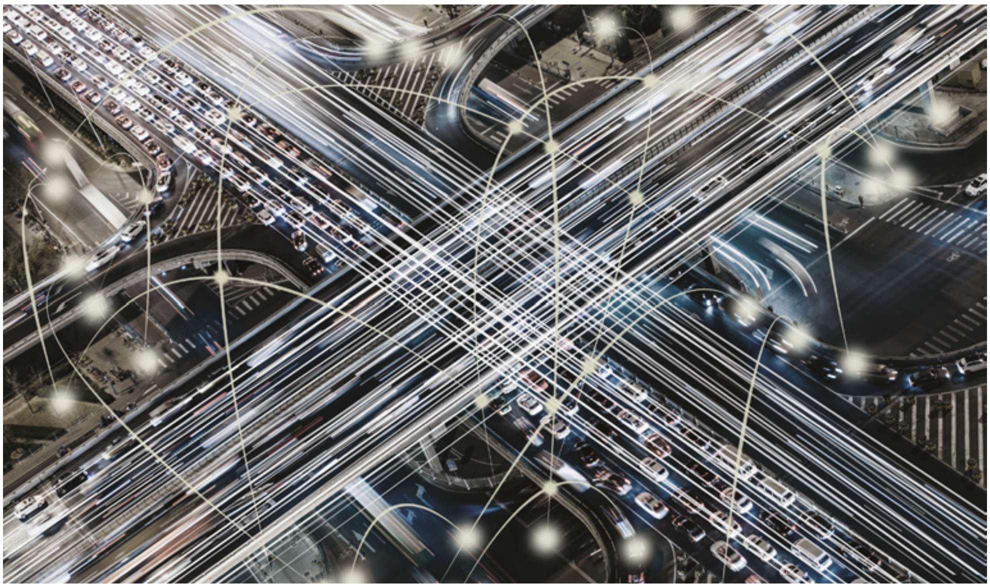
Perspectives

1st quarter 2023

The future of globalisation



IHAG PRIVATBANK

A concept faces headwinds

Dear investor

On 22 January 1970, the US aviation company PanAm brought the first Boeing 747 aircraft into service. It would later be widely referred to as the "Jumbo Jet". Thanks to significantly greater passenger capacity and technological advances, these planes could be operated at a 30% lower cost per passenger. This in turn paved the way for the democratisation of air travel – flying having previously been the privilege of the wealthier classes.

Thanks to its broader use, greater range, and more direct connections, the "747" also came to epitomise globalisation in its modern guise: countries were brought closer together, goods and services could be exchanged across wider distances, borders became blurred and cultural exchanges were intensified.

In theory, globalisation is the simple and logical embodiment of economic optimisation; in practice, it has also given rise to many problems and negative effects. When countries concentrate on the production of goods in an area in which they have a cost advantage, and then trade these goods for those of other countries that likewise focus on particular areas in which they enjoy a cost advantage, it ultimately works to the benefit of all countries – quite irrespective of a country's state of development. Thanks to the focus on cost advantages in each country, a larger cake is baked – and through trading, each country ultimately gets a larger slice than if they had done all the work in their own bakery.

In the past, globalisation was favoured by many different factors: alongside continuous political integration and the end of the "two-block" world, open trading zones were created and obstacles to trade were consistently removed through tariff reductions. With the rise of the internet and its globally integrating characteristics, globalisation then enjoyed a further strong boost until finally peaking – in both trade volume and trade value terms – in the years prior to the financial crisis of 2008.

However, globalisation has faced increasing headwinds ever since. On the one hand, negative side-effects have given rise to political pressure, while on the other, both the conflict between Russia and Ukraine and measures to combat the global COVID pandemic have highlighted the vulnerability of the global trade system. Below we take a look at what drives globalisation, why it is increasingly losing momentum, and what this means for us as investors.

Incidentally: in February 2019, Airbus "clipped the wings" of its A380 superjumbo, which had in any case originally been designed for an even larger aircraft, by announcing an end to production. Moreover, the very last Boeing 747 is also about to roll off the production line. An era is coming to an end – and so too perhaps the era of untrammelled globalisation.

We wish you an enjoyable read.

Christoph Boner
Chief Investment Officer

When global growth comes up against its limits

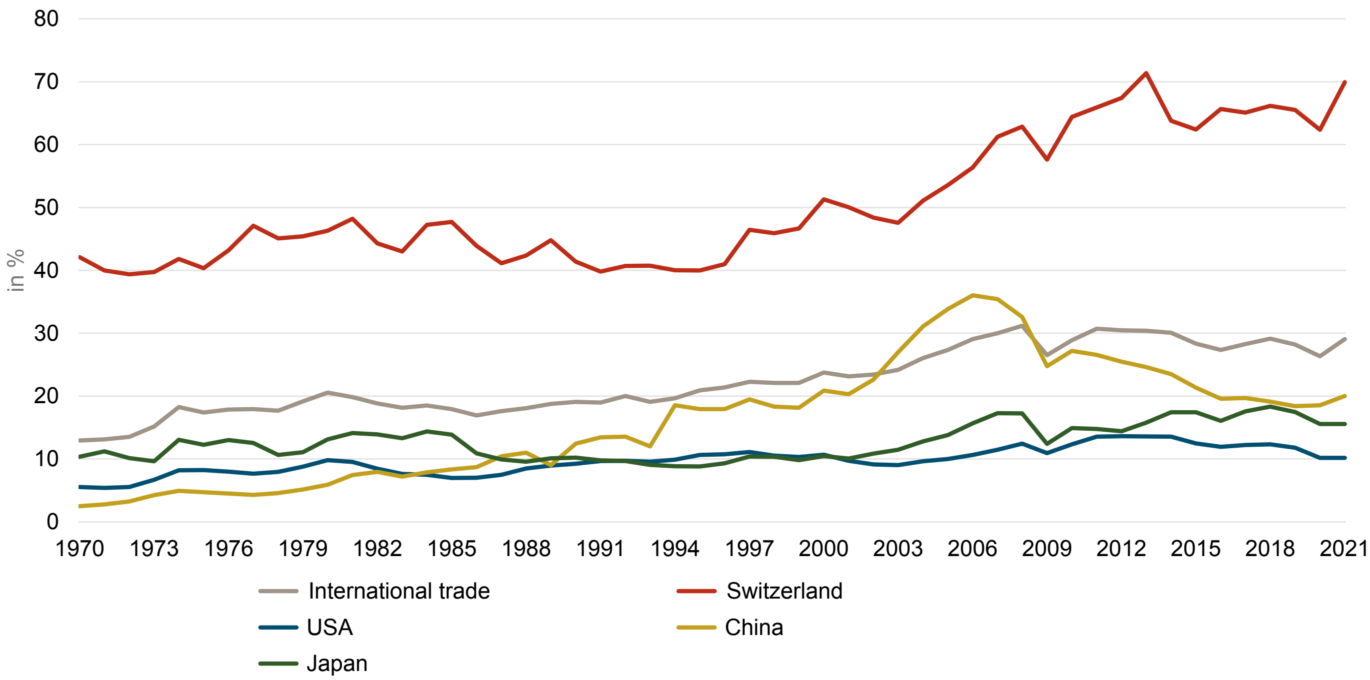
Globalisation in its modern guise began with the economic upturn following the Second World War. After the fall of the Iron Curtain and the quantum leap in technology thanks to the possibilities opened up by global networking via the internet, it then enjoyed a further unprecedented boom in the 1990s and the first decade of the new millennium. The peak point of globalisation can be pinpointed in the years leading up to the financial crisis of 2008. Since then, any number of crises and shocks have buffeted global trade. The financial crisis of 2008, the US-China trade war, Brexit, the omnipresent restrictions during the pandemic, and most recently the outbreak of the Russia-Ukraine war have all led to declines in the global trading of goods and services, in some cases of a dramatic nature.

The global volume of exported goods and services as a proportion of global gross domestic product (GDP) stood at 29% as of the end of 2021. The figure had risen continuously from 12% in 1970 to a peak of 31% in 2008. This development was driven not least by China, whose international trade as a proportion of economic output has increased tenfold from just 2% half a century ago to 20% today – after peaking at 36% in 2006. Even more domestically-oriented countries such as the US and Japan have seen a steady rise in the relative importance of international trade – even though their most recent shares (as at the end of 2021) are some way off their peaks at 10% and 16% respectively. For open economies, international trade‘s share of GDP is currently at record levels. In Switzerland, it now stands at 70%, although – rather contrary to the trend – this figure is still close to its peak of 71%.

The relative decline in global trade has a number of underlying causes. The financial crisis led to an increased repatriation of funds invested abroad, while trade disputes – most notably between the US and China – and Brexit have been heavily shaped by domestic politics. Also, shocks such as the COVID containment measures and the Russia-Ukraine war have fundamentally obstructed international trade, in some cases significantly. Security considerations – whether relating to national security or supply security – ultimately play an important role here too.

Longer-term trends such as the convergence of the level of industrial development of emerging nations with those of Western economies, the internalisation of environmental and transport costs, and ongoing technological developments that have the effect of reducing the need for labour are further factors preventing any resurgence of globalisation.

International trade as a percentage of GDP



The WTO (World Trade Organisation) is a multilateral organisation whose fundamental purpose is to support global trade by pushing for the reduction of tariffs and trade barriers, as well as institutionalising mechanisms for resolving trade disputes. However, this organisation has lost much of its potency in recent years against a backdrop of a multi-polarised world in which its chief cheerleader – the US – is losing not only its power to drive globalisation but also its interest in doing so.

Above and beyond the developments described above, two further aspects deserve particular attention: with the growing integration of the global economy, we have seen a certain amount of (economic) equalisation, which essentially reduces the potential for international trade. In addition, the development of the global economy is going hand in hand with a structural shift away from goods and towards services, which by their nature are less likely to be traded across borders. Ultimately, the expansion of international trade as a proportion of economic output is likely to be an asymptotic development – so while there is probably further scope for increases, there will also be a natural ceiling.

2008

represented a peak in globalisation in terms of international trade as a proportion of total economic output. In that year it reached 31%, a figure that has not been matched since.

70%

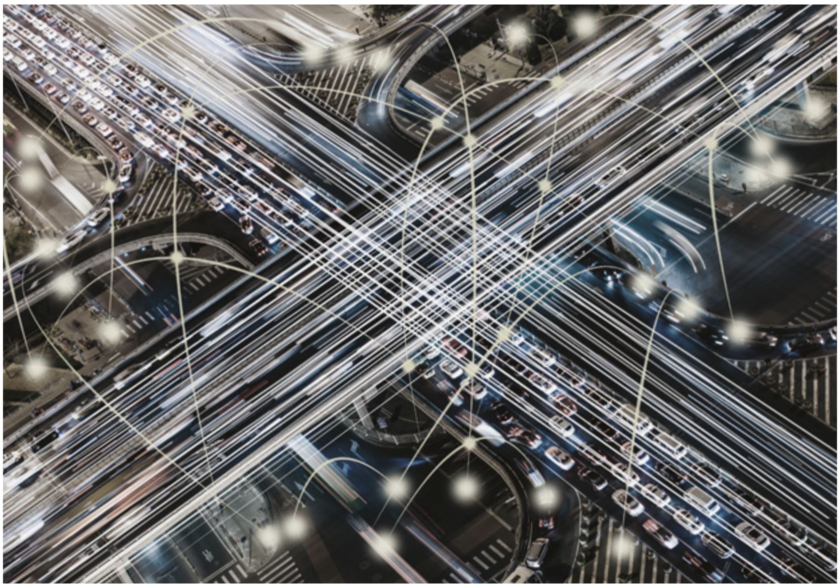
International trade accounted for 70% of Swiss GDP. The figures for countries such as Luxembourg, Hong Kong and Singapore are around 200%.

Regional trade simplifications as a future trend

The motivation to trade across borders is obvious. But equally obvious are the potential problems this can give rise to. Whereas in the past the primary focus was on cushioning these effects with parallel measures, the preferred option in the current environment is to reduce cross-border trade. Trade barriers are being raised, isolationist initiatives are being pursued for political reasons, and findings in respect of dependencies and risks are attracting plenty of attention. Last but not least, cultural and environmental factors have also been brought into the discussion on the pros and cons of global trade in recent years.

That said, it would be very wrong to assert that a process of de-globalisation is taking place. Nor is there any evidence of individual countries or regions committing themselves wholly to autarky; the economic benefits of cross-border trade are too great notwithstanding the restrictions that are being imposed.

The slowdown in (and reduction of) global trade will entail a slowdown in global growth. More importantly, an increasing fragmentation of trade is conducive to rising inflation. These two effects are currently putting markets under pressure, but are manageable for now at their current intensity.



It became evident in the aftermath of the financial crisis of 2008 that new regulatory barriers were being raised, with a resulting slowdown in financial integration. The effects of waning globalisation are likely to be more last-ing.While institutionalised multilateral integration through an organisation such as the WTO can be expected to weaken due to the decline in the relative significance of the US, commercial forms of interaction in the future will increasingly take the form of trade simplifications on a multilateral, selective and regional basis. However, the US dollar will remain the dominant global currency for the foreseeable fu-ture due to the sheer size of America‘s financial markets and the enduring preference for the greenback as a unit of account.

Globalisation will evolve more slowly – and more deliberately

Christoph Boner
Chief Investment Officer

What should we understand by the term globalisation?
Essentially, globalisation stands for the process of interaction and integration between individuals, companies and government institutions on a global basis. In a narrower economic sense, the term globalisation means the global exchange of goods, services and capital. In a modern definition of the International Monetary Fund (IMF), the key aspects of globalisation include not just trade, but also shifts in capital, migration movements and the dissemination of knowledge.
Although international trade was prevalent even before the Age of Discovery in Europe (15th to 17th centuries), broad-based globalisation can only be really said to have taken hold with the emergence of technological developments in the course of industrialisation – the invention of the steam engine and the telephone, for example. But the real surge in globalisation came after 1990 with the end of the "two-block" geopolitical situation and the rise of the internet.

So where does the economic argument for globalisation lie?
The theoretical basis for the economic added value of globalisation lies in the concept of comparative advantage – which means simply the allocation of labour on a greater scale in order to maximise the overall economic result. Comparative advantages exist because not all countries have the same (economic) parameters: if every country focuses on the goods and services that can be produced/delivered particularly efficiently, the resulting outcome is increased supply. This increased supply can be exchanged through international trade, so that every country has recourse to more goods and services in net terms than would be the case if it produced and delivered these itself – i.e self-sufficiently.

What negative repercussions can globalisation unleash, and how can these be mitigated?
Focusing on the production and delivery of goods and services with a corresponding comparative advantage can also give rise to a number of negative effects:

- Areas and industries with a comparative disadvantage in a given country will suffer, as the corresponding goods and services can be obtained more cost-efficiently from abroad. To avoid further-reaching problems as a result of such shifts in the structure of an economy, the corresponding areas can be compensated by parallel measures, or the commercial viability of these areas can be protected by tariff and other such barriers.

- In addition, concentrating on selected areas can lead to an economy becoming lopsided, which – aside from social and environmental problems – can also produce wider negative effects such as dependencies and risks to (national) security. While certain areas of an economy may, for example, deliberately not be internationalised for reasons of security and be supported (for instance) through subsidies, other forms of state intervention can help to prevent unhealthy imbalances.

- Concentrating on just a few goods and services will directly give rise to dependencies on external sources in other areas. As touched on above, for the division of labour to work effectively, trade between countries needs to function smoothly and trade barriers need to be kept to a minimum. This is ultimately the reason why the WTO – or GATT as it was once known – was founded. Its objective is to lower trade barriers at a multilateral level and institutionalise procedures, thereby facilitating the resolution of any disagreements over trading matters.

What is the current status of globalisation, and what should we expect over the next few years?
Globalisation has gained huge momentum since the early 1990s. Political integration, institutionalisation of trading relationships, technological advances and low energy costs have allowed global trade to flourish. It should also be noted that globalisation has had the effect of putting downward pressure on prices, which explains why inflationary pressure stayed low for 15 years until very recently, despite an excessive money supply.

Political pressure – both domestic and foreign – and increasing awareness of trading dependency issues have led to a sharp slowdown in globalisation in recent years, and in some cases to its reversal. The term used in this context is "de-globalisation".

Globalisation as such will continue. However, the efficient multilateral forms of globalisation will in many cases be replaced by bilateral, regional or selective integration agreements. Either way, any continued globalisation in the future will take place in smaller and more deliberate steps.

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