STRATEGY FOCUS

Globalisation : Recent trends and consequences

- **No sudden halt to globalisation so far.** The Covid crisis and geopolitical tensions have reinforced protectionist measures on international trade and financial flows. At the same time, several announcements of the implementation of "national" industrial policies by the major economies fuelled fears of an abrupt halt to globalisation. However, to date, data show a different picture, with a still very high level of trade and financial exchanges.

- **A globalisation changing in terms of dynamics and geography.** While the overall level of trade remains very high, we can nevertheless make several observations:
  - **Globalisation may have peaked.** While the dynamics of trade in goods and investment flows still appear to be high, the number of restrictions is increasing and is likely to imply less momentum in the future.
  - **Remapping supplier countries.** While the volume of trade in goods remains high, the United States has redirected some of its imports or investments from China to countries close (nearshoring) or friendly (friendshoring). In Europe, on the other hand, China is gaining market share in manufacturing imports at the expense of Eastern and Central Europe.
  - **While China retains an important trade role, it appears to be clearly penalised in terms of new investment flows,** which could ultimately weigh on its growth prospects.

- **Consequence #1 - Structurally higher inflation:** Globalisation may not be halted but it will clearly be a weaker force going forward than in the past. This is likely to mean less imported deflation and therefore structurally higher inflation – and hence interest rates – in developed economies.

- **Consequence #2 – A reordering of emerging market performances.** The phenomenon of nearshoring/friendshoring will continue to favour new regions to the detriment of China, with consequences to be expected on equity markets.

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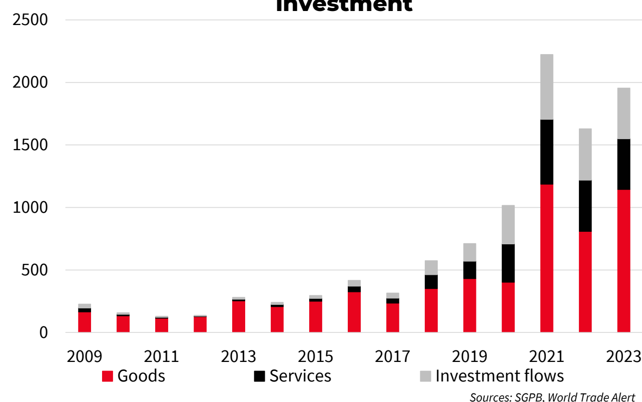
RISE IN PROTECTIONISM AND RESURGENCE OF NATIONAL INDUSTRIAL POLICIES

The economic phenomenon of "globalisation" gained momentum in the 1990s and consisted of a reduction in tariffs, in constraints/norms on trade in traded goods and the liberalisation of financial flows. This globalisation has been reinforced with China's entry into the WTO as well as the integration of Eastern European countries into the European Union. This has resulted in strong growth in trade in manufactured goods, significant development of value chains in several countries, and increased direct investment flows to emerging economies.

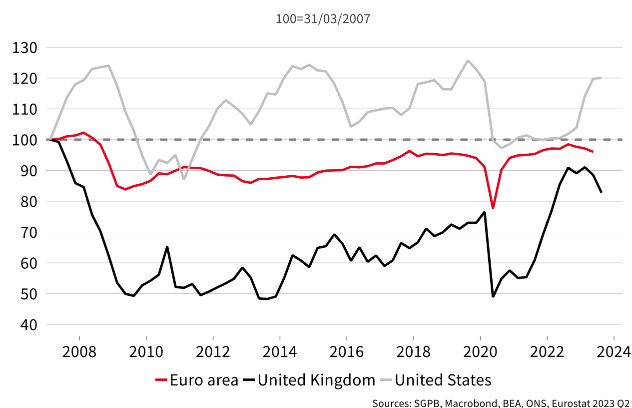
However, since the financial crisis of 2007 but especially since the election of Donald Trump in 2017, the number of restrictive measures (tariffs, standards, export or investment restrictions) on trade in goods and services but also on investment flows has increased significantly (**Chart 1**). Indeed, according to the IMF, the number of trade restriction measures stood at around 200 per year (net), before increasing to more than 500 in 2018 and exceeding 1500 since 2021. Beyond the numbers, their nature has also changed. They mainly concerned small and medium-sized economies and focused mainly on commodity trade. However, since Donald Trump's term in office, protectionist measures have multiplied against large economies and concern manufactured goods. The Covid-19 crisis, the continuation of trade tensions between the United States and China (with the expansion to high value-added sectors such as semiconductors) and geopolitical fragmentation have resulted in a sharp increase in protectionist measures, and it is likely that this trend will continue in the coming years. The European Union has recently started to put in place restrictive measures, especially in sectors considered strategic such as the energy transition.

Alongside protectionist measures, national industrial policies (defined here as efforts by governments to shape the economy by targeting specific industries, firms, or economic activities) have made a comeback in most developed economies. Indeed, governments are putting in place more and more measures to promote the relocation of the production of certain industrial goods but also the development of new technologies (such as semiconductors) and new energies. The IRA in the United States and the European Green Deal are the best examples. To date, the impact of these policies is already visible in the United States and the United Kingdom (**Chart 2**), where investment in new manufacturing plants is very dynamic and has accompanied the strong recovery of the economy. These investments are being made despite the high interest rate environment

C1. Net number of restrictives measures on international trade and international investment



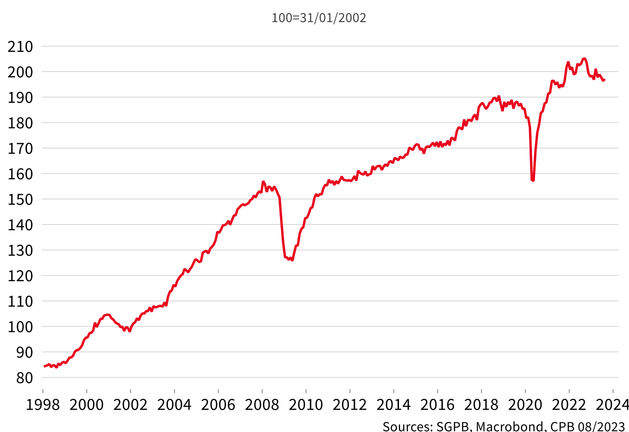
C2. Investment in manufacturing and energy facilities

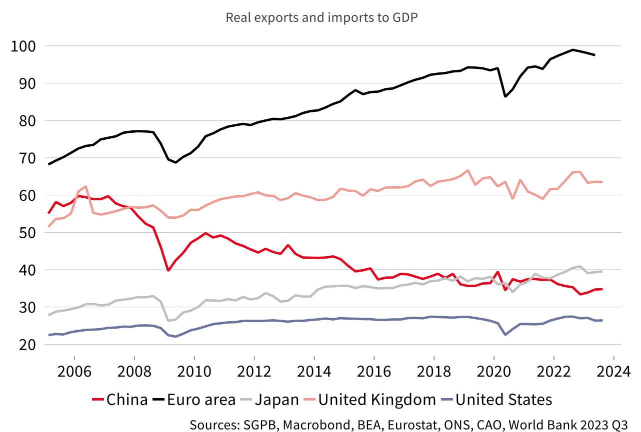


GLOBALISATION BY THE NUMBERS: A PEAK RATHER THAN A DECLINE (WITH THE EXCEPTION OF CHINA)

Despite increases in protectionist measures in recent years, international trade has grown significantly since the Covid-19 crisis (**Chart 3**). Indeed, the level of international trade in volume terms reached a first peak in 2018-2019, concomitant with the increase in protectionist measures. However, while it collapsed with the Covid crisis, global trade then experienced a strong recovery, returning to its pre-Covid level in October 2020 and recording growth of 5% on average in 2021 and 2022. This strong growth reflects the rapid economic recovery of major economies following the lifting of health restrictions. Indeed, in the United States, imports in volume of consumer goods recorded growth of 18% and 10% in 2021 and 2022 respectively, in line with the strong recovery in household consumption. In the euro area, imports of consumer goods also increased significantly in 2022 (+10% in volume) in line with the lifting of health restrictions. In 2023, international trade momentum seems to be peaking, with a slowdown over the recent period, but which at this stage reflects the slowdown of the major economies rather than a trend towards deglobalisation.

The peak of globalisation can also be seen in the trade openness ratio of the major economies (**Figure 4**). Indeed, this ratio, which measures the weight of exports and imports in GDP, is at its highest since the 2000s. The euro area is the region where the ratio has increased the most since 2019, with a level close to 100% at the end of 2022. This not only reflects the strong trade integration of the common currency area (especially with the economies of Eastern Europe) but also the post-Covid recovery in consumption. In the UK, the openness ratio has gradually increased to 60% and has been stable since 2016, even in the wake of Brexit. In the United States, the most closed economy in terms of trade, the openness ratio gradually increased during the 2000s from 19% to 27% in 2022. The introduction of trade restrictions vis-à-vis China has resulted in only a modest reduction in the rate of opening. Thus, the only major economy that is indeed "deglobalising" is China. Indeed, despite still significant trade surpluses, the openness ratio has fallen significantly, from nearly 60% in 2007 to 34%. This decline reflects the change in China's economic model after the Lehman crisis, where the country's economic recovery has resulted in real estate investment (and therefore domestic) rather than external demand.





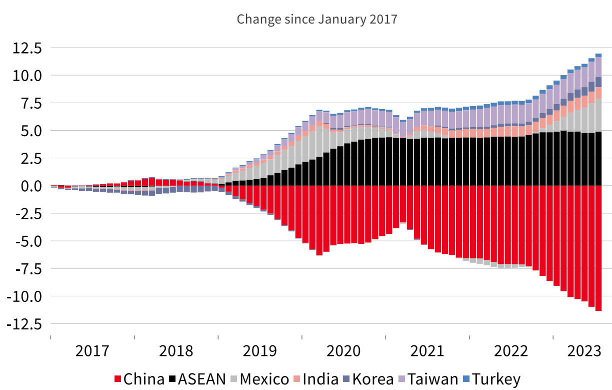
A SIGNIFICANT CHANGE IN THE GEOGRAPHY OF "SUPPLIER" COUNTRIES

The aggregate figures reveal little change in the overall globalisation trend other than suggesting we have recently passed a peak. But, looking beneath the headline numbers, the protectionist measures have been radically remapping the world's value chains.

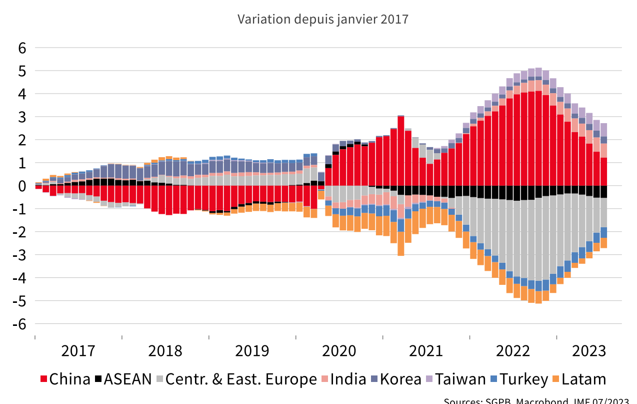
These changes are most noticeable in the United States, where data show a real decoupling from China. Indeed, since the election of Donald Trump, the United States has multiplied protectionist measures against Chinese trade and investment. This translates into lower imports from China, offset by higher imports of goods from other emerging economies (**Chart 5**). Thus, at the beginning of 2017, China accounted for 37% of the United States' imports of goods from emerging industrial economies*. This share decreased by more than 10 points, to 26% in July 2023. On the other hand, the market share of ASEAN economies increased by almost 5 percentage points over the period to 17%. Mexico has also gained market share since 2017 with an increase of 3 points and thus becomes once again the leading emerging "supplier" to the United States (27% of total imports from emerging industrial economies). Finally, India – whose economy is often seen as a winner in trade tensions due to the size of its economy and its specialisation in the new technology sector – gained just 1 point of market share. The escalation of tensions between the United States and China should imply the continuation of these trends in the geographical evolution of the countries supplying the United States.

While China has lost market share in the United States, it has regained some of it in Europe (**Chart 6**). Indeed, China has made significant gains since the Covid crisis. Between 2020 and 2022, it gained nearly 4 points of market share, to represent 37% of Europe's "emerging" imports and thus became the leading "supplier". This reflects the decline in imports from Eastern European economies, which have been penalised by the loss of competitiveness linked to the energy shock. It also reflects the increase in the consumption of goods related to the energy transition (solar panels, electric cars) from China and has resulted in a widening of the bilateral trade deficit. It can be noted that in 2023 this imbalance with the EU will be slightly reduced, both due to the introduction of protectionist measures for certain strategic sectors and the renewed competitiveness of Eastern European economies. However, at this stage, trade policies and trends do not suggest as sharp a decoupling between Europe and China as in the United States.

C5. United States: Change in the imports market share of industrial EM



C5. Euro area: Change in the imports market share of industrial EM



**: China, India, ASEAN, Korea, Taiwan, Turkey, Mexico, Brazil, Eastern and Central Europe*

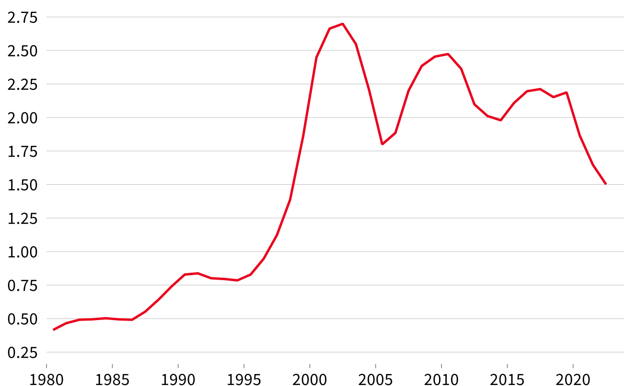
INTERNATIONAL CAPITAL FLOWS ALSO SUGGEST GLOBALISATION HAS PEAKED

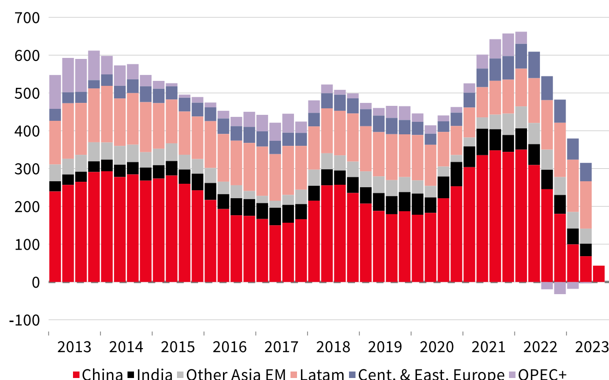
In contrast to trade flows, international capital flows show a clear downward trend, particularly vis-à-vis China. It is important to note, however, that while new investment flows to emerging economies are declining, they are not negative, which means that companies are not withdrawing. These figures thus confirm a peak in globalisation rather than a decline.

Foreign Direct Investment (FDI) shows a clear downward trend. These flows, which consist of purchases of shares in companies or the installation of production units abroad, perfectly illustrate the globalisation of the 20th century, with a significant increase from the 1990s to 2007 (**Chart 7**). These flows rose from an average of 0.8% of global GDP in the 1900s to more than 2.5% of global GDP in the 2000s. However, a downward trend has clearly emerged since the financial crisis, with an acceleration of the decline since Covid-19, with FDI around 1.2% of GDP since 2020.

A significant part of this decline corresponds in fact to changes in the taxation of developed economies. Indeed, the passage of the Tax Cut and Job Act (TCJA) in the United States in 2017 resulted in a sharp reduction in FDI to the European Union. However, this reduction mainly concerns flows to the Netherlands and Ireland, jurisdictions where companies repatriated part of their profits for the purposes of tax arbitrage, and therefore does not represent a drop in "real FDI". As a result, flows to these economies have collapsed from an average of USD 250 billion per year before 2018 to a negative average since 2018. Outside these jurisdictions, FDI to developed economies remains stable, with flows to the United States still robust (USD 300bn on average over the last 5 years).

Another important factor explaining the downward trend in FDI is the sharp slowdown in flows to emerging economies (**Chart 8**), particularly to China. This decline is mainly the result of trade tensions with the United States. Indeed, the restrictions put in place by the United States relate in particular to investments in China in several strategic sectors. In addition, the reorganisation of value chains following the Covid-19 crisis is also contributing to the decline in new investment flows into China. This decline was not offset by an increase in FDI to other emerging economies. In particular, FDI flows to India have remained broadly stable so far. In Latin America, FDI flows are on a slightly upward trend, reflecting an increase in FDI in the manufacturing sector but also in commodities sectors.





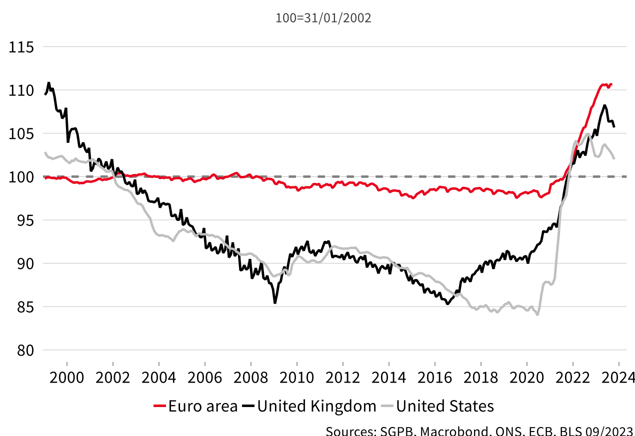
TOWARDS MORE INFLATION IN DEVELOPED ECONOMIES AND A RERANKING OF EMERGING EQUITY MARKETS

A confirmation of the peak of globalisation would imply structurally higher inflation in developed economies..., notably via the price dynamics of durable goods (such as cars, home equipment,...). Indeed, since the end of 2001 and China's integration into the WTO, durable goods prices have fallen sharply in most major economies (**Chart 9**). In the United States and the United Kingdom, these price declines have been particularly strong, with contractions of nearly 15% between 2002 and 2020. In the euro area, the price of durable goods has also fallen, but to a lesser extent. Thus, the strong globalisation of the 2000s was accompanied by a sharp decline in the prices of durable goods and contributed to the moderation of inflation during the years 2000/20. The Covid-19 crisis and the disruptions to value chains that it entailed, as well as the subsequent increase in tariffs, stopped this deflationary trend. Durable goods have since seen very significant price increases. In the future, in an environment where globalisation is at its peak, durable goods inflation will remain higher and more volatile than before. As a result, inflation would be structurally higher, implying interest rates that would also be higher than in the past**.**

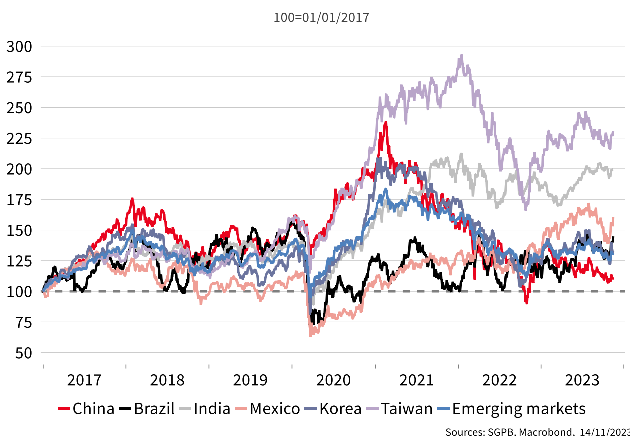
The geographical shift of globalisation would continue to lead to a reordering of the performance of emerging market equities. Indeed, since the beginning of the trade tensions between the United States and China, the equity indices of the main emerging economies (**Chart 10**) have been moving according to their potential gain in the reorientation of supplier countries, particularly in favour of countries that can benefit from "friendshoring" (reorientation of offshoring to "friendly" countries). While FDI flows to India do not yet show a phenomenon of friendshoring, the performance of the equity market is one of the best among emerging markets, surpassed only by that of Taiwan. This performance certainly reflects the good growth momentum and the various structural reforms implemented in the country, but it also illustrates the bet that India (due to its population and demographic dynamics) could welcome manufacturing investments that are no longer going to China. Several U.S. companies, previously based in China, have already announced the installation of new production plants in India.

The Mexican market is the other equity market that has outperformed since the Covid crisis, clearly benefiting from the USMCA free trade agreement with the United States and Canada. In contrast to the performance of India and Mexico, the Chinese equity market appears to be penalised for a long time, as these developments in global trade add to the structural slowdown in its growth and the persistence of tensions in its real estate market.

C9. Durable goods price indices



C10. EM equity indices in USD



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