GLOBAL ECONOMIC PROSPECTS

June 2013

Annex

# TRADE

# Recent Developments

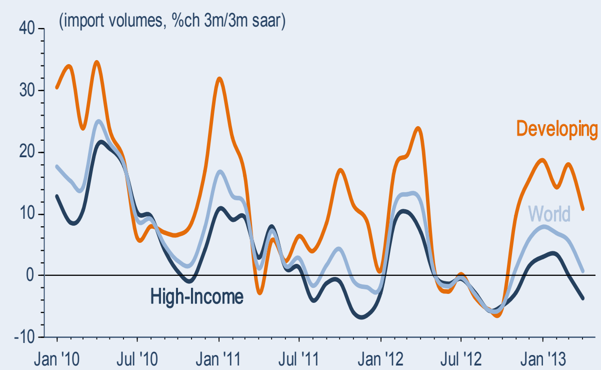
## After a cyclical rebound in global trade, the pace of trade expansion is decelerating once again

Following the slump in Q2 2012, global trade began a cyclical rebound in Q3, led by an acceleration in developing country imports, which sparked an uptick in both high-income country and developing-country exports.FN1 As high-income country activity picked up, so too did their import demand helping to further boost overall trade in the fourth quarter and into the first quarter of 2013. However, reflecting ongoing fragility in the global economic recovery, particularly in high-income countries, the pace of trade expansion has slowed in recent months. Indeed, in the three months leading to April 2013, global trade expansion had decelerated to a below trend pace of 0.8 percent (3m/3m saar) compared with 10.9 percent in March (figure TRADE.1).

## The deceleration in import demand has been broad-based, impacting both developing and high-income countries

The rebound in developing country import demand began almost as soon as the Euro Area financial market tensions of May-June 2012 began to ease. In both Q4 2012 and Q1 2013, this import rebound gained strength in part because of the firming derived demand it generated in high-income and other developing countries. However, weaker growth momentum in some large developing countries (including Brazil, China, India, Russia and South Africa) is reflected in the slowing down of the aggregate developing country import demand, even if still remaining robust. Indeed, in the three months to April 2013, developing country import demand was expanding at a 10.9 percent pace (down from the 18.0 percent pace registered in March). Nonetheless, developments differ across developing regions (see box TRADE.1).

**Fig TRADE.1** **Divergence in import growth among high-income countries**




Source: World Bank; Datastream.

Similar to the slowdown observed in developing countries, high-income country import demand also weakened in recent months. However, unlike the still positive import demand growth in developing countries (reflecting stronger domestic demand conditions there), high-income countries import demand growth contracted in the three months leading to April (-3.7%, 3m/3m saar). Although on aggregate import demand among high -income countries decelerated in April, developments have not been uniform across individual economies (figure TRADE.2).

## US import demand growth decelerates, after earlier cyclical rebound.

The ongoing steady strengthening of US private sector economic activity, (GDP grew at 2.4 percent in Q1 2013, q/q saar compared with 0.4 percent in Q4 2012) was supportive of the rebound in its import demand. After contracting for four consecutive months between August 2012 and November 2012, US import demand growth started expanding once again in December, peaking at 5.9 percent (3m/3m saar) in January Nonetheless, by March, business sentiment indicators for the US began declining. This decline in sentiment was reflected in real-side activity as both US industrial production and trade expansion slowed. Indeed, in March, US import demand growth contracted at a 2.5 percent (3m/3m saar) pace. And although there was an uptick in April (0.3 percent, 3m/3m saar), import demand is still expanding below trend. A strengthening US

**Box TRADE.1** **Regional import developments**

Import demand in **East Asia & the Pacific** registered a solid rebound in both Q4 2012 and Q1 2013 (Box fig TRADE 1.1). The robustness of trade in the region also reflects increasing trade and financial integration, although concerns have been raised about the potential impact on regional trade of the decline in Sino-Japanese trade and from the sharp depreciation of the yen (see main text). Indeed, declining business sentiment for some of the larger economies in the region suggest a weakening of this expansion in Q2 2013. Available data for April shows that the pace of import momentum decelerated to 13.4 percent (3m/3m saar) from 25.4 percent in March.

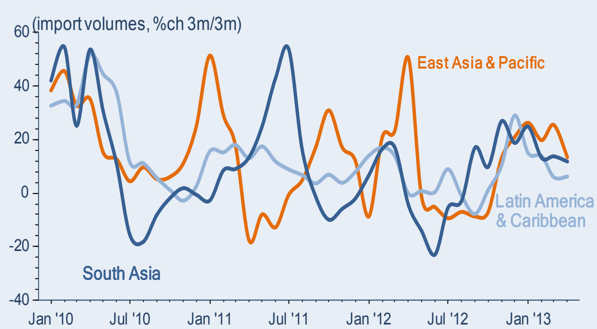
In **Europe and Central Asia,** import demand in the two largest economies in the region, Russia and Turkey, has rebounded rapidly — rising at a 19.7 percent pace in Russia and at 12.1 percent in Turkey in Q1 2013— partly reflecting the advanced stage of recovery in these economies. In those developing European countries with closer ties to the Euro Area, output gaps remain elevated and the recovery in import demand has lagged, the expansion in import demand has been weaker. On aggregate import demand in the region expanded at 16.8 percent rate in the three months ending March 2013.

Strong domestic demand in **Latin America's** largest economy (Brazil), supported by loose monetary policy and household tax incentives, contributed to solid import demand in the region. Indeed in Q1 2013, import demand in Brazil grew at an above trend 21.3 percent pace. However, for the region as an aggregate import demand was 5.9 percent in Q1 2013. The weaker aggregate regional expansion in Q1 2013 reflects recent deceleration in import demand in both Argentina and Mexico. In April Brazil's import growth contracted, but strengthening import demand from other countries in the region supported the acceleration of the region's import demand to 6.1 percent (3m/3m saar).

In **South Asia** where India, dominates trade activity, the replenishing of depleted stocks and earlier monetary policy easing, contributed to the robust expansion in South Asia's imports. However, India's export growth has not kept apace with its import demand, thus contributing to a growing trade balance and current account deficit.

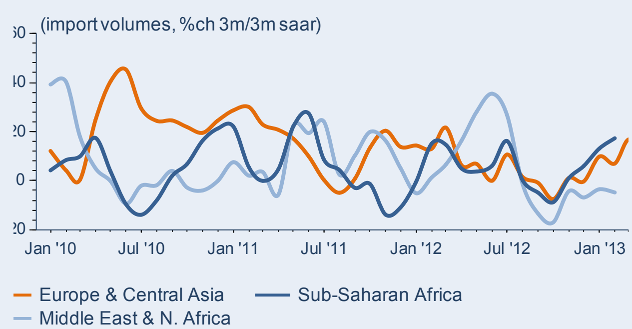
The latest available region wide data for **Sub Saharan Africa** and the **Middle East and North Africa** is February 2013 (Box fig Trade 1.2). Fortunes for both regions however, diverge. As was the case for other developing regions, import demand in Sub Saharan Africa strengthened through February to a robust 17.5 percent pace (slightly higher than the developing country average of 16.6 percent at the time) from 13.1 percent in the previous month. However, in the Middle East and North Africa, the contraction in import demand which commenced in August 2012 was sustained through February 2013 (-4.8 percent, 3m/3m saar), even if at a weaker pace. The weakness in import demand in the region in part reflects the effects of political challenges on demand conditions in some countries in the region.

**Box fig TRADE 1.1** **Import volume growth among selected developing regions**



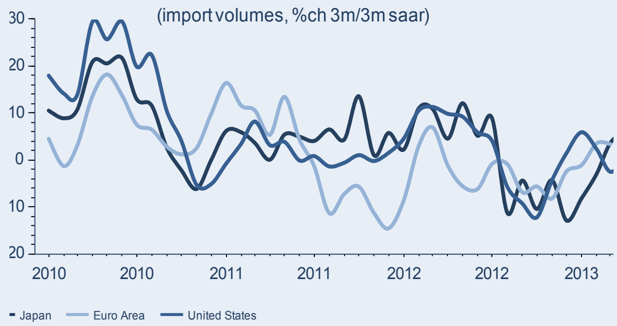

Source: World Bank; Datastream.

**Box fig TRADE 1.2** **Import volume growth among selected developing regions**



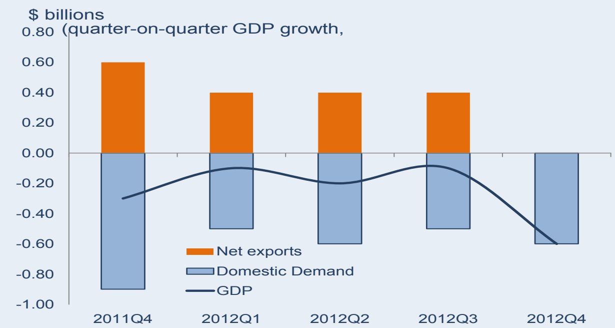

Source: World Bank; Datastream.

**Fig TRADE.2** **Import demand in selected high-income economies**




Source: World Bank; Eurostat.

**Fig TRADE.3** **External demand is mitigating the weakness in Euro Area domestic demands**




Source: World Bank; Eurostat.

economy should be supportive of global trade as the US still remains the world's largest importer, accounting for some 12.5 percent of global imports in 2011.

## After contracting for several months, import demand in high-income Europe begins expanding once again.

Notwithstanding a steady trend decline in its market share, the European Union still remains the world's largest trading bloc and customs union, hence developments in Europe are of significant importance in global trade. Euro Area import demand began expanding once again in February 2013 (3.5 percent, 3m/3m saar) – the first expansion in ten months— and has continued expanding through March (3.4 percent, 3m/3m saar). The pick-up in Euro Area imports has occurred not with standing the weak domestic demand conditions there: rising and record high unemployment, tight lending conditions, ongoing fiscal uncertainty, and lingering uncertainty weighing down on investor confidence. The strengthening of import demand could reflect the rebuilding of inventories after several months of contracting imports demand, rather than strengthening of domestic demand conditions in the bloc.

Overall, net exports demand in the Euro Area is contributing to mitigating the weakness in Euro Area demand. For instance, in 2012, net exports contributed 1.6 percentage points to Euro Area GDP growth, notwithstanding the overall contraction of 0.6 percent in output (figure TRADE.3). Since exports tend to have a large import component, the acceleration in imports in 2013 Q1 likely reflects better exports as well as modest strengthening in the Euro Area economy.

## Japanese imports demand has rebounded in recent months.

Japan accounts for 6.5 percent of global trade, hence developments there remain important, particularly so in the East Asia region where it is an important final market for several economies.

After several months of contracting import demand (between August 2012 and February 2013), import demand in Japan has begun accelerating once again, consistent with the strengthening of economic activity recorded in Q1 2013 (3.5 percent, q/q saar up from 0.3 percent in Q4 2012) as the effects of strong government stimulus measures begin to impact real side activity. Indeed, in the three months to April import demand accelerated to 6.3 percent compared with a 12.9 percent pace of contraction that occurred in December 2012.

## Exports have lagged imports but are growing rapidly — with all regions participating in the trade rebound

Supported by the rebound in global economic activity (as observed by the pick-up in import

**Table TRADE.1** Export growth in developing regions

| Regions | Export Volume Growth | | | | |
|---|---|---|---|---|---|
| | 2012 (q/q, saar) | | | 2013 (3m/3m, saar) | |
| | Q2 | Q3 | Q4 | Q1 | April |
| East Asia & Pacific | 23.2 | -12.2 | 17.5 | 26.1 | 11 |
| Europe & Central Asia | 8.3 | -10.5 | 9.2 | 1.8 | -3 |
| Latin America & Carribbean | -6.1 | -4.1 | 10.6 | -7.5 | 5 |
| Middle East & North Africa | -21.5 | -42.9 | 38.7 | | |
| South Asia | -6.4 | -11.8 | 9.6 | 25.8 | 15.3 |
| Sub Saharan Africa | 48.4 | -34.2 | 4.9 | | |

Source: World Bank; Datastream.

demand), developing country exports strengthened in Q4 2012 (14.8 percent, q/q saar), and this pick-up was sustained through Q1 2013 (15.5 percent, q/q saar), albeit at a different pace across individual developing regions (table Trade.1). Nonetheless, along with the deceleration in global import demand, the pace of export growth is showing signs of deceleration, with developing country export growth expanding at an annualized pace of 7.8 percent in the three months to April 2013 compared with the 15.4 percent recorded in the previous month.

During Q1 2013 the pace of export expansion was strongest in East Asia (26.1 percent, q/q saar) led by China and also in South Asia (23.2 percent, q/q saar) led by India. Central and Eastern European countries are benefitting from the strengthening import demand in the Euro Area with exports from the region expanding by a solid 14.5 percent (3m/3m saar) annualized pace in Q1 2013. However stagnant export growth from Russia and the sharp decline in Turkey's export growth weighed down on the overall Europe and Central Asia exports. Hence in Q1 2013 overall exports in the region expanded by only 1.8 percent—well below the developing country growth of 15.4 percent. Latin America and the Caribbean region was the only developing region where export growth contracted in Q1 2013, mainly due to contracting export growth in Mexico (-7.4 percent, q/q saar) and Brazil (-4.4 percent, q/q saar). However, a pick-up in Brazil's export volumes in supported the rebound observed for the region in April (5.0 percent , 3m/3m saar)

Data for both Sub Saharan Africa and the Middle East lags behind other developing regions. Latest available for the region is February 2013. In both regions, export growth had rebounded from the contracting activity in the months prior to November 2012. Indeed, in the three months to February export growth was accelerating at 19.7 percent in Sub Saharan Africa and 12.8 percent in the Middle East and North Africa.

# Medium Term Prospects for Global Trade

After its slump in 2012 (2.8 percent growth), global trade growth is projected to pick-up in 2013 and gradually strengthen through 2015. Underlying this pick-up in activity is the expected strengthening of the Euro Area economy (largest trading bloc) by Q3 2013, and the ongoing steady recovery in the US and robust developing country growth expected to continue through 2015.

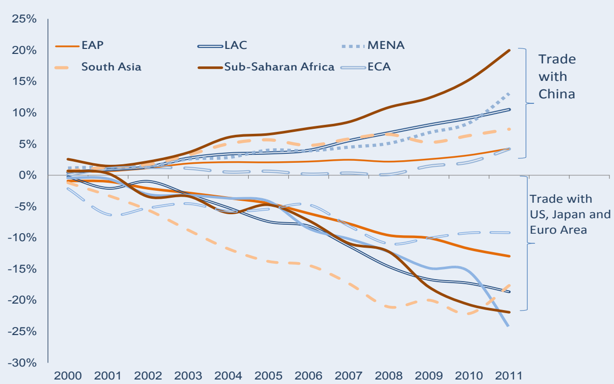
Global trade in goods and services is projected to increase by 4.0 percent in 2013, before strengthening to 5.0 percent in 2014 and reaching 5.4 percent in 2015. Despite this relatively strong growth projection, global trade volumes will remain below their pre-crisis trend — potentially suggesting a slowing in the long-term trend for

**Box TRADE.2** **The Re-orientation of South-South Trading Partners in Recent Years**

Though accounting for about a third of global trade, the faster projected trade growth for developing countries (between 6.4 percent to 8.4 percent annual growth over forecast horizon) compared to high-income countries (2.8 percent to 4.3 percent over forecast horizon) between 2013 and 2015 is expected to be a key driver in the expansion of global trade. As documented in GEP 2013A, over the past decade, the most dynamic segment of global trade is trade among developing countries – so called “South-South” trade. Indeed, over the past decade the USD value of trade between developing countries has grown annually by an average of 19.3 percent (17.5 percent if trade with China is excluded) versus about 11 percent for developing country exports to high-income countries.

This trend is expected to continue over the forecast horizon. One significant element that has driven this South-South trade has been the growing role of East Asia as a major global trading bloc. Together this region, accounts for about half of the re-orientation towards South-South trade, with China, being the most dynamic trading partner. Indeed, without exception, every single developing region has increased its trade with China, while contemporaneously reducing their trade dependency on high-income markets (Box Figure Trade 2.1). The developing regions to have most re-oriented and increased their trade with China over the past decade have been those with a comparative advantage in natural resources. Between 1999 to 2011 Sub Saharan Africa increased their exports to China from 2.23 percent of their total exports to 22.73 percent, Latin America increased theirs from 1.0 percent to 11.5 percent and the Middle East and North Africa from 2.21 percent to 15.29 percent. Reflecting the strong integration of production networks in East Asia, the share of exports from other East Asian economies to China has increased from 4.5 percent in 1999 to 18.6 percent in 2011.

**Box Fig TRADE 2.1** **Cumulative change in share of regions total exports going to China and high-income countries, 2000—2011 (percent).**




Source: UN COMTRADE.

**Box Fig TRADE 2.2** **Intra-regional import shares among developing regions ( percent)**


Source: UN COMTRADE.

The rapidly growing South-South trade has however not been driven by only China but also other developing regions, in particular the rest of the East Asia region. However, outside of China and East Asia Pacific region, in general, the diversification of trading partners towards other developing regions, though occurring, has been less dynamic compared to that with the East Asia region (see Box Table TRADE 2.1).

Indeed, outside of trade with the East Asia region, the most significant re-orientation has been increasing exports from both the Middle East and North Africa. Excluding this, the re-orientation of trade with other developing regions has been somewhat less dynamic (see Box Table TRADE 2.1). More surprising however is the relatively slow progress towards increased integration among developing countries in the same region, with the exception of East Asia where regional trade integration (share of intra-regional imports) almost tripled since 1999. Indeed, excluding China which tends to export a greater share to high-income countries, the share of the other East Asian countries exports to the East Asia region increased by 20 percentage points (from 7.1 percent to 30.3 percent of their total exports). This is not the case in other developing regions. Although Europe and Central Asia remains the second most trade-integrated developing region (thanks to many countries benefitting from multiple trade agreements in the region, especially those associated with the European Union) part of the progress made in regional integration appears to have been eroded by the weak demand post crisis, as intra-regional trade having risen to 27.8 percent by 2008 (from 19.2 percent in 1999), has since declined to 25.5 percent in 2011 (see Box Fig TRADE

2.2). For both Latin America regional trade integration has steadied around 16 percent over the past decade. And in Sub Saharan Africa, after increasing by some 5 percentage points between 1999 and 2002, the share of regional trade has also steadied at around 12 percent of total trade, reflecting significant cross border barriers as well as increased external competition due in part to unilateral tariff liberalization. Among developing regions, the Middle East and North Africa and in South Asia remain regions with the least intra-regional trade, about 3 and 4 percent of their total trade is carried among regional neighbors. Not surprising several analytical studies (including those using gravity models) continue to point to the underperformance of intra-regional trade in the Middle East and North Africa (Dennis, 2006; Devlin and Yee, 2005; Zarrouk, 2003 Al-Atrash and Yousef, 2000), as well as in South Asia (Kumar etal 2009) and in Sub-Saharan Africa (Buys etal. 2010).

While trade in natural resources, in particular ores and metals has been the fastest growing commodity category of imports among developing countries, the growth in trade in manufactured goods among developing countries has also been solid - growing as fast as petroleum imports and faster than agricultural raw material imports. The strength of importance of ores and metals is however accentuated by the inclusion of China. Excluding China, manufactured goods has been the fastest component of south-south trade, reflecting increased production chain interlinkages among developing countries, particularly in the East Asian region.

**Box table TRADE 2.1** **The diversification of trading partners between developing regions has been most dynamic between all developing regions and the East Asia region**

| | EXPORT MARKET<br>(additional increase in exports share going to import market, in percentage points)<br>( e.g. an additional 18.0% of SSA share of its total exports was re-oriented towards the EAP region) | | | | | | |
|---|---|---|---|---|---|---|---|
| **IMPORT MARKET** | EAO | EAP | ECA | LAC | MENA | SAS | SSA |
| East Asia excl. China (EAO) | 6.3 | 4.2 | 0.5 | 1.0 | -0.2 | 2.2 | 0.5 |
| East Asia & Pacific (EAP) | 20.4 | 8.0 | 3.6 | 10.8 | 11.1 | 8.5 | 18.0 |
| Europe Central Asia (ECA) | 1.4 | 3.1 | 6.2 | 1.0 | 1.3 | 2.9 | 0.8 |
| Latin America & Carribean (LAC) | 1.3 | 4.1 | 0.0 | 1.3 | -0.6 | 2.7 | 0.5 |
| Middle East & North Africa (MENA) | 0.4 | 0.6 | 0.5 | 0.6 | 0.4 | 1.4 | -0.7 |
| South Asia (SAS) | 2.5 | 2.5 | 0.5 | 1.2 | 6.6 | 1.5 | 0.5 |
| Sub Saharan Africa (SSA) | 0.4 | 1.0 | 0.2 | 0.7 | 0.4 | 2.5 | 5.2 |

Source: UN COMTRADE.

rapidly growing developing country market shares. Nevertheless, trade is expected to continue reorienting itself toward developing countries (box Trade.2). Partly as a result of this trend, increasingly more of developing country trade is now with other developing countries — both reflecting increases in inter-regional and intra-regional trade, especially the in the East Asian region.

# Risks

*Fragile global economy*. Downside risks to the forecasted uptick in global trade activity have not changed over the past six months. Nonetheless, unlike earlier periods where the balance of risks were weighted on the downside, these are now more balanced (see main text). Downside risks continue to include a worsening of conditions in the Euro Area, the possibility that markets react badly to a failure of either the United States or Japan to map out a credible medium-term deficit reduction strategy, a rapid decline in Chinese growth and geopolitical concerns. To these may be added the possibility that high commodity prices, which have supported the value of global trade — if not the volume — could decline rapidly with deleterious consequences for incomes and imports of commodity exporting countries, but benefits for importers.

However, outturns in the global economy, particularly from high-income countries could surprise on the upside, compared to the subdued uptick embedded in our current forecasts (high-income growth of 1.2 percent in 2013 strengthening to 2.3 percent by 2015 – see main text for details). This could arise from another of reasons including the pent-up demand in high-income countries, low levels of inventories, and improved credit flows to real economy in high-income countries. If this were to occur, this would lead to a rapid rise in not only high-income trade but also that of developing country trade than currently embedded in our forecasts.

*A rise in protectionism.* With unemployment remaining at elevated levels, weak global demand and little progress in multilateral trade talks, the incidence of new restrictive trade measures, while slowing down compared to a year ago, still reveals some worrisome trends. The World Trade Organization reports that in the five months leading to mid-October 2012, an additional 71 new trade restricting or potentially distorting measures were introduced. The most frequent measure used was the initiation of anti-dumping investigations, followed by stringent customs procedures. This represents a decline from the 108 new measures introduced a year ago. Nonetheless, although the pace of imposition of new restrictions dropped, recent experience suggest that, once imposed it is difficult to remove such restrictions, inevitably due to the political constituencies that they build. For instance, only 21 percent of new trade-restricting measures introduced since October 2008 by G-20 countries have been removed, thereby leading to a cumulative increase in the stock of trade restrictions. Indeed on a net basis (i.e. accounting from removal of restrictions), current existing measures imposed by G-20 countries since October 2008, is estimated to affect some 3.5 percent of global trade (as of October 2012), up from 2.9 percent in May 2012.

**The resurgence in announced bilateral and regional trade agreements among high-income countries could mitigate the acceleration of developing country trade.**

Notable among these are the US-EU free trade agreement and the Trans Pacific Partnership (US and nine other economies, including high-income countries such as Japan, Australia, New Zealand, Singapore and Chile). While bilateral and regional preferential trade agreements have proliferated in past decades, these new accords (if agreed to) are much larger in scope. A trade agreement between the US and the EU alone would be unprecedented in size - accounting for some 40 percent of global trade! Hence were the preferences included in a potential deal between the US and the EU, not extended to other developing countries within the multilateral trading system this could disadvantage developing countries.

A principle concern with agreements is the extent to which non-participant third parties will be affected by trade diversion, potentially leading to a decline in global welfare, even if the agreement benefits the parties to it. Given the size of high-income countries, these potential trade-diverting impacts from preferential trade agreements are further magnified and developing countries are likely to be the loosers from such an agreement, were it to be trade-diverting. Hence, efforts to clinch a multilateral deal (Doha Round) will over the long-term maximize global welfare.

## Notes

1. The null hypothesis that developing country import volumes do not granger cause high-income export volumes is rejected at 1 percent level, after 3 lags. Similarly the null hypothesis that high-income import volumes do not granger cause developing country export volumes is rejected at 1 percent level, after 4 lags.

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