank GDP at purchasing power parity	-4.1	4.3	-13.4	5.3	3.3	1.2

The outlook for the global economy over the next two years remains highly uncertain. This is reflected in the wide range of GDP estimates from international organizations, in some cases relying on multiple scenarios.

Generally the IOs forecasts range between 2.5 to 8 per cent or greater – with the range largely reflecting the length of time pandemic health related measures remain in place.

Trade Developments

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Preliminary trade statistics and trade-related indicators show world trade slowing sharply in the first half of 2020 as the Covid-19 virus spread globally. The volume of merchandise trade was down 2.3% year-on-year in the first quarter according to WTO statistics, while initial estimates indicate a drop of around 18.5% in the second quarter.

While large, the declines are thus far more consistent with the more optimistic scenario advanced in the WTO's most recent trade forecast, and seem reasonably in line with IMF, WBG and OECD forecasts for 2020. Much more uncertainty remains regarding the extemt of a trade recovery 2021.

Rapid and extensive fiscal and monetary policy responses in most countries around the world have likely helped moderate both the GDP and trade impacts thus far.

Summary of COVID impacts and implications for global trade?

Biggest declines in GDP and Trade in decades.

Weak recovery

- **particularly if psychological (confidence/habits) effects on consumers and businesses result in weak consumption and investment recovery.**
- **If govt. policies are either not large enough or structurally ineffective at dealing with demand and liquidity issues.**

Trade

- **big impact on trade from decreased consumption and investment, but also from increased trade costs.**
- **Supply shock from reduced labor participation can, if health issues resolved (vaccine?), quickly recover – capital and infrastructure undamaged physically.**

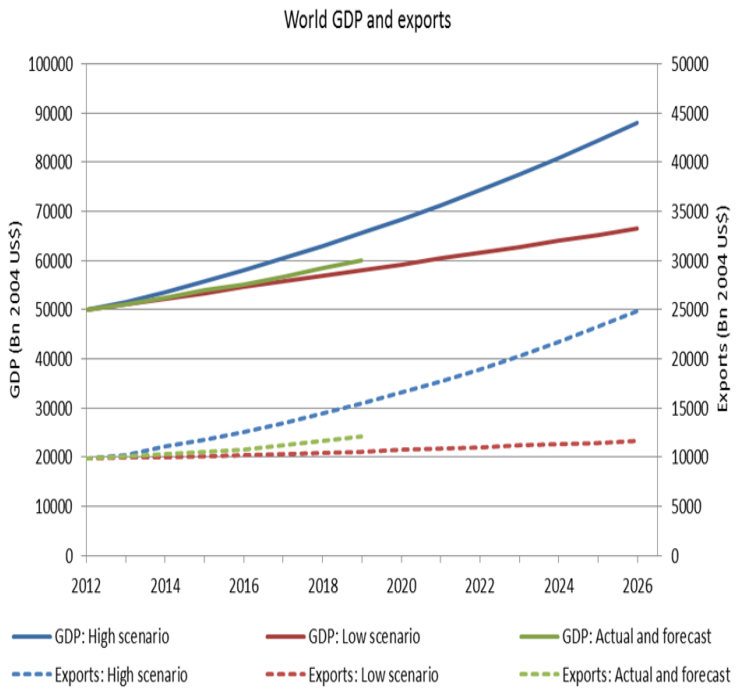
Globalization? Reorganization of globalization, re-globalization

- **Not recover to rapid growth of goods trade during 1990-2005 – Trade growth 2^{+} X > income growth**
- **But probably back to long term growth from 1865 to present – Trade growth 1.4X > income growth**
- **More digital cross border trade**
- **More diversification in supply chain sourcing**
- **More automation of production and supply chain steps**
- **More flexible production processes**

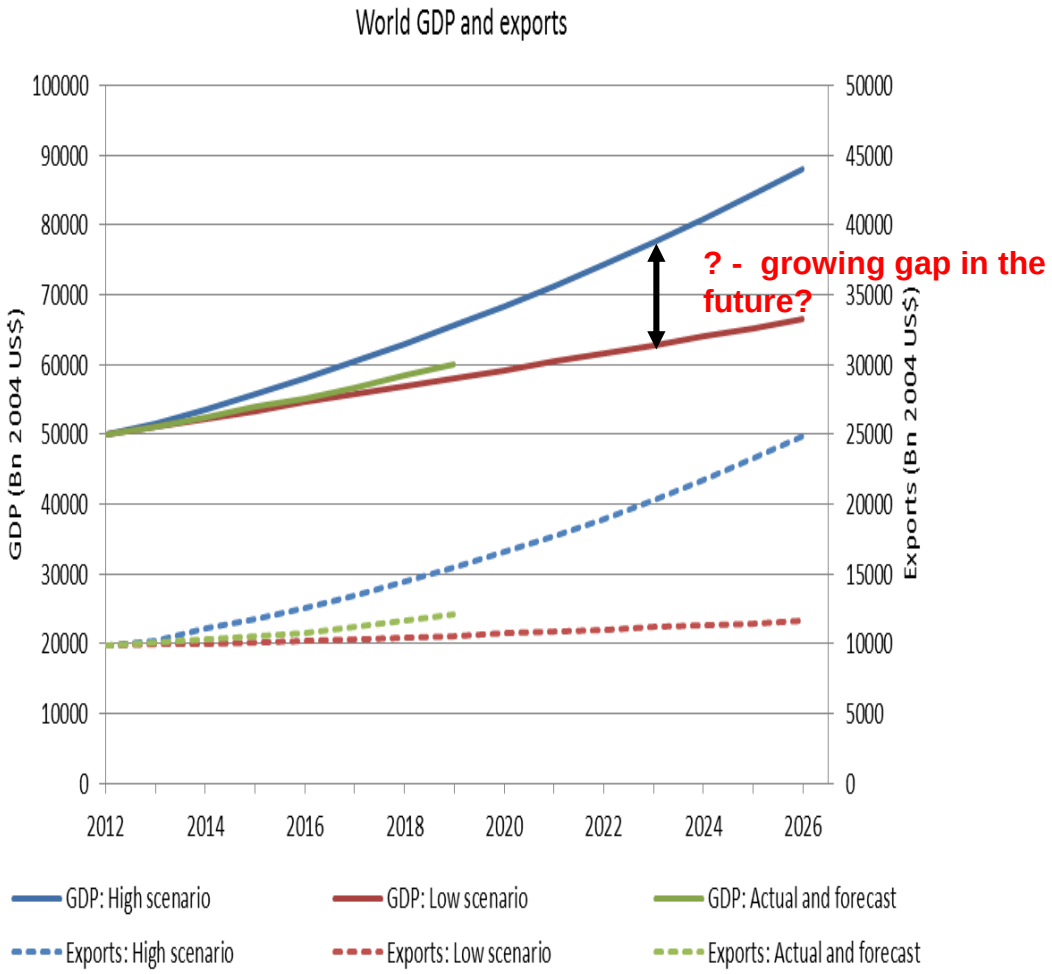
Adam Smith's specialization and David Ricardo's comparative advantage forces will still be at play, but with firms changing weights and values on risk (of production disruptions) vs. efficiency (lowest absolute cost of production) trade-offs.

Long-term Forces driving growth and trade – a new, normal of reduced growth prospects?

- What drives trade growth? What drives economic growth?
- Macro matters C+I+G
- Investment most "trade intensive"
- Liberalization policies – maybe 25% of trade growth – tariff increases work the other way of course.
- Why bother? Long term growth – shifting out PPF/dynamics effects of trade liberalization
- Falling behind.



Long-term implications…slower long-term growth adding up to significant foregone income and consumption – efficiency, productivity, competition



US potential output vs actual output - GFC

MITIGATING RISKS OF FUTURE PANDEMICS/CRISES AND/OR TRADE POLICY UNCERTAINTY?

Firms, Households, and Governments will need to evaluate risk vs. efficiency trade offs:

Risks for firms – inventories (from "just in time" to larger inventories for critical parts), supply chains (diversification), production (automation and digitization). It's a risk vs. efficiency calculation for them.

Governments – how to manage for demand spikes above average supply? Build and manage emergency stockpiles in ways that taxpayers/citizens can afford/accept = role for trade, flexible domestic production and/or international "insurance" agreements. Tracking and tracing. Uncertainty as to requirements of next pandemic/crisis (climate?) Again, risk vs. efficiency trade off.

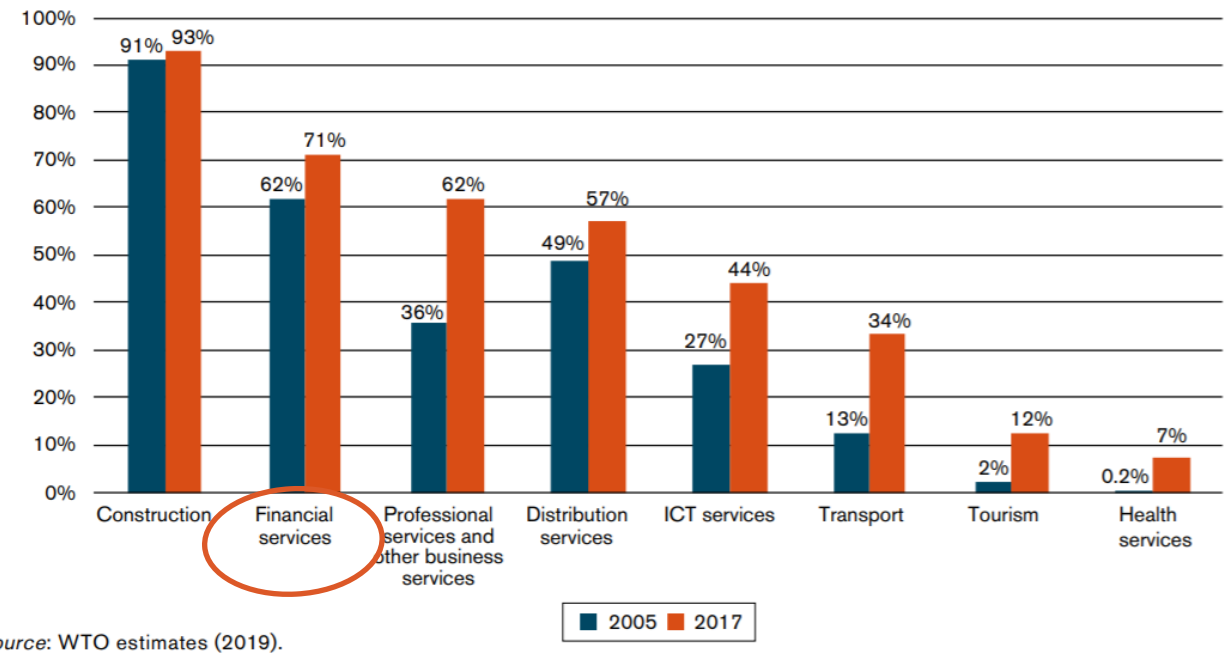
Households – remote work, privacy, ability to social distance and earn income, get critical services (education, health care, etc), and access/purchase necessary products while isolated.

WHAT IS THE ROLE AND OUTLOOK FOR FINANCIAL SERVICES?

Developing exporters of financial services focus currently on physical presence abroad….moving more digital

Figure B.12: For the top five developing economies, commercial presence is the dominant mode for exporting services

Five leading developing economies' exports through foreign-controlled affiliates abroad (commercial presence) in selected services sectors, 2005 and 2017



Source: WTO estimates (2019).

- China,
  Singapore,
  Korea,
  Hong Kong, China and
  India
  are the largest developing exporters of services
- 71% of their financial services exports were through foreign presence in 2017

But digitalization is reshaping the business model

- Increased digitalization, e-banking and mobile banking are reshaping business models for the finance sector.

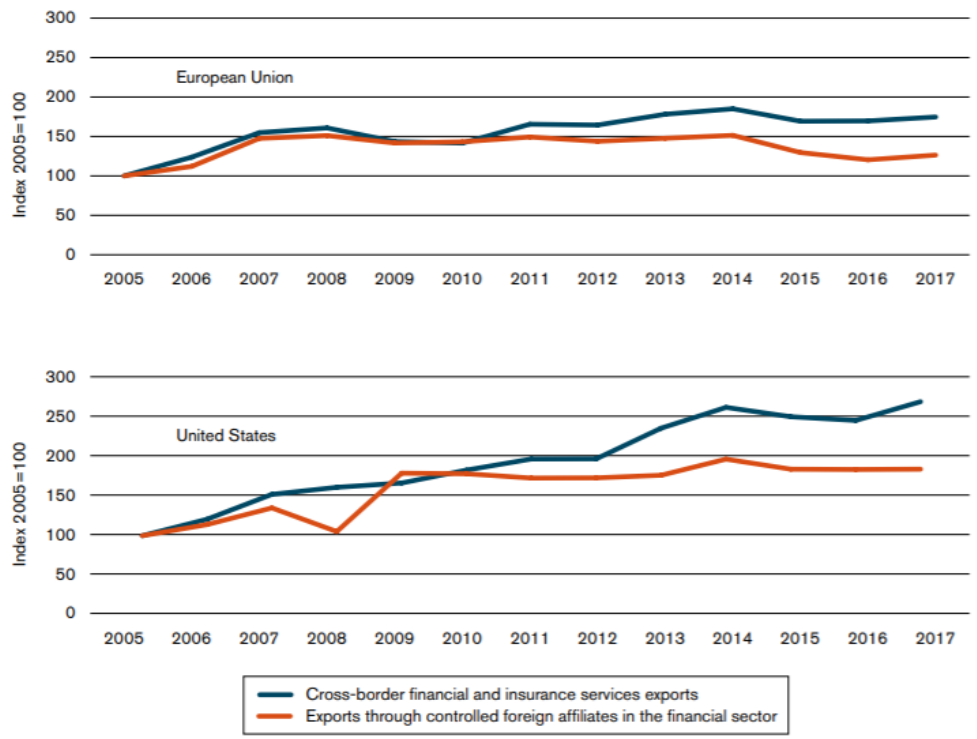
- Although banks and other financial services institutions maintain affiliates abroad for operations, they are offering an increasing number of services online, from credit card transactions to finance management.

- Insurance companies are making it possible to underwrite and submit claims online. These are only a fraction of the online cross-border services that digitalization is expected to bring to the industry in the near future.

Cross-border supply of financial services is gaining importance

Figure B.3: EU and US cross-border financial and insurance services exports are growing faster than exports through foreign-controlled affiliates

EU and US cross-border exports of financial and insurance services and exports through controlled affiliates abroad (mode 3), 2005-17



Source: WTO estimates (2019).

Note: The European Union is calculated as the sum of the 28 EU member states and includes intra-EU trade.

- The share of financial services exports through foreign presence is declining in the EU and the US.
- In 2017, the share of financial services exported by EU-controlled affiliates was 6 percentage points lower than in 2005.
- The United States' financial services exports through cross-border transactions almost tripled compared with 2005, reaching US$ 109.6 billion.

Summary

- Trade war tariffs – direct effects – small. Efficiency impacts/reallocation effects. What we see is a range of sectoral effects and trade diversion.
- Trade war tariffs – indirect effects – potentially very large – discourage investment and consumption – macro impacts.
  - We see this starting, but in some countries has been offset or diminished by fiscal and monetary policy actions.
- Trade war uncertainty – tied to indirect effects – potentially large and long-term impacts – reduce current growth, and reduce future potential growth from reduced investment and relatively less efficient investment.
- COVID impacts ***very large*** compared to trade war – brings added uncertainty!
- Fragmentation of global economy into blocs? Digital blocs?
- Continued fragmentation of countries as policies not addressing most of the underlying challenges – technology, changing preferences, demographics, economic geography.
- What might that mean for financial services, which are increasingly being provided digitally