

The Big Drop – Trade and the Great Recession

Joseph F. Francois

Johannes Kepler University (Linz) and CEPR (London)

Julia Woerz

Oesterreichische Nationalbank (Vienna)

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Recent trends in trade have invited a mix of consternation and hyperbole in the business and economics press and blogosphere alike. Discussion has ranged from worries about export credit shortfalls to resurgent import protection. The focus has been on finding the cause, and the assumption has been that the collapse in trade is unprecedented, inconsistent with the general level of economic downturn, and indicative of a trade-related set of problems calling for trade-specific solutions. There are indeed important public policy questions here. Is this recession being confounded by a set of trade-specific problems and issues? If so, how big, and should we be worried?

In confronting these questions, we need to be careful when comparing real and nominal changes in trade. The last 12 months have seen a dramatic drop in commodity prices, so that real and nominal trade data can tell a very different story. In addition, because the importance of various sectors in trade varies from their importance in GDP, and also varies considerably across countries, we also need to pay close attention to how we deflate trade flows to control for falling prices across a range of commodities. We also need to examine what is happening to domestic production (specific elements of GDP) before deciding we have a mismatch between trade and GDP trends.

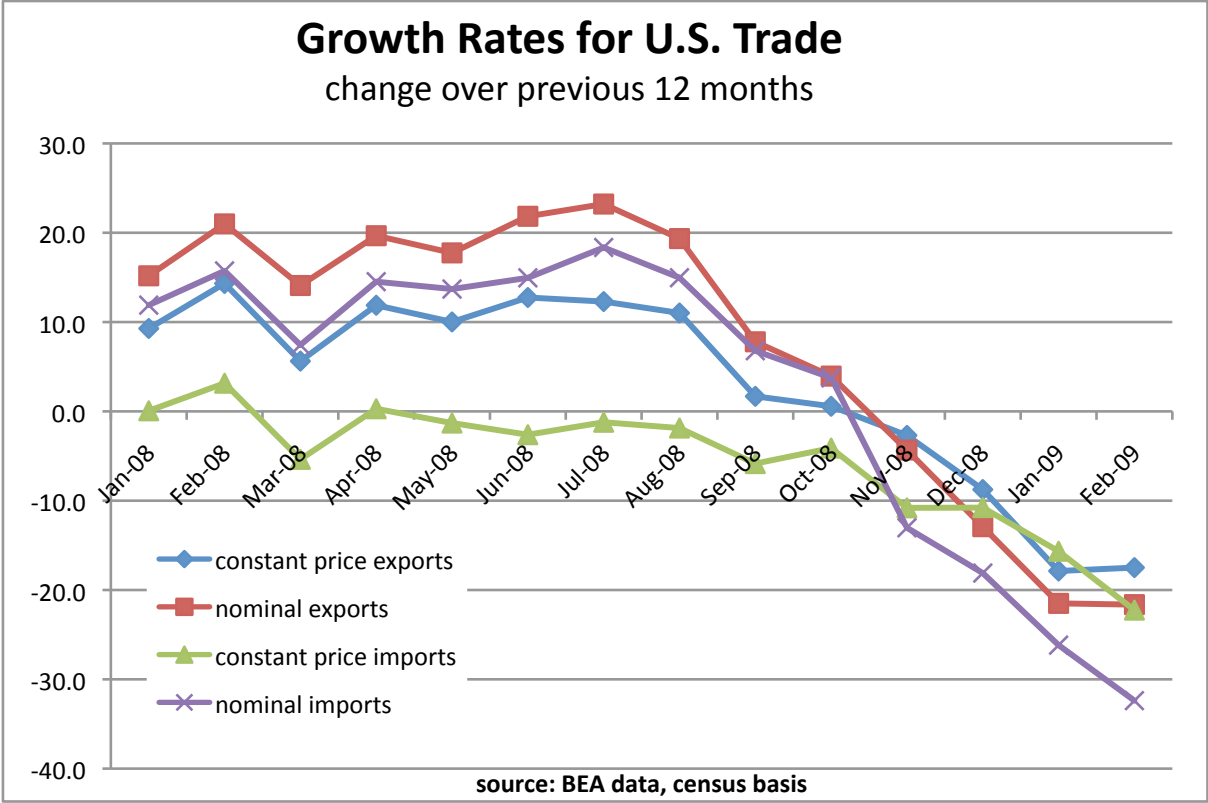
Global trade plummeted in the last months of 2008. Indeed, world trade volumes fell 13.7% from December 2008 to February 2009. (This is somewhat better than the November-January drop of 17.5%, reflecting a 0.8% rise in February.) In the three months ending in February, Japanese exports were down 29.1%. EU15 exports were up 0.3% in February over January levels, after falling 2.3 percent in December and 5.3 percent in January. (CPB World trade monitor from April 21, 2009). The projections for the entire year 2009 offer little comfort. The WTO has forecast a 9% decline in global export volumes for 2009.

When digesting this information, the arcane question of appropriate price deflators is important. Real trade figures can vary substantially according to the underlying prices used for deflating the data. The recent, highly cited WTO-figures rely on world GDP prices. There are problems with this approach. GDP includes a high share of non-traded components. Trade prices have fallen considerably, not least due to the large decline in oil prices. According to the CPB, energy prices were down 51.1% in the 4th quarter, compared to the 3rd. Consequently a smaller real drop is to be expected when deflating the value of trade flows with trade prices. The CPB figures quoted above are based on world trade price developments. In a modelling exercise by the French Centre d'Études Prospectives et d'Informations Internationales (Bénassy-Quéré et al. 2009) these differences are illustrated very clearly with trade falling – under identical scenarios concerning world GDP growth – by 8.9% when deflated by the GDP deflator and only by 1.7% when using constant trade prices. Thus, a large part of the story hinges on global price developments. Nominal EU-27 exports grew by 3.1% in 2008, while in real terms

they had already fallen by 0.9% over the year due to the oil-price hike and subsequent fall that ran through 2008. Interestingly this comes from falling real intra-EU exports (-2.3%), while extra-EU exports still grew in real terms (by 3.6%) in 2008. In the US, nominal exports grew by as much as 12.4% in 2008, but with 6.4% only half as much in real terms.

What is striking is the rapid drop in trade in the second half of 2008. This is shown in the figure below. Through August 2008, U.S. exports were still 20% above corresponding August 2007 levels in nominal terms. However, the trade tides have turned quickly, and by January 2009 exports at current prices were 21.5 percent below January 2008 levels, very much noticed by the general public. Similar trends can be seen in European data. But even in real terms, the drop was huge. Real year-on-year growth rates in the US exceeded 10% up until August 2008, followed by a stagnation of real exports and real declines starting to be seen in November and amounting to as much as 19.9% in February 2009. This explains the alarm bells.

Figure 1. Growth Rates for US Trade, Jan. '08 – Feb. '09

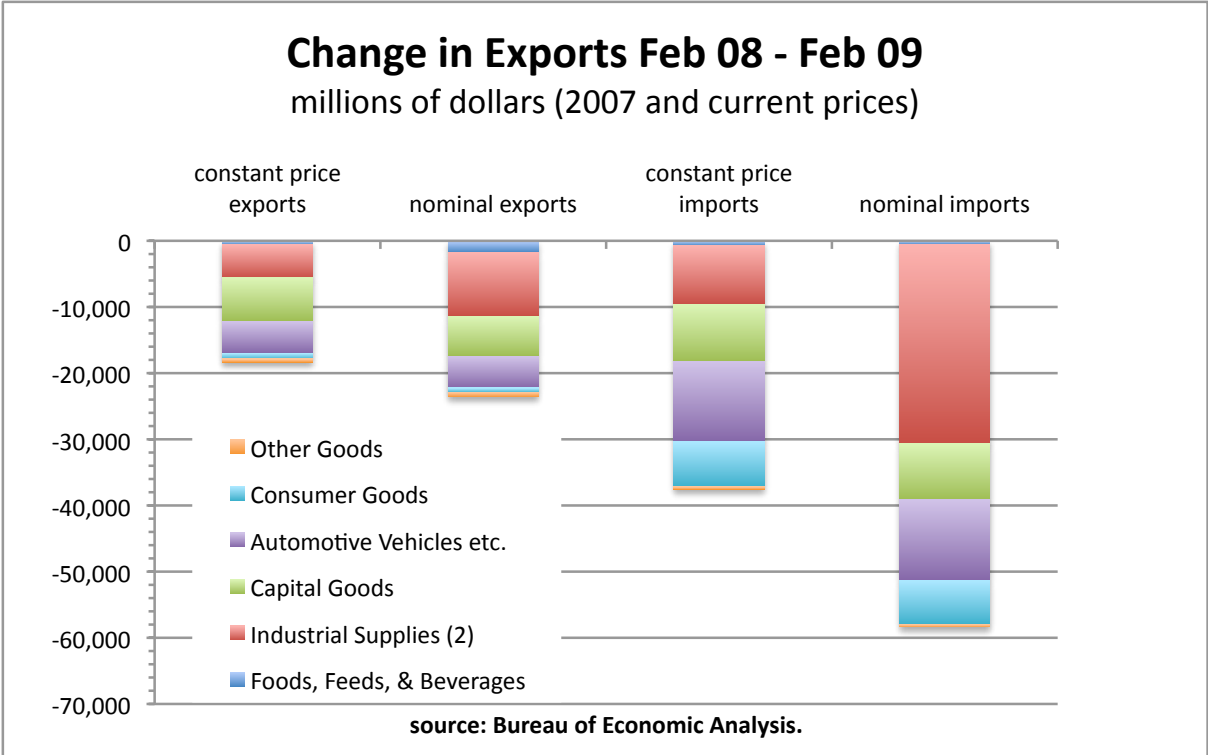


The trade data are certainly disturbing. The fact that GDP contractions have been relatively minor compared to trade (5 or 6 percent in some countries in the last quarter of 2008, but nowhere near 20% as witnessed in early 2009 for trade) is the reason alarm bells have woken up trade policy makers. Before we roll out the trade policy guns, however, we need to identify the underlying forces at work. If we break down recent trends in U.S. trade, and control for the broad mix of price and sector changes driving the overall result, the trade changes look relatively consistent with the general pattern of this recession. The problem is not trade finance, but rather “finance” finance. This recession has been characterized by a massive collapse of credit mechanisms that has hit the capital goods and

vehicle sectors particularly hard. It turns out that motor vehicles are also the driver of much of the recent trend in OECD trade data. We focus here on the U.S., but a similar story can be told with German data as well.

The figure below presents a break down in the change in U.S. trade flows for the 12 months ending February 2009. We present both nominal flows, and also real flows. For real changes, we use BEA price deflators for traded goods by broad Census categories, as reported by the BEA. We have used these to express all real flows in 2007 dollars.

Figure 2. Change in US Exports, Feb. '08 – Feb. '09.



From the figure above, it is clear that roughly half of the drop in imports over the 12 months ending in February 2009 was due to a drop in raw materials like oil (“industrial supplies” in the figure). However, much of this was due to the collapse in commodity prices. Once we control for this, 55.7 percent of the “real” drop in exports is in motor vehicles and capital goods. Raw materials represent another 24 percent of the drop. Motor vehicles and capital goods represent 61.9% of the real drop in exports. The drop in motor vehicle trade actually lags the corresponding drop in U.S. production. According to BEA, domestic production of cars was down 60% from February 2008 to February 2009 – from 342.8 thousand units to 138.7 thousand. Over the same period, real exports fell “only” 45%, which is slightly better than the 47% drop from January 2008 to January 2009.

The table below presents the trade situation for a broader set of countries. For some countries, the decline in real terms was greater than in nominal terms, implying an underlying fall in export prices. For other countries real changes are lower than nominal changes, i.e. prices in 2008 were still rising, even if moderating.

Table 1. Year-on-Year Growth Rates of Monthly Exports, Jan. '08 – Feb. '09.

	US		EU27		DE		FR		UK	
	<i>real</i>	<i>nominal</i>	<i>real</i>	<i>nominal</i>	<i>real</i>	<i>nominal</i>	<i>real</i>	<i>nominal</i>	<i>real</i>	<i>nominal</i>
Jan. 2008	9.2	15.2	2.6	9.3	-5.3	9.4	-2.7	10.5	0.7	-0.4
Feb. 2008	14.3	21.0	3.9	12.2	-11.4	9.4	2.4	13.2	-9.0	6.8
Mar. 2008	5.7	14.1	-3.7	-2.0	-5.2	0.3	-8.3	-2.8	-6.8	-8.2
Apr. 2008	12.0	19.7	9.2	16.4	-3.2	14.4	8.4	14.0	0.8	2.8
May. 2008	10.2	17.7	3.1	3.8	3.1	2.7	-0.2	0.0	-1.3	-0.8
Jun. 2008	12.9	21.8	1.0	5.4	-4.9	8.4	-0.5	1.9	-3.3	-0.1
Jul. 2008	12.2	23.2	1.7	9.0	-2.6	7.3	2.7	7.5	-2.8	4.7
Aug. 2008	11.2	19.3	-5.6	-1.5	-9.5	-2.2	-10.8	-3.5	-4.9	-7.9
Sep. 2008	1.8	7.8	3.0	9.6	-7.3	7.1	6.9	8.3	4.4	5.7
Oct. 2008	0.7	4.0	-4.7	-0.4	-6.0	1.3	-2.5	-5.3	-2.3	-1.3
Nov. 2008	-2.5	-4.3	-11.2	-13.5	-9.1	-12.0	-13.2	-12.6	-6.0	-18.1
Dec. 2008	-8.5	-12.9	-9.8	-8.8	-16.6	-7.9	-8.7	-2.6	-0.6	-14.7
Jan.-Dec. 2008	0.7	11.9	-0.9	3.1	-6.4	3.1	-2.1	2.2	-2.6	-2.7
Jan. 2009	-17.8	-21.5	n.a.	n.a.	n.a.	n.a.	-27.9	-23.6	-10.9	-27.1
Feb. 2009	-19.9	-24.0	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Source: Eurostat COMEXT, and BEA.

We have clearly been witnessing a dramatic drop in world trade. For policy purposes though, an important question is whether the decline is out of line with the global shock to GDP and the underlying credit crisis. At the moment, trade seems to be a victim, but one reflecting non-trade weaknesses in credit and demand. The countries with the greatest trade shocks are also more exposed to sectors hit hard by the recession. They are also victims, so far, of the general pattern of recession rather than of systemic protection. This does not mean we should let down our guard against protection. Rather, while maintaining a rearguard action on the import protection front, the cure for the symptoms lies in curing the underlying illness -- recession linked to a deep credit crisis.

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