

# The Global Trade Depression And Its Consequences on Inflation and Central Bank Policy

Global trade has stagnated since 2011.

## Why has trade stagnated?

In the wake of the global financial crisis of 2008/9 countries realized that their consumers were weakened, their businesses were discouraged, and their governments had used much financial reserves to bailout their banking systems. The only feasible driver of output was trade. All countries therefore attempted to increase net exports.

A state of Cold Trade War has persisted since then. Initial battles were fought in foreign exchange where each country in turn attempted competitive devaluation. Subsequent gambits included reshoring of manufacturing and protection of intellectual property to protect domestic businesses. It is impossible that all trading nations are net exporters. Currencies are quoted one in terms of the other. There is no successful resolution to trade wars, cold or hot.

## What are the consequences of a Trade Depression?

In a trade war, exporters suffer, as currency volatility, protectionism and mercantilism weigh on business conditions.

Manufacturing is more export exposed than services. Manufacturing suffers relative to non-manufacturing. This has been supported by empirical data.

A general favoring of non-manufacturing over manufacturing explains the weakness in the Chinese economy as the larger part of its economy slows and the smaller services part of the economy takes over. It means, however, that the rebalancing is not a voluntary action by the Chinese but a reality imposed by circumstances.

A reduction in trade negatively impacts productive efficiency and lowers global productivity growth. Post 2008/9, productivity has been volatile and weak and this is set to continue.

Slower productivity growth implies lower efficiency and a smaller output gap. So far it has been

assumed that central banks have much latitude to operate expansionary policy, however, a tighter output gap could challenge this assumption and introduce more uncertainty around interest rate assumptions across term structures via inflation expectations.

The uncertainty created around central bank policy and around the trajectory of rates and the shape of term structures will have significant impact on asset valuations.

IMF World Trade, Exports:

