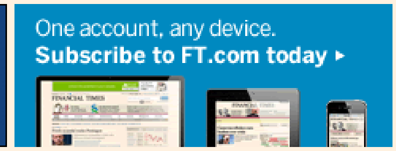

October 9, 2013 2:57 pm

Trade is the true test of the world's green shoots

By Ashoka Mody

A necessary amplifying force for the recovery is missing, writes Ashoka Mody


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Following its sixth consecutive downgrade of global economic performance, the International Monetary Fund's World Economic Outlook again projects a recovery around the corner. The government shutdown aside, news from the US has been encouraging; despair on the eurozone is abating; and the Chinese slowdown has been orderly. Green shoots have appeared before, only to disappoint. Might this time be different?

World trade is a helpful lens through which to monitor global economic health. The collapse of 2008-09 was triggered by a financial earthquake but transmitted across the world by a precipitous fall in trade. Early in the crisis, industrial production fell at the same pace as at the start of the Great Depression in 1929-30 – but the trade collapse was unprecedented. Looking into the abyss, world leaders mustered a co-ordinated stimulus to limit the fall. Yet the rebound was powered by the Chinese appetite for imports that accelerated global trade in 2010.

That was misread as the end of the crisis. In early 2010, the recovery was expected to propel world gross domestic product to more than 4 per cent annual growth over the next five years, higher than in the boom years of 2003-07. But GDP growth in 2013 will be less than 3 per cent. Private deleveraging, the shift from fiscal stimulus to austerity, and structural deficiencies – now more manifest – are to blame.

A crucial element of global forecasts was the view on world trade, which was projected to grow between 2011 and 2013 at an annual rate of 6 per cent, 1

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percentage point above its average over the past few decades. It has fallen short. For 18 months it has grown at a paltry annual rate of about 2 per cent.

Today the world economy is in an unusual phase: world trade growth is below world production growth rates. So a necessary amplifying force for a global recovery is missing. In fact, economic distress is being spread through global trade.

The eurozone is central to this dynamic. Though the global ripples are not as manifest as they were amid financial turmoil, they are real. European economies are among the most trade-intensive. As they have fallen into a stupor, their imports from each other have imploded.

But Europe’s economic size ensures its sharply reduced imports generate substantial global spillovers too. The effects have been felt directly in Asia, with which Europe has strong trade links. As Asia has slowed, so has the demand for commodities, sucking a larger group of emerging economies into this downward ambit.

In turn, weak world demand is exacerbating the domestic dysfunctions of emerging markets. Their resilience was applauded during the critical phase of the crisis. The IMF’s WEO just six months ago still viewed emerging economies as the new engine of world growth. But without the buffer of global demand, their longstanding structural problems have resurfaced. The sharp currency depreciations faced by Brazil, India, Indonesia and Turkey were a wake-up call.

Now the bets are again on developed economies. Yet today there is no global locomotive. Continued US recovery requires the same consumer-driven boom that led to the crisis. China must curb its excesses. Economic revival elsewhere awaits a boost from robust trade; but deep-rooted country stresses, magnified by global interconnections, hamper trade growth. There is little scope for further monetary activism and no appetite for fiscal stimulus. Politics everywhere is stymieing the pace of policy action, as the US government shutdown reminds us.

The global economy is barely moving forwards. The hope is that good news will jolt it into a self-reinforcing lift-off. But equally, bad news and policy errors could rapidly aggravate vulnerabilities.

History requires us to heed this warning. During the climb back from the Depression, world trade also grew at or below world production rates. Barry Eichengreen of the University of California, Berkeley, wrote that, without a co-ordinated global policy, each country needed time to heal its wounds before re-emerging as a productive contributor to world trade and growth. The healing happened in time – but, if the Depression started in 1929, we may still be in 1933, with a few years before global growth is robust. A quick change in that dynamic may prove elusive.

The writer is a visiting professor at Princeton University and a fellow at the Bruegel think-tank

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