I The trade situation in 2009-10

The economic and financial crisis that shook the world economy in the closing months of 2008 produced a global recession in 2009 that resulted in the largest decline in world trade in more than 70 years. The rate of trade growth had already slowed from 6.4 per cent in 2007 to 2.1 per cent in 2008, but the 12.2 per cent contraction in 2009 was without precedent in recent history. The WTO has projected a modest recovery in 2010 which should reverse some of the impact of the trade collapse.

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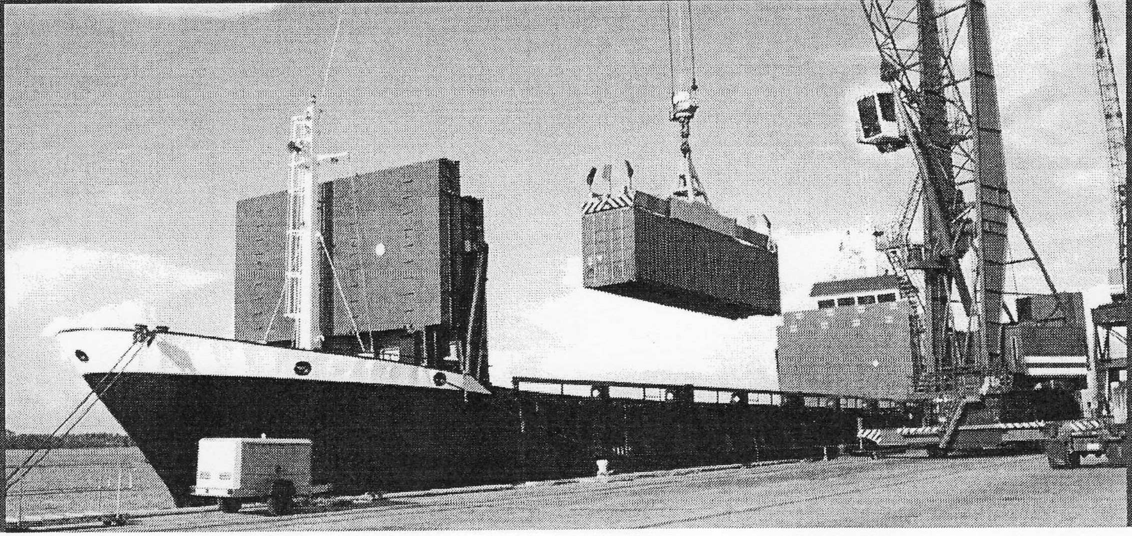


A. Introduction

Trade and output growth resumed in the second half of 2009 following record declines earlier in the year. The recovery through the first quarter of 2010 was insufficient to attain pre-crisis levels. The WTO has projected a further recovery in 2010 from the depressed levels of 2009, which should reverse some but not all of the impact of the trade collapse. One positive development in 2009 was the absence of any major increase in trade barriers imposed by WTO members in response to the crisis, despite high unemployment in many countries. The WTO system of trade regulation played a significant role in helping to prevent another descent into protectionism that so exacerbated economic conditions in the 1930s.

The dramatic decline in world trade in 2009 (see Figure 1) was even greater in US dollar terms (-22.6 per cent) than in volume terms (-12.2 per cent), thanks in large part to falling prices for oil and other primary products.[1] World output as measured by gross domestic product (GDP) also fell by 2.3 per cent in 2009, the first such decline since the end of the Second World War. Taken together, these developments amounted to the most severe global economic slowdown since the Great Depression.

1. Explaining the size of the trade collapse

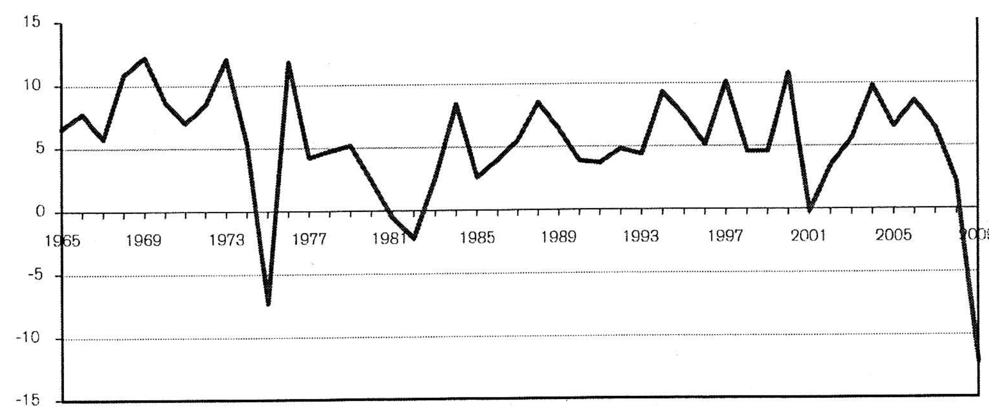
World trade volumes fell on three other occasions since 1965 (-0.2 per cent in 2001, -2.0 per cent in 1982, and -7.0 per cent in 1975), but none of these episodes approached the magnitude of last year's plunge. The slump in trade in 2009 was larger than most econometric models would have predicted given the size of the drop in GDP, and it was also larger than the decline predicted by the WTO in the early stages of the crisis.

Economists have suggested a number of explanations for the trade collapse, including the imposition of some protectionist measures and reduced access to credit to finance trade transactions. However, the consensus that has emerged centres on a sharp contraction in global demand as the primary cause.[2] The weakness in demand had its roots in the sub-prime mortgage crisis in the United States, which became apparent in 2007 and intensified towards the end of 2008. What began as a crisis in the US financial sector spread to the real economy, to other developed economies, and to the rest of the world in short order. The impact of the crisis on trade was further magnified by the product composition of the fall in demand, by the fact that the decline was synchronized across countries and regions, and by the growth of global supply chains in recent decades.

Sharp falls in wealth linked to the recession caused households to reduce their spending on consumer durables such as automobiles (trade in automotive products was down 32 per cent in 2009), and also made firms reconsider expenditures on investment goods such as industrial machinery (down 29 per cent in 2009 – see Table 1). Purchases of these items could be postponed easily in response to heightened economic uncertainty, and they may also have been more sensitive to credit conditions than other types of goods. The reduction in demand for these products then fed through to markets that supply inputs for their production, particularly iron and steel (down 47 per cent in 2009). Shrinking demand for iron and steel was also linked to the slump in building construction in countries where property markets had been booming before the crisis. Consumer durables and capital goods make up a relatively small fraction of global GDP but a relatively large part of world trade. As a result, falling demand for these products may have had a greater impact on world trade than on world GDP.

The magnitude of the trade contraction of 2009 may also have been inflated somewhat compared with earlier declines in the 1970s and '80s due to the spread of global supply chains in the intervening years. With today's more extensive supply chains, goods frequently cross national borders several times during the production process

Figure 1: Volume of world merchandise exports, 1965-2009 (Annual percentage change)



Source: WTO International Trade Statistics.

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Table 1: World trade in manufactured goods by product, 2008Q1-2009Q4
(Year-to-year percentage change in current dollars)

	2008Q1	2008Q2	2008Q3	2008Q4	2009Q1	2009Q2	2009Q3	2009Q4	2009
Manufactures	**16**	**18**	**13**	**-11**	**-28**	**-30**	**-22**	**0**	**-21**
Iron and steel	15	27	43	4	-39	-56	-55	-31	-47
Chemicals	19	24	20	-7	-24	-25	-17	8	-15
Office and telecom equipment	10	13	7	-14	-29	-22	-15	8	-15
Automotive products	15	16	3	-26	-47	-46	-29	6	-32
Industrial machinery	21	22	15	-8	-29	-36	-32	-15	-29
Textiles	11	9	3	-13	-27	-27	-17	0	-19
Clothing	11	11	8	-2	-11	-15	-12	-6	-11

Source: WTO Secretariat estimates.

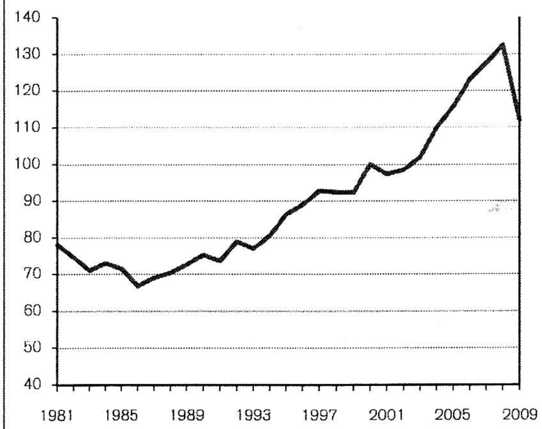
before arriving at their final destination. Merchandise trade statistics record the value of goods every time they cross national boundaries, so when these data are added together to arrive at a figure for total world trade, the number will be larger when supply chains are more extensive due to a certain amount of double counting. Consequently, a given fall in demand in 2009 would probably produce a bigger measured decline in trade than an equivalent fall in demand in 1982 or 1975.

The extent of this double counting is difficult to gauge due to a lack of readily available data, but it is reflected in the fact that trade has been growing faster than production since the 1980s. As a result, the ratio of world exports to GDP has increased steadily since 1985, and jumped by nearly one-third between 2000 and 2008, before dropping in 2009 as world trade fell faster than world GDP (see Figure 2).

A final factor that reinforced the trade slump was its synchronized nature. Exports and imports of all countries fell at the same time, leaving no region untouched (see Figure 3). It is intuitively clear that the fall in world trade would have been smaller if contraction in some regions had been balanced by expansion in others, but this was not the case in 2009.

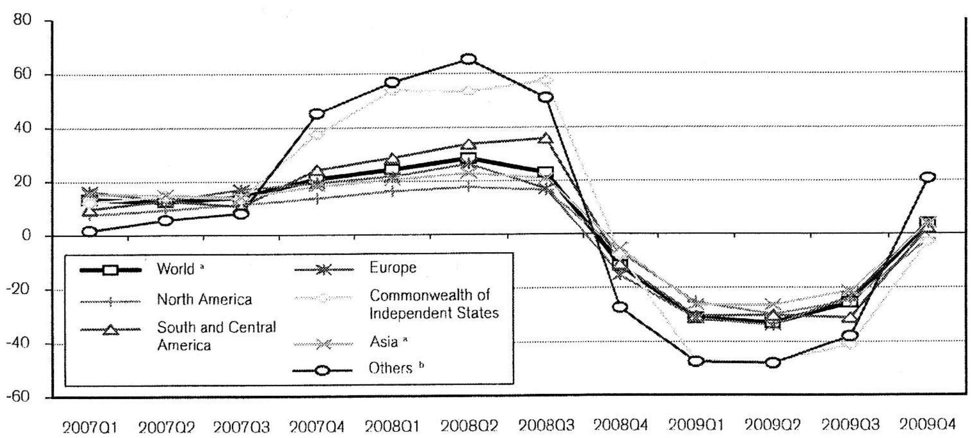
The synchronized nature of the decline is closely related to the spread of international supply chains and information technology, which allows producers in one region to respond almost instantly to market conditions in another part of the world. This usually contributes to global and national welfare by encouraging the most efficient use of scarce resources, but in the case of the trade collapse it may have acted as a transmission mechanism.

Figure 2: Ratio of world exports of goods and commercial services to GDP, 1981-2009
(Index 2000=100)



Source: IMF for world GDP, WTO Secretariat for world trade in goods and commercial services.

Figure 3: World merchandise exports by region, 2007Q1-2009Q4
(Year-to-year percentage change in current US dollars)



a Includes significant re-exports.
b Includes Africa and Middle East.
Source: IMF, International Financial Statistics; Eurostat, Comext Database; National statistics; Global Trade Atlas.

B. Overview of output and price developments in 2009-10

1. Economic growth

World GDP growth turned sharply negative in 2009 for the first time since the 1930s, dropping to -2.3 per cent from 1.6 per cent in 2008. Both years were well below the 2000-08 average of 3.0 per cent. Although the contraction in output started in the developed economies in the fourth quarter of 2008, it accelerated in the first half of 2009 and eventually affected all countries and regions to varying degrees. However, many developing countries only experienced slower GDP growth rather than absolute declines in output.

Figure 4 shows the quarterly evolution of GDP, as well as exports and imports of goods and services for the industrialized economies of the Organisation for Economic Cooperation and Development (OECD). Positive quarter-on-quarter GDP growth resumed in the second quarter of 2009 in OECD countries, but year-on-year changes remained negative throughout the year. An interesting feature of Figure 4 is that trade and output began their declines and started their recoveries at the same time. This provides some support for the notion that the trade decline was mostly related to falling demand rather than other factors.

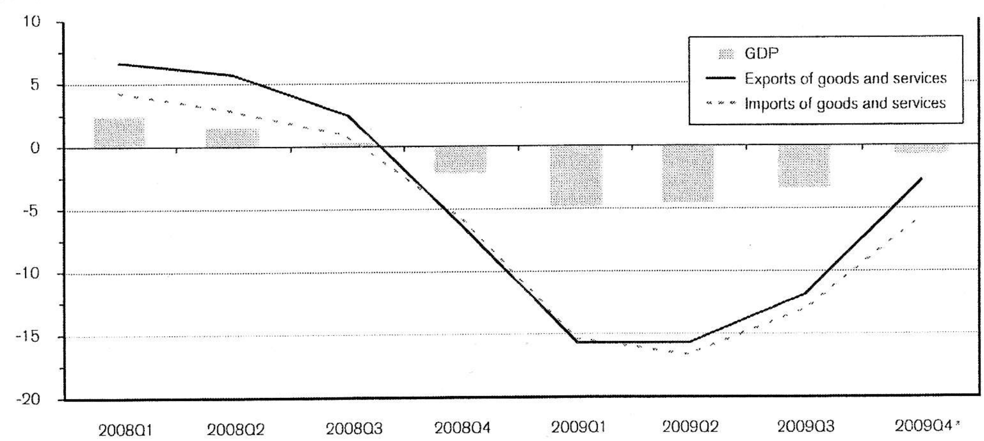
Output of developed economies fell 3.5 per cent in 2009 after growing just 0.5 per cent in 2008. Among the leading developed economies, Japan suffered the largest decline in its GDP (-5.0 per cent) followed by the European Union (-4.2 per cent)[3] and the United States (-2.4 per cent). On the other hand, developing economies still managed to increase their collective output by 2.6 per cent in 2009, although this was down sharply from the 5.6 per cent growth of the previous year. The continued positive GDP growth of developing economies can be partly credited to the strong performances of China and India, whose output increased by 8.5 per cent and 5.4 per cent, respectively, in 2009. Oil-exporting countries saw their collective GDP fall to 2.0 per cent in 2009, down from 5.1 per cent in 2008, while least-developed countries (LDCs) grew 3.7 per cent, down from 6.7 per cent in 2008.

North America's GDP growth fell to -2.7 per cent in 2009, while South and Central America's rate dropped to -0.8 per cent. The decline in Europe's output was even larger (-4.0 per cent), and that of the Commonwealth of Independent States (CIS) larger still (-7.0 per cent). On the other hand, Africa managed to increase its production of goods and services by 1.6 per cent, as did the Middle East, which recorded GDP growth of 1.0 per cent. Asia's GDP growth was almost flat at 0.1 per cent, as the sharp decline of Japan cancelled out the expansions of China and India.

2. Prices and exchange rates

After plunging in the early stages of the economic crisis, prices for primary products stabilized and staged a significant recovery in the second half of 2009. This is illustrated by Figure 5, which shows indices of world primary product prices from the International Monetary Fund (IMF). Between July 2008 and February 2009, energy prices fell by 64 per cent and metals prices dropped by 50 per cent, but between February 2009 and January 2010 prices for energy and metals rose 60 per cent and 65 per cent, respectively. Average commodity prices for 2009 were down for energy (-37 per cent), metals (-29 per cent), agricultural raw materials (-17 per cent) and food (-15 per cent). The only primary product category registering an increase in prices last year was beverages (1.7 per cent), which includes coffee and tea (see Figure 6).

Figure 4: Real GDP and trade growth of OECD countries, 2008-09 (year-to-year percentage change)



a Estimated based on available data.
Source: OECD Quarterly National Accounts.

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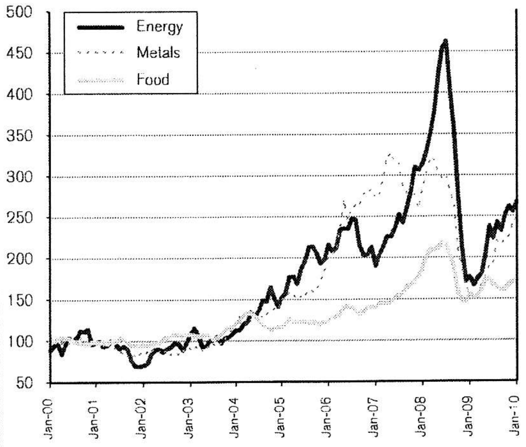
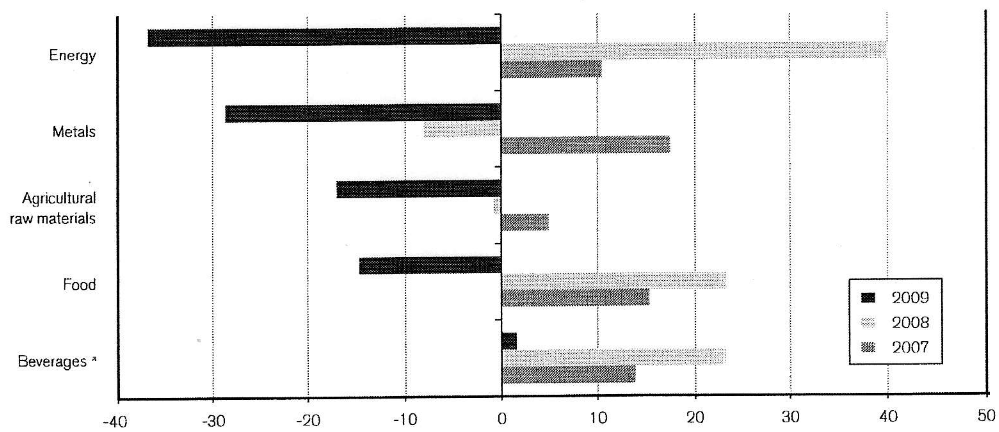
Figure 5: **Export prices of selected primary products, January 2000-January 2010**
(Index, January 2000=100)



Source: IMF International Financial Statistics.

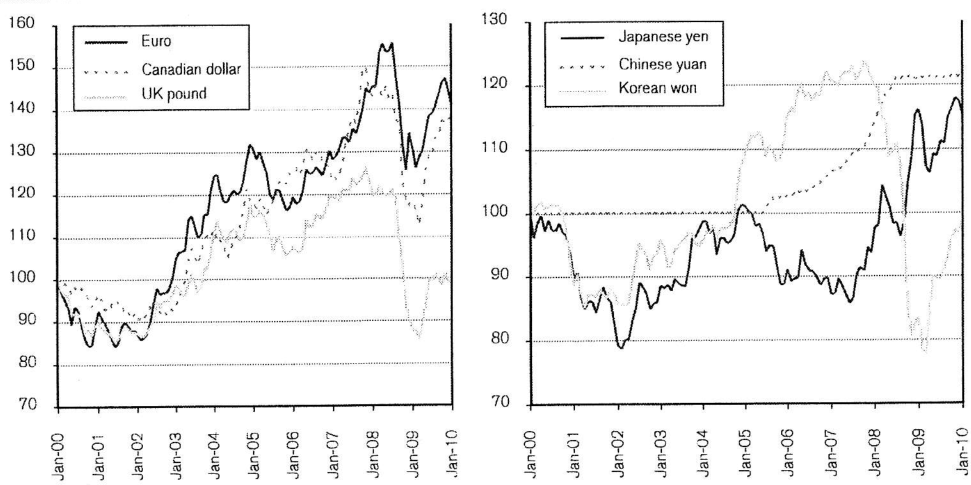
Major currencies have undergone significant fluctuations against the US dollar since the beginning of the economic crisis, with the exception of the Chinese yuan, which has been effectively pegged to the dollar since July 2008. For example, after falling nearly 20 per cent in value against the dollar between July and November 2008, the euro then appreciated 17 per cent between February and November 2009. Many other currencies followed a similar pattern, depreciating against the dollar as the crisis worsened and appreciating as conditions eased, probably due to the dollar's role as a safe haven currency in times of economic uncertainty. An exception to this rule is the Japanese yen, which appreciated against the dollar as a result of the unwinding of the so called yen "carry trade" in which large amounts of yen were borrowed in Japan and invested in assets denominated in other currencies in order to obtain a higher rate of return. The liquidation of these positions increased capital inflows into Japan and put upward pressure on the country's currency (see Figure 7).

Figure 6: **Export prices of selected primary products, 2007-09** (Annual percentage change)



Source: IMF International Financial Statistics.

Figure 7: **Dollar exchange rates of selected currencies, January 2000-January 2010**
(Index, January 2000=100)



Source: IMF International Financial Statistics.

C. Merchandise trade, volume (real) terms, 2009

World merchandise trade in volume terms (i.e. excluding the influence of prices and exchange rates) fell by 12.2 per cent in 2009 (see Table 2). This was well below the 2.1 per cent increase for 2008, and significantly lower than the 10 year average increase of 4.1 per cent. The drop in trade was also larger than the 2.3 per cent decline in GDP for 2009, which is not surprising since world trade generally grows faster than GDP when output is accelerating and declines more when output slows (see Figure 8).

All countries and regions in Table 2 saw the volume of their exports decline last year. North America and Europe fell more than the world average (14.4 per cent each) while the smallest declines were recorded by oil-exporting regions such as the Middle East (-4.9 per cent), Africa (-5.6 per cent) and South and Central America (-5.7 per cent). The declines for Asia (-11.1 per cent) and the CIS (-9.5 per cent) were somewhat larger, but still less than the world average.

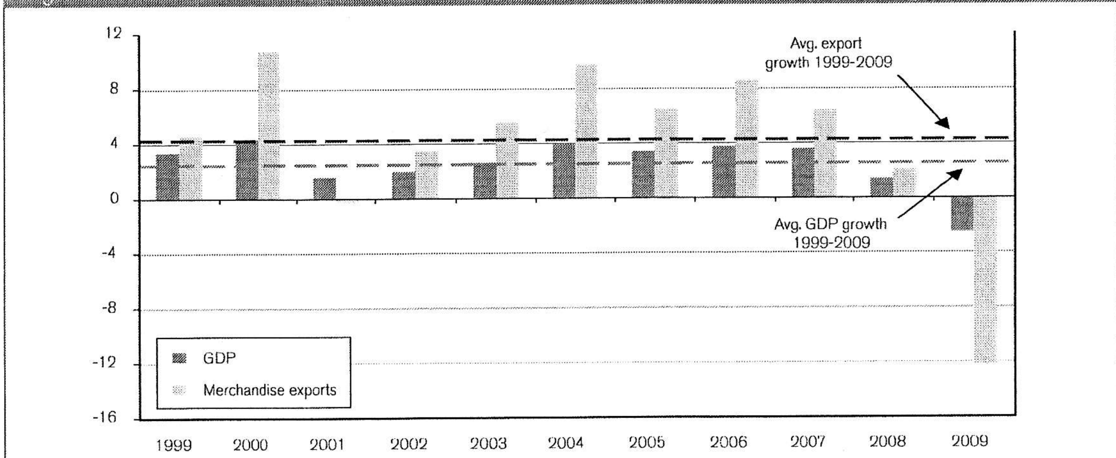
The United States (-13.9 per cent), European Union (-14.8 per cent) and Japan (-24.9 per cent) all saw their exports fall by more than the world average, but China's drop was smaller (-10.5 per cent). Collectively, the newly industrialized countries (NICs) experienced a relatively small decline in exports (-5.9 per cent) despite their vulnerability during the crisis due to the export orientation of their economies. The reduction in India's exports was also comparatively small (-6.2 per cent).

Table 2: GDP and merchandise trade by region, 2007-09 (Annual percentage change)

	GDP			Exports			Imports		
	2007	2008	2009	2007	2008	2009	2007	2008	2009
World	3.8	1.6	-2.3	6.4	2.1	-12.2	6.1	2.2	-12.9
North America	2.2	0.5	-2.7	4.8	2.1	-14.4	2.0	-2.4	-16.3
United States	2.1	0.4	-2.4	6.7	5.8	-13.9	1.1	-3.7	-16.5
South and Central America [a]	6.4	5.0	-0.8	3.3	0.8	-5.7	17.6	13.3	-16.3
Europe	2.9	0.8	-4.0	4.2	0.0	-14.4	4.4	-0.6	-14.5
European Union (27)	2.8	0.7	-4.2	4.0	-0.1	-14.8	4.1	-0.8	-14.5
Commonwealth of Independent States (CIS)	8.3	5.3	-7.1	7.5	2.2	-9.5	19.9	16.3	-20.2
Africa	5.8	4.7	1.6	4.8	0.7	-5.6	13.8	14.1	-5.6
Middle East	5.5	5.4	1.0	4.5	2.3	-4.9	14.6	14.6	-10.6
Asia	6.0	2.7	0.1	11.7	5.5	-11.1	8.2	4.7	-7.9
China	13.0	9.0	8.5	19.8	8.6	-10.5	13.8	3.8	2.8
Japan	2.3	-1.2	-5.0	9.4	2.3	-24.9	1.3	-1.3	-12.8
India	9.4	7.3	5.4	14.4	14.4	-6.2	18.7	17.3	-4.4
Newly industrialized economies (4) [b]	5.6	1.6	-0.8	9.0	4.9	-5.9	5.3	3.5	-11.4

[a] Includes the Caribbean.
[b] Hong Kong, China; Republic of Korea: Singapore and Chinese Taipei.
Source: WTO Secretariat.

Figure 8: Growth in the volume of world merchandise trade and GDP, 1999-2009 (Annual percentage change)



Source: WTO Secretariat.

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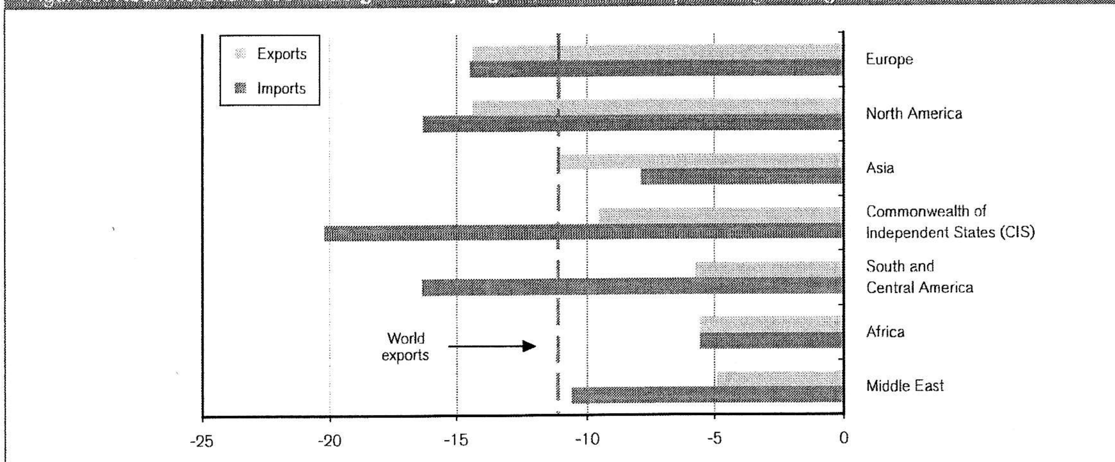
The situation was reversed on the import side, where the regions with the largest declines in 2009 included major exporters of oil and other natural resources – the CIS (-20 per cent) and South and Central America (-16.5 per cent – see Figure 9). This can be partly explained by falling export revenues as a result of lower oil prices in 2009. North America, Europe and the Middle East all saw their imports drop sharply (-16 per cent, -14.5 per cent and -10.6 per cent, respectively), but Africa and Asia only suffered single-digit declines (-5.6 per cent and -7.9 per cent respectively).

The declines in imports for the United States and the European Union (-16.5 per cent and -14.5 per cent, respectively) were greater than the world average, while Japan's drop was nearly equal to the world rate (-12.8 per cent). India recorded a relatively small drop in its imports (-4.4 per cent) while the volume of China's purchases from other countries actually increased (2.8 per cent). This increase can be partly explained by China's stockpiling of minerals and other natural resources while prices for these commodities were temporarily depressed.

Figure 9: **Real merchandise trade growth by region, 2009** (Annual percentage change)



Source: WTO Secretariat.

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