

Unpacking the resiliency of global trade

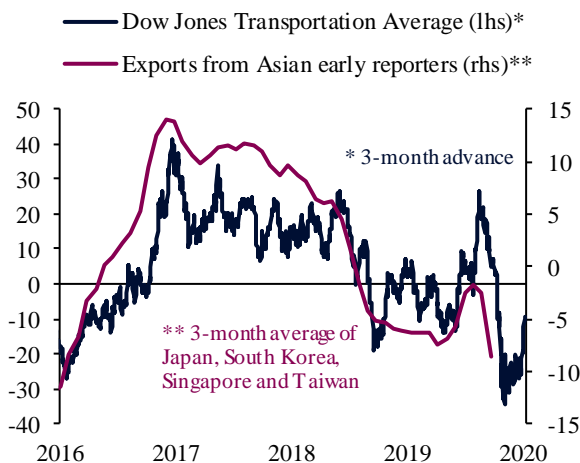
It is not all doom and gloom for the global economy. In fact, a cautious optimism has recently swept markets, as several advanced economies prepare to “re-open” their activities, hopefully leaving the peak of the pandemic pain behind. Make no mistake, the fallout from the Covid-19 shock produced unprecedented market dislocations, and the consequences are deep and will likely persist for several quarters. But as new data is released and the path to a recovery becomes clearer, we can take proper stock of the pockets of resiliency and strength as well as the vulnerabilities of the global economy. This analysis delves into the resiliency and relative strength of global trade during the current downturn.

Given the depth and breadth of the recent collapse of supply and demand in the global economy, merchandise trade has so far held up better than anticipated. Exports of early-reporting and highly open economies of East Asia, which are a reliable coincident indicator of overall trade dynamics, are so far down 19% y/y in April 2020. While this represents a significant downturn, it is far off from the collapse experienced during the Global Financial Crisis of 2008-09, when exports crumbled by more than 30%. Moreover, a smoother trend-line of 3-month average y/y figures for exports point to a better picture of a 9% slump in April.

Most importantly, however, there are promising signs that global trade may have bottomed out. South Korean export data, which is the first to be released early in the month, point to a continuous contraction of exports in May, but with an improvement in the rate of change. Exports for China, in particular, have stabilized significantly, suggesting a quick “re-opening” rebound. The Dow Jones Transportation Average, an equity index comprised of airlines, trucking, marine transportation, railroads and delivery companies, whose performance traditionally leads exports by 3 months, are not only signalling a stabilization of global trade but a significant recovery over the next few months.

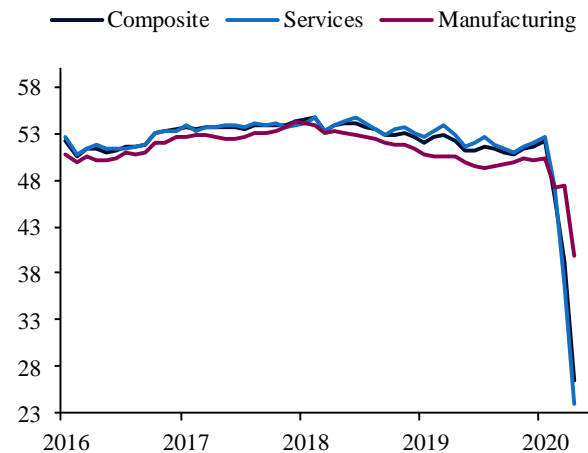
Three reasons are contributing to the current resiliency of global trade.

Key indicators for global trade
(y/y, %)



Sources: Haver, Federal Reserve Bank of St. Louis, QNB analysis

Global Purchasing Managers Survey
(50 = threshold between contraction and expansion)



Sources: Haver, IHS Markit, QNB analysis

First, because of the need for social distancing and the front-facing nature of service activities, the global spread of Covid-19 tend to affect the service sector more than the export-intensive manufacturing sector. This is unusual as manufacturing and trade tend to be more cyclical and less resilient than the service sector, i.e., manufacturing and trade normally contract more during recessions than services. The global purchasing managers survey (PMI) is pointing to a much deeper contraction of services this time with a record low outturn of 24 for April versus 40

for manufacturing (50 is the threshold that separates a contraction from an expansion).

Second, the Covid-19 shock affected the export-intensive manufacturing sector after 19 months of steep industrial deceleration, when the manufacturing cycle was ripe to turn into expansive mode. The build-up of inventories related to preventive measures against disruptions in US-China trade relations in 2018 were gradually drawdown over 2019, requiring new orders and an increase in trade flows. The pandemic did not completely wipe out the need for this new orders.

Third, global trade is also benefiting from the particularly strong performance of the electronics sector and some crisis-related sub-sectors. The adoption of 5G technology and the required IT infrastructure for its proper functioning is boosting

demand for the semiconductor industry. Working from home requirements are also propping up the demand for hardware and electronics. Moreover, the health crisis created a pent up demand for pharmaceutical products and personal protective equipment.

All in all, merchandise trade is less affected by the big pandemic shock and the manufacturing sector seems better positioned to benefit from a gradual economic “re-opening.” This is a positive development and should provide additional evidence to the optimistic scenario of a global economic recovery.

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