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THEMATIC

In this report:

Global Markets: Backdoor Deglobalization

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Backdoor Deglobalization

- The current global economic environment is clearly pointing towards more downside risk following slower growth and the uncertain trade environment. For the first time since the 2009 global recession, the world economy is expected to grow below 3% in a challenging global trade environment, and likely to expand between 1% and 2%. As opposed to 2019 when trade tension took centre stage besides political and geopolitical issues, today, the biggest challenge comes from the outbreak of the novel coronavirus (Covid-19).

- In the past, global health crises and other disasters such as the SARS, Sept 11, 2001 attack, Hurricane Katrina in 2005, and the meltdown at the Fukushima Daiichi nuclear power plant in 2011 (following an earthquake and tsunami) have impacted the global supply chain. Today, the quarantine in China and a lack of labour will hurt global economic activities. These have halted production, sales and shipment, thus damaging the global supply chain. This is, in part, because the Chinese economy has become an indispensable part of world business as it grew to become the global factory after the 2003 SARS outbreak. This economy accounts for one-third of the global GDP and 34% of world trade, compared to only 3% and 1.2% respectively in 2000.

- Hence, the Covid-19 impact could be long-lasting. As globalization has encouraged companies to build supply chains that cut across national borders, it has made economies more interconnected. Today, companies and businesses are more reliant on Chinese factories than they were during the SARS outbreak in 2003. This is, in part, due to their business strategies that seek to lower costs by keeping stocks at low levels with the confidence that they can replenish their inventories "just in time".

- However, such confidence is now being misplaced despite companies increasingly having disaster recovery plans and trying to anticipate the consequences of unexpected events on their suppliers and shippers. The setback to some of their plans is that it may not have considered the delays in production and transport. Thus, investments are slowing down, with a growing weakness on discretionary spending and rising financial market volatility, all of which will impact businesses and companies' bottom line. The job market will turn soft with rising retrenchment.

- It will take some time before production gets back to normal levels. A backlog, coupled with limited transport space, will see transport and shipping costs rise substantially. Seeking alternative suppliers and shippers to circumvent delays remains challenging. The effects of this virus outbreak might also affect the compromise in the US-China trade war. The "phase one" trade deal was signed on 15 Jan where the US administration promised US$200bil in sales to China. The trade war has opened competitive production markets in Mexico, India, Vietnam, Malaysia, and Indonesia, among other places. But there is little, if any excuse, not to have identified other production centres that can make up the shortfall in the event of a disaster.

- The World Health Organization (WHO) on 24 Feb declared that the world should prepare for a possible coronavirus pandemic. Outbreaks in South Korea, Iran and Italy have caused alarm. Clearly, the virus has travelled widely and rapidly. Although the WHO raised the risk assessment of the coronavirus as it has spread to at least 49 countries in a matter of weeks to "very high", it has yet to declare the outbreak as "pandemic" as the current figures do not warrant such a level.

- If the Covid-19 outbreak is declared as "pandemic", that means every human on this world will be exposed to it. China has clearly shown that it is not necessary for such declaration with everyone taking the necessary action collectively to address the spread of Covid-19 quickly. Clearly, this virus is now a "black swan" with an unpredictable effect on companies and businesses while its impact on the global economy and trade remains unclear.

- Knock-on effects from this outbreak have been easily visible in commodity prices. Commodity prices such as copper and oil fell as investors predict that the world's factory shutdown will see less demand for raw materials. Appetite for safe-haven assets like gold and currencies remain attractive. Besides manufacturing, the service industries such as tourism-related ones are also affected while indirect industries suffer domino effects.

- Fears could be heightening in China on the negative short- and long-term impacts from this virus. There are growing concerns of a "backdoor" deglobalization although barriers are being put up not to halt trade and migration flows but to prevent the spread of this virus. Still, the economic effects remain the same — hurting global supply chain, lowering business confidence and a weaker global trade. Policymakers are unveiling stimulus measures to support growth. But they can do little given the shock the economy is experiencing in supporting the capacity to produce goods and services due to supply and shipping disruptions. This leaves the world economy largely at the mercy of nature. How bad the impact on global growth depends on how quickly the virus can be contained.

- Globalization was sold as a way of boosting prosperity for all by making markets bigger and more efficient. For a while the model worked, but when it blew up, it caused extensive collateral damage. A backlash was inevitable. Now, the risk of "backdoor" protectionism cannot be ruled out. Every movement of globalization requires a champion to spread free trade and open markets. That role fell to Britain in the late 19th century and the United States in the second half of the 20th century.

- Today, the era of open markets and open borders – where trade and transnational capital flows rose rapidly as a share of global output — may have run its course. It could be happening as a result of geopolitics, economic sluggishness, rising inequality, failure to develop new political structures to manage globalization, and the response to new threats. Besides the virus and trade war, there is global heating which looks certain to add to pressure of deglobalization. It suggests that the world is at the mercy of nature as the threat posed by the climate emergency is forcing governments, businesses and consumers to ask questions about the way the global economy works.

- Deglobalization has happened in the past, notably between 1914 and 1945. It could also be happening now. Today, governments are less keen on dismantling trade barriers. They are focusing more on safeguarding jobs, protecting intellectual property theft and curbing rising cybercrime. Businesses and companies are realizing that lengthy global supply chains, which should provide advantage by reaping on low wages in the developing world, have costs as well as benefits from this virus attack. Hence, they are more likely to further encourage the return of production that was offshored in the 1990s and 2000s. Deglobalization is the result.

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