World Trade: Pirated by the Downturn

World trade is often measured by the total amount of merchandise exports in the world in a given year. In real (inflation-adjusted) terms, world trade increased faster than world gross domestic product (GDP) in 49 of 58 years from 1951 to 2008 (see chart). For 2009, the World Trade Organization projects a decline in export growth of 9 percent, which would be the largest decline since 1951. This essay examines why 2009 will likely be a record-setting year.

The first explanation for this decline in world trade involves the current global recession. World trade declined in just five years—1958, 1975, 1981, 1982, and 2001—for the period under consideration. World GDP increased by 1.1 percent, on average, for these five years, which was substantially slower growth than the 3.8 percent average for the entire period. World GDP did not fall in any of the five years with trade declines; in fact, world GDP has increased every year from 1951 to 2008. For 2009, however, the International Monetary Fund and the World Bank are forecasting 1.4 and 2.9 percent declines in world GDP, respectively. When GDP declines, the demand for traded goods generally falls as well.

The second factor reducing trade flows follows from the current disruption of financial markets, which has tied up credit for international trade. The financial crisis has adversely affected both the availability of funds and the borrowing terms to finance international trade, which have contributed to declining trade volumes.

The third factor stems from the increasing importance of global supply chains. The recent increase in global supply chains, also termed “vertical specialization,” causes trade to rise at a faster rate than production because countries tend to specialize more in steps of the production process rather than in the complete production of a final product. With global supply chains, components and partially finished goods cross borders several times before a product is completed—increasing world trade. Thus, declining production will reduce trade even more in the current downturn than in previous downturns.

Governmental actions to favor domestically produced goods at the expense of foreign goods might turn out to be a final factor, although its effect has been minimal thus far. Without question, protectionist pressures increase during downturns. Yielding to these pressures by implementing trade restrictions on foreign products will reduce trade flows and likely prolong the downturn.

A post-World War II record decline in world trade is likely in 2009. Although piracy of a different sort remains an important issue for world trade, the “pirates” in the present case are the global slowdown, trade financing difficulties, and the increasing importance of global supply chains. Protectionism also lurks on the horizon.

—Cletus C. Coughlin

1 World exports measure world trade; one country’s exports are simply the imports of other countries.
2 A similar comment applies to trade in services, which is not examined in the current essay.
3 A recent article in The Economist (“The Rich and Restless Come Apart,” March 28, 2009, pp. 79-81) states that the credit crunch has caused a shortage of $100 billion in trade finance. Trade finance plays a role in 90 percent of world trade.

World Merchandise Export Growth and GDP Growth, 1951-2008

Growth (percent year/ year)

15
10
5
0
-5
-10
-15


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Notes

Euro-area Data: Euro-area countries are Austria, Belgium, Cyprus, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia, and Spain. Data series are broken and include all entries for countries with the exception of Greece; for the euro area without Greece, data for Greece are not included. For euro-area data, to avoid breaks in time series, for countries with exceptions, data for euro-area data are not adjusted for Greek government bond yields and budget deficit data do not include Slovakia, Cyprus, Malta, and Slovenia.

Euro-area interest rates prior to December 1999 are calculated on the basis of national government yield yields whereas after December 1999, short-term interest rates are euro interbank offered rates. Long-term rates are calculated on the basis of national government bond yields weighted by the nominal outstanding amounts of government bonds in each maturity band. The collardridge exchange rate used in the chart on page 12 is in a synthetic rate prior to January 1999. This is constructed from a weighted average of the exchange rate of the euro-area currencies, excluding Greece and Luxembourg, against the dollar. The weights are based on 1997 GDP shares.

German Data: As a result of reunification, data for all of Germany are now incorporated in the statistical series. The starting periods for updated German data are listed below. Care should be exercised when interpreting the data between these break periods.

First quarter 1999: stock exchange index.

Capacity Utilization covers the manufacturing sector for Canada, France, Japan, the United Kingdom, the United States, and the euro area; manufacturing, excluding food, beverage, and tobacco for Germany; and mining and manufacturing for Italy.

Consumer Price Index is for all items. The current index is based on goods and services consumed by all individuals for Canada, all multi-person households for France, all urban goods and services for Germany, all goods and services for Japan, all households except pensioners dependent on state pension and high income households for the United Kingdom, and all urban households for the United States. Data for the euro area, France, Germany, and Italy are based on the harmonized index of consumer prices.

Current Account Balance is the sum of merchandise and service exports and imports and invisible income accruing to domestic residents and foreign income accruing to domestic service providers and investment income from foreign sources in the domestic economy not including the euro area. For countries in the United Kingdom, the United States, and the euro area; hourly earnings in manufacturing excluding food, drinks, tobacco, and tobacco products for Canada; and hourly earnings in manufacturing for Germany, Italy, and France.

Real Earnings are based on hourly earnings in manufacturing for Canada, Germany, the United States, and the euro area; hourly earnings in manufacturing excluding food, drinks, tobacco, and tobacco products for Canada; and hourly earnings in manufacturing for Germany, Italy, and France.

Effective Exchange Rate is a weighted average index of the exchange rates of the euro-area currencies, excluding Greece and Luxembourg, against the dollar. The weights are based on 1997 GDP shares.

Reserve Money is in circulation, deposits of the deposit money banks, and demand deposits of other residents (with the exception of the central government) with the monetary authority.

Adjusted Monetary Base is Japan: currency in circulation and current and deposit accounts at the Bank of Japan.

Unemployment Rate is for the euro area, using data from the Eurostat database at the National Statistical Committee for European Union (NCS) at the Eurostat database at the National Statistical Committee for European Union (NCS) at the Eurostat database at the National Statistical Committee for European Union (NCS).

Notes and Coins in Circulation


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International Economic Trends

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Foreign Exchange Reserve data are end of period. The dollar value of reserves may fluctuate as a result of changes in reserve holdings and since the value of the currencies held varies with changes in the U.S. dollar.

Government Budget Balance is the difference between general government current expenditures and receipts and total outlays. Total outlays consist of current expenditures for goods and services, interest payments, and transfer payments to other general government units, the central government, and social insurance funds. Revenue includes taxation of the general government sector. The general government sector is defined as the central government, social security, and other social insurance funds. The current account of the central government sector includes all types of income, transfers, and capital transactions. The current account of the central government sector is calculated as the central government sector revenue less the central government sector expenditure. The central government sector revenue includes all types of central government tax payments and other income, such as imputed rent paid to government housing projects and income from the sale of government real estate. The central government sector expenditure includes all types of central government spending, such as for goods and services, capital investment, and transfers to households and other government units.

Climatic Inflation Differentiation is the cumulative change in the foreign consumer price index (CPI) over the change in the U.S. CPI in that particular. The base-quarter is the average of the calendar quarters in the base year. The cumulative inflation differentials that were used for the first period of the chart. For example, if the base period is 2000-Q1, then the cumulative inflation differential for Japan is 2000-Q3 as follows:

\[
\text{cumulative inflation differential} = \frac{\text{foreign CPI in period} - \text{foreign CPI in base}}{\text{U.S. CPI in period} - \text{U.S. CPI in base}}
\]

Retail Sales are index numbers of the weighted average of the CPIs of countries where these data are available. The U.S. CPI is used as the trade exchange rate index. Starting in 1999, the euro-area harmonized consumer price index is used for the euro area. Prior to 1999, the price levels for the individual euro-area countries (excluding Greece and Luxembourg) are used. The cumulative inflation differential is shown because the theory of purchasing power parity states that exchange rates should change by systematically positively related to this variable.

Industrial Production measures the change in the volume of output in the mining, manufacturing, electricity, gas, and water industries.

The Short-Term Interest Rate is on page 4-13 the relevant 3-month interest rate shown in the country pages.

The Long-Term Interest Rate is on page 4 the government bond rate. The government bond rate is a composite of yields on federal bonds with maturities of more than 10 years for the United States, 10-year benchmark bonds for France; 7-to-15-year benchmark bonds for Germany; 10-year to 20-year bond yields from 1990 to 1990 government bonds starting in 1999 for Italy and 10-year government bonds for the euro area, Japan, and United States.

The Reserve Money on page 4 refers to the adjusted monetary base for Japan and the United States; reserve money for Canada; and M2 for the United Kingdom. Reserve Money is currency in circulation, deposits of the deposit money banks, and demand deposits of other residents (with the exception of the central government) with the monetary authority.

Adjusted Monetary Base is Japan: currency in circulation and current and deposit accounts at the Bank of Japan.

Unemployment Rate is the labor force minus the number of unemployed as a percentage of the labor force.

Unemployment Rate is for the euro area, using data from the Eurostat database at the National Statistical Committee for European Union (NCS) at the Eurostat database at the National Statistical Committee for European Union (NCS).
International Economic Trends

**International Trade - Goods and Services**

Percent of GDP

**Current Account Balance**

Percent of GDP

**Foreign Exchange Reserves**

Billions of US$

**Real Effective Exchange Rate**

Index 2005 = 100

**Canada**

**Real GDP**

Percent change from year ago

**Employment**

Percent change from year ago

**Consumer Price Index**

Percent change from year ago

**Unemployment Rate**

Percent

**Real Hourly Earnings**

Percent change from year ago

**Current Account Balance**

Percent of GDP
International Economic Trends

Canada

Reserve Money
Percent change from year ago

Interest Rates
Percent

10-Year Government Bonds

90-Day Prime Corporate Paper

Exchange Rate and Inflation Differential

Foreign/US Inflation Differential (left scale)

Exchange Rate (right scale)

Real Effective Exchange Rate
Index 2005 = 100

United States

Real Hourly Earnings and Output per Worker
Percent change from year ago

Hourly Earnings

Output per Worker

Labor Force Indicators
Percent change from year ago

Unemployment Rate (left scale)

Employment (right scale)

Inflation
Percent change from year ago

Consumer Price Index

Producer Price Index

Gross Government Debt and Budget Balance
Percent of GDP, annual data

Budget Balance

Gross Debt

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