“De-globalization” Already Happened And It Didn’t Matter

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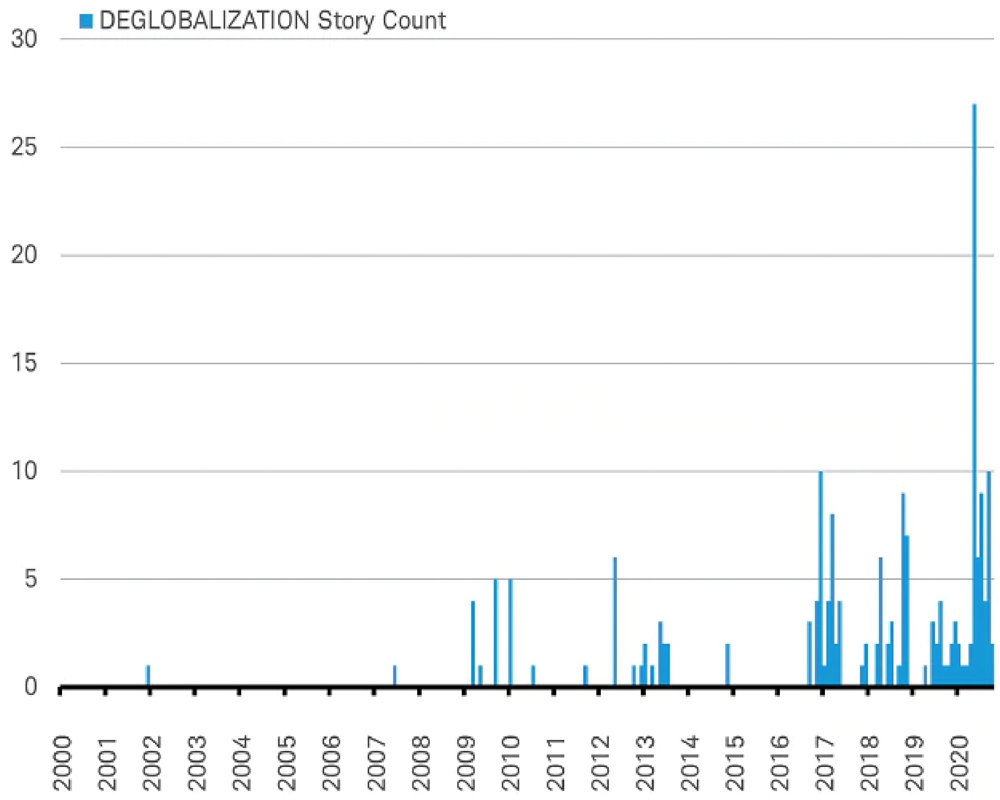
Key Points

- In 2020, politics and the pandemic have led to a lot of speculation that they could bring about an end to the rise of globalization—yet that began over a decade ago.
- Three major causes of the stall in global trade growth over the past 12 years are: the drop in oil trade, the rise in the value of the U.S. dollar, and products crossing borders fewer times during the manufacturing process.
- For investors, the stall in global trade since 2008 hasn’t necessarily lead to a stall in profits for multinational companies that make up the major stock market indexes or a decline in the international portion of those profits.

The “end of globalization” is a phrase that has come up a lot lately. Stories written about deglobalization have soared this year with the pandemic. But they began four years ago, right after the last U.S. Presidential election, as you can see in the chart of major news stories below. Although some authors attribute the potential end of world trade growth to President Trump’s trade policy and the supply chain impacts of the COVID-19 pandemic, the data shows that neither of these caused the peak in global trade momentum.

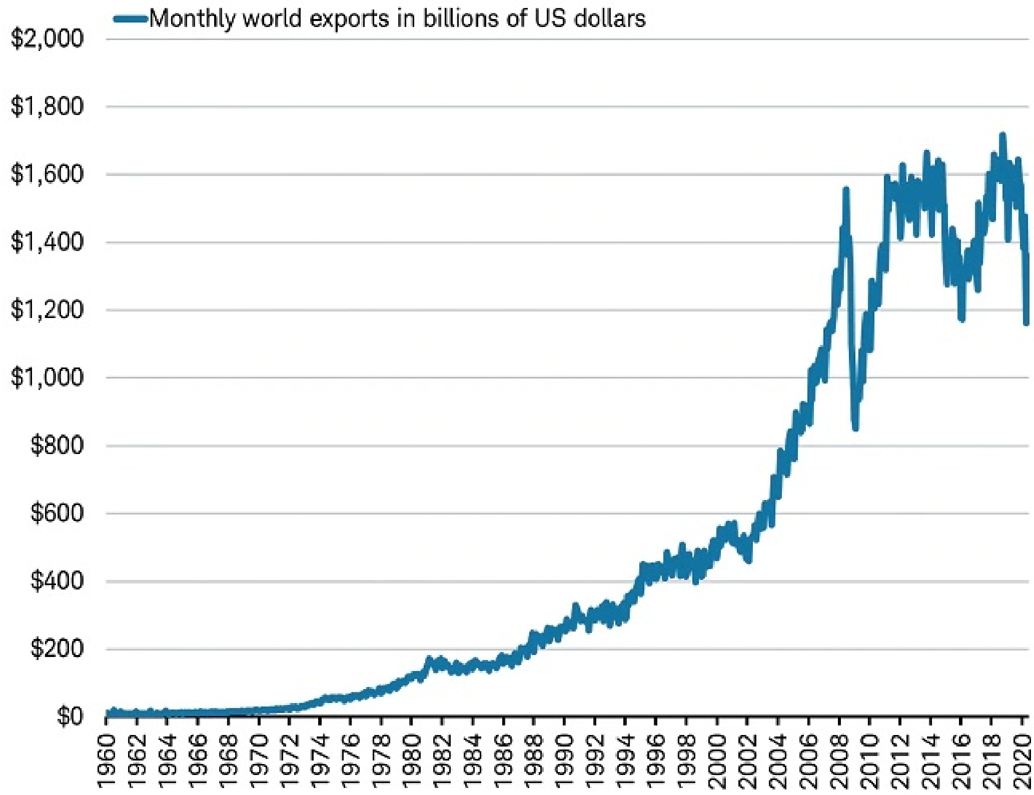
Hot topic



Source: Charles Schwab, Bloomberg news search of major publications as of 10/22/20.

The decline in global trade momentum started back in 2008, as you can see in the chart below, years before articles were being written on the subject. At that time, Obama was elected President and Avian Influenza was declared a pandemic by the World Health Organization. But, the stall in global trade had nothing to do with either of those things either.

World trade has been stalled since 2008

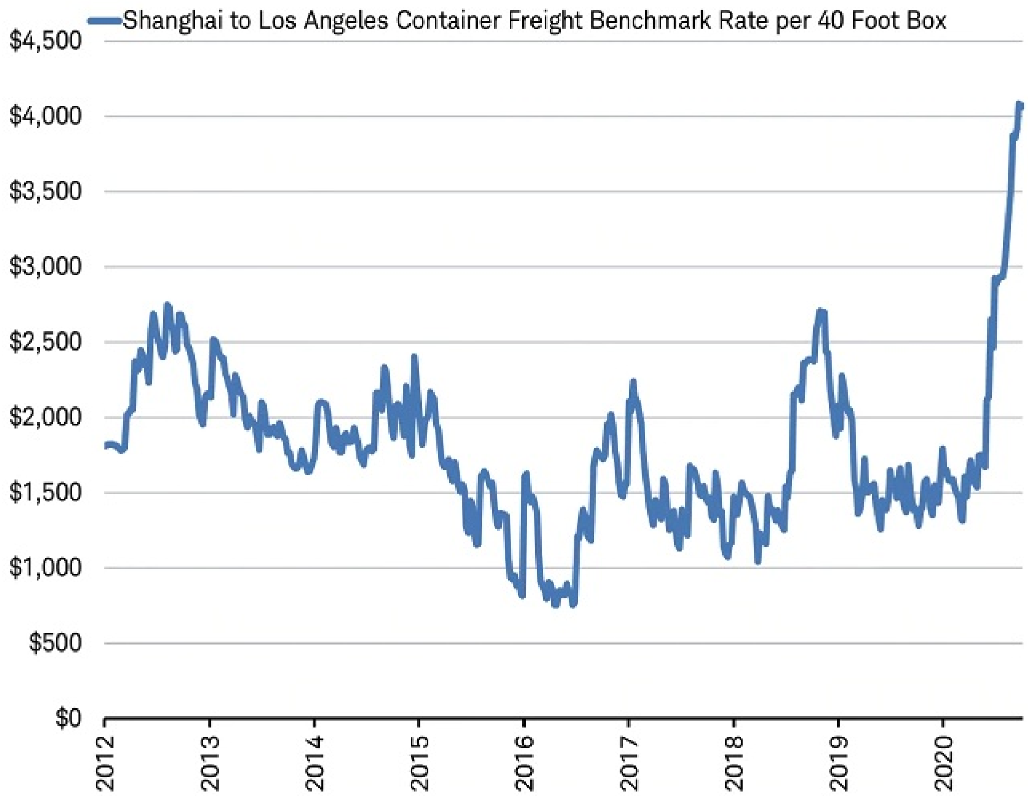


Source: Charles Schwab, IMF data as of 6/30/2020.

It wasn't recent politics or pandemics that changed the long-term trajectory of trade. In fact, the dollar amount of world trade rose 12% during the first three years of the Trump administration from January 2017 to January 2020, rebounding from the oil-related downturn in late 2015 and early 2016. This year, trade has made a sharp comeback, growing 14.5% q-o-q from the low in Q2 during the beginning of the pandemic, according to UNCTAD. Instead of travelling and experiences, consumers are spending on cars and other manufactured goods. The global manufacturing purchasing manager index (PMI) is on track to rise for the sixth straight month in October, while the services PMI fell. Demand for goods has led China's exports to rise 9.9% year-over-year in September, the most since March 2019.

This year's rebound in global merchandise shipments has been record-breaking. For example, Amazon's deadline of November 6 for sellers to get their products to Amazon's fulfillment centers in advance of Black Friday and Cyber Monday means a lot of goods are currently in transit. The shipping rate for a 40-foot shipping container from Shanghai to Los Angeles has more than doubled. Online sales anticipated to set records this year. It seems the pandemic has led to an unexpected resurgence in the trade of manufactured goods, rather than triggering its decline.

Surging demand pushing up shipping prices in USD from China to U.S. for the holidays



Source: Charles Schwab, Bloomberg data as of 10/22/20.

The stall in global trade over the past 12 years took place during general growth in the global economy. Overall, tariffs and non-tariff barriers to trade were lowered, not raised, according to actions tracked by the World Trade Organization.

So, what caused trade growth to stall? And, more importantly, what does the future likely hold for trade and the trade-dependent revenues of global companies?

The causes

Three major causes of the stall in global trade growth over the past 12 years:

1. The oil market acted as a drag on global trade. Fuel made up 16% of global exports in 2008 and fell to just 11% in 2019. This 5% drop in oil trade took place as world growth became less dependent on fossil fuels and U.S. oil supply rose, which eliminated the country’s dependence on fuel imports (which once made up nearly half of the U.S. trade deficit).
2. When measuring global trade in U.S. dollars, the appreciation of the dollar weighs on the dollar value of trade, independently of the unit volume. Merchandise trade volume grew 17% from January 2008 to January 2020, according to the widely watched World Trade Monitor, prepared by the Netherlands Bureau of Economy Policy Analysis. But, measured in dollars, that volume gain disappeared. The broad trade-weighted value of the U.S. dollar rose 35%, from 95 to 128, from mid-2008 to the end of 2019, negating the effect of the increase of volume.
3. The localization and vertical integration of supply chains within borders has reduced cross-border trade in intermediate goods. What this means is that a larger portion of overall supply chains are falling within one country more so than in the past so products cross borders fewer times during the manufacturing process than before. The impact of these business decisions may be measured by the falling share of intermediate goods exports relative to final goods exports, especially in China.

The future

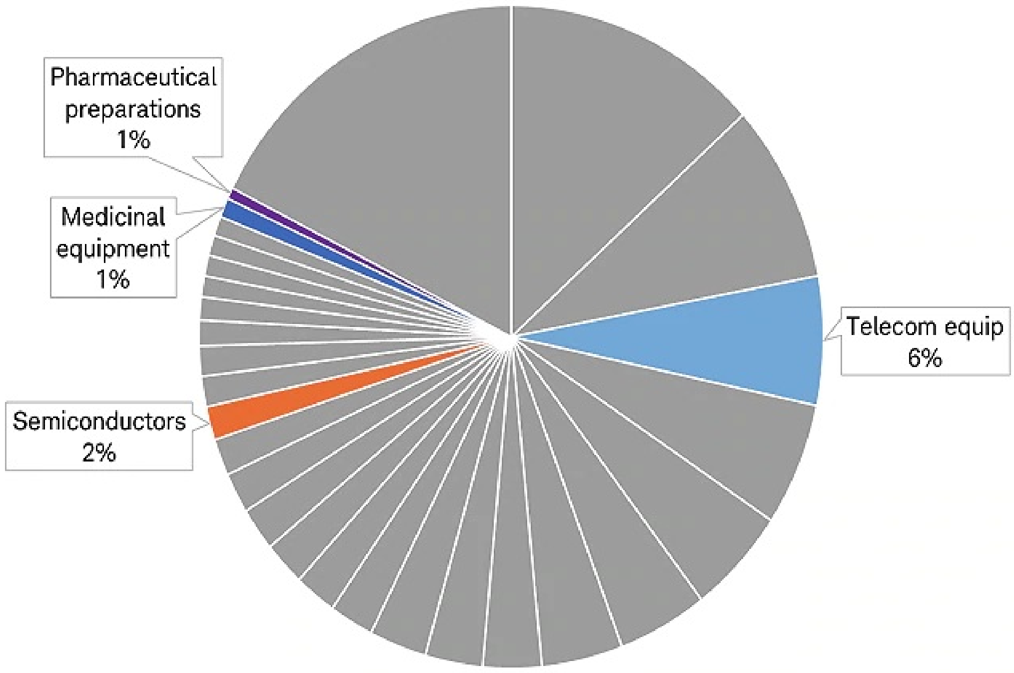
Those who believe deglobalization is related entirely to politics and the pandemic may be surprised. Future developments in the actual drivers may have different impacts on global trade growth:

- Negative: The trend of shrinking demand for oil may continue and further act as a drag on both the volume and value of global trade.
- Positive: The value of the U.S. dollar may have peaked and could head lower in the coming years, counter to the trend of the past 12 years. A return to a declining dollar may boost the dollar value of global trade, as last seen from 2001 to 2008.
- Neutral: Further vertical integration of supply chains in advanced and emerging markets may be offset

by scope for a finer division of supply chains in frontier markets like Africa, South America and less-developed parts of Asia.

Politics and the pandemic have favored policies to re-shore supply chains for items deemed essential, like certain health care products and telecommunications equipment. However, these targeted products are just a very small part of global trade. To put it in perspective, overall U.S.-China trade makes up less than 3% of world trade. Within that, only about 2% of China's exports to the U.S. are in the form of health care products recently deemed essential. Another 6% are telecommunications products, some of which could be impacted by the actions of politicians to restrict access in 5G networks. Overall, these targeted areas are very small from the perspective of the entire scope of global trade. Nevertheless, largely because trade between China and the U.S. is the biggest bilateral trade relationship between the two largest economies in the world, these reshoring policies garner a lot of attention and have been the focus of the recent deglobalization narrative.

Percent of China exports to U.S.



Source: Charles Schwab, U.S. Census Bureau for 2018, data pulled 10/22/2020.

Ultimately, the combination of the factors that acted as a drag on global trade growth over the past 12 years may be a net neutral to global trade as we look forward. Global trade could again begin to grow in sync with global economic growth.

Alternatively, the negatives could more than offset the positives. The deepening localization of supply chains means less need for products to cross borders during manufacturing, which could keep the dollar amount of global trade in check and prolong the stall in global trade.

Of course, there could also be other unknown factors yet to emerge and influence the trend in global trade.

The portfolios

For investors, it might not matter that much. The stall in trade since 2008 has not necessarily lead to a stall in profits for multinational companies that make up the major stock market indexes or a decline in the international portion of those profits. Profits for global companies in the MSCI All Country World Index rose 38% from 2008 to 2019. The share of revenue coming from foreign sales remained stable over that period, at around 75% for companies in Europe and around 50% for companies in Japan and the U.S., according to data from Standard & Poors, Nikkei and Factset.

The idea of globalization defined as the sourcing of production in one country with the lowest labor cost and exporting the final product to be sold everywhere else is increasingly outdated. With the advances in robotics and other manufacturing technology, labor has become less of a cost input to manufactured products. The miniaturization and localization of manufacturing has allowed for multiple redundant supply chains and local customization for the products sold around the world, generating profits for companies independent of where they are headquartered. Sales and profits have become increasingly globalized even as the goods being sold rely less on cross-border transportation.

If the past 12 years is any indication, the takeaway for investors is that deglobalization may have very specific impacts for portfolios, but is not likely to be an overall negative for corporate profits, the main driver for stock market returns. There could be some reshoring of industries that make up a small portion of trade and some companies focused in the tech and telecom sectors may be negatively impacted by trade politics. But past 12 years show that as global trade patterns evolve, companies remain as committed to globalization as ever.

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