Allianz Global Investors

Dimensions of disruption: Deglobalisation

The world is being transformed at an unprecedented pace. The interplay between technological, political and economic drivers is fuelling what we describe as "disruption", with destructive and creative forces acting in tandem. This transformation can be summed up with the dimensions of deglobalisation, digitalisation, demographics and decarbonisation.[1]

The first part of this study sheds light on the process of deglobalisation.

Deglobalisation

In the eyes of an economist, progress in the world can be boiled down to a fairly simple formula: the more global, the better. Here, "global" refers to the trade in goods and services with as few barriers as possible. This is based on findings by David Ricardo, one of great pioneers of economics who died almost exactly 200 years ago and who identified the "comparative advantages" between different locations.[2] In a nutshell, he stated that if every location focuses on manufacturing what it is relatively better at producing and engages in trade with other locations, which also concentrate on what they are relatively better at producing, this results in a win-win situation. Economies of scale and the different advantages each location offers drive down costs.

More on the dimension decarbonisation

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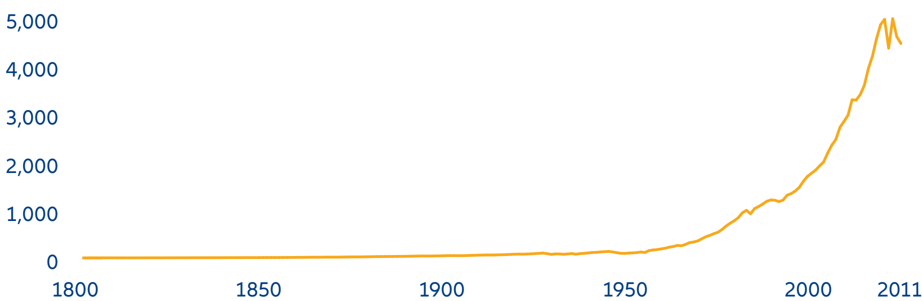
What we have come to know as "globalisation" is the triumph of this Ricardian view of the world. Over the previous 200 years, exports have positively skyrocketed, even after adjusting for the effects of inflation.[3] Yet, we have witnessed a decline – or at least a stagnation – in this development over the last decade (see figure 1).

(GDP). Ultimately then, only a relative analysis can reveal the true extent to which trade has transformed the world.

This is illustrated from a slightly narrower perspective in figure 2, which shows how trade in goods and services, i.e. imports and exports, has increased as a proportion of gross domestic product in recent decades. Internationally, its share of GDP has

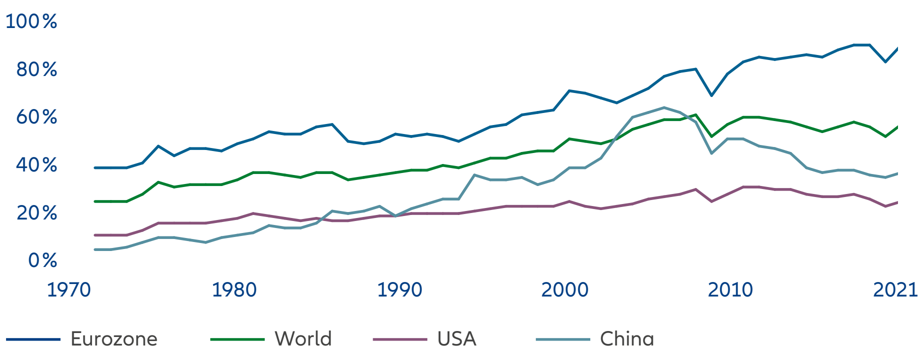
Fig. 1: Growth in exports (Global)

Inflation-adjusted total world exports (constant prices), based on 1913. The values correspond to the world export volume indexed to 1913.



Source: Our World in Data and AllianzGI Global Capital Markets & Thematic Research, April 2023

Fig. 2: Trade in goods and services as a share of gross domestic product



Source: Refinitiv Datastream, AllianzGI Global Capital Markets & Thematic Research, 12.04.2023

However, given that this view is based solely on the value of exports, it is something of an exaggeration in the sense that, over the same period, there has been a simultaneous and dramatic rise in the added value as measured by gross domestic product

risen to around 60% (cf. figure 2), which also demonstrates the greater significance of global supply chains. In the euro area, this figure is close to as high as 90% (see graph) – primarily due to trade between countries in the single currency area.

A key factor in the incredible surge in globalisation we have seen has also been the growing importance of services among global trade, in addition to the emergence of global value chains. The vast majority of goods traded worldwide are no longer finished products but, rather, intermediate products.

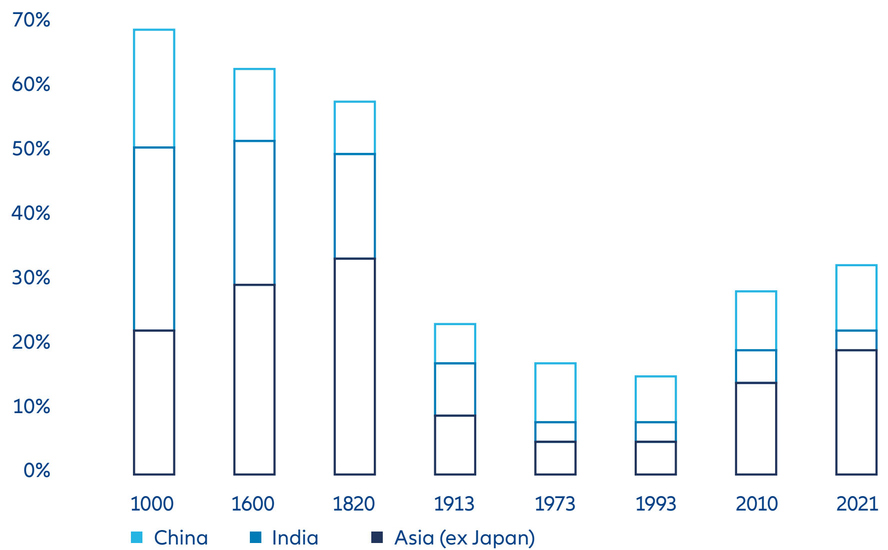
Taking a closer look at these figures, it is evident that the ratio of foreign trade to GDP has in fact been flatlining for roughly the last ten years on a global level, but also in the United States. In China, which has been pursuing a strategy of rebalancing its largely export-driven growth model towards greater domestic demand, it has even been in decline – a sign that this policy appears to be paying off.

The recent levelling off in the trade-to-GDP ratio provides a first tentative glimpse into why the term "deglobalisation" is increasingly making the rounds. Judging by how often it has been mentioned in publications listed on Google Books, as tracked by Google's Ngram Viewer, the popularity of the term has seen extraordinarily stellar growth that began around the mid-1990s. Some years later, the concept of onshoring also started to gain prominence in publications. In contrast to offshoring, which involves relocating manufacturing processes to other countries, onshoring refers to producing goods and providing services in a company's domestic market.

There are many reasons why deglobalisation is more than just a mere buzzword, including:
- Geopolitics
- COVID-19
- Digitalisation
- Decarbonisation

Geopolitics: While the United States was considered the only global superpower for a prolonged stretch since the end of World War II, and especially after the collapse of the Soviet Union, the rise of China means that this unipolar dominance has reverted to a multipolar world. In terms of gross domestic product, adjusted for purchasing power parity (PPP), the Middle Kingdom is now the largest economy in the world. In this sense, it has picked up where it left off a thousand years ago. According to findings by the economic historian Angus Maddison[4], and by extrapolating his data using the IMF's database, China's share of global gross domestic product amounts to 19% (adjusted for each country's purchasing power). In 1993, this share was a mere 5%. To put this into perspective: in the year 1000, China accounted for as much as 22% of the world's economy.

Fig. 3: China's share of global GDP from 1000 to 2016 (adjusted for purchasing power)



Source: A. Maddison, Contours Of The World Economy 1-2030 AD, IMF, The World Bank, AllianzGI Global Capital Markets & Thematic Research, December 2022

The geopolitical tectonic plates are shifting along the lines of economic power. As its share of global GDP (PPP-adjusted) shows, since the introduction of reforms by Deng Xiaoping, China has rebounded from its nadir under Mao Zedong and regained its former glory. At the same time, the share of global GDP of Asian emerging economies has also increased (see figure 3).

On top of systemic competition, as well as competition for jobs, a race is also underway for technological supremacy. It is therefore hardly surprising that barriers to trade are on the rise again. As the "GTA report"[5] reveals, the number of discriminatory trade policies has more than quadrupled since 2002, with the main culprit being the United States, followed by China and – some distance behind – by Germany.

Over the same period, there has been an enormous shift in manufacturing to developing countries.

On the one hand, this is a reflection of the growing share of the service sector in industrialised countries; on the other hand, it is also a consequence of the expansion of offshore production facilities in other parts of the world. The share of total exports from industrialised nations has fallen in line with this development, while there has been a simultaneous increase in the proportion of exports from emerging economies - with China again leading the way.[6]

Fig. 4a:
Number of discriminatory interventions imposed since November 2009

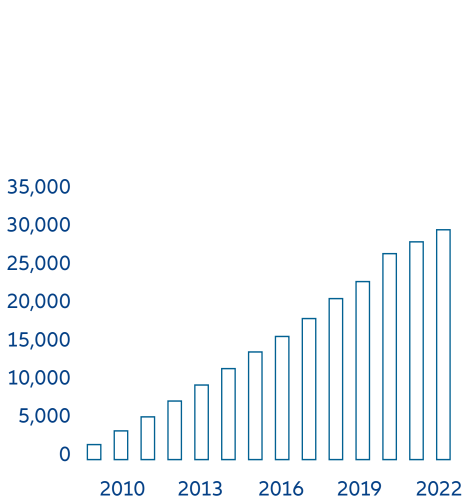
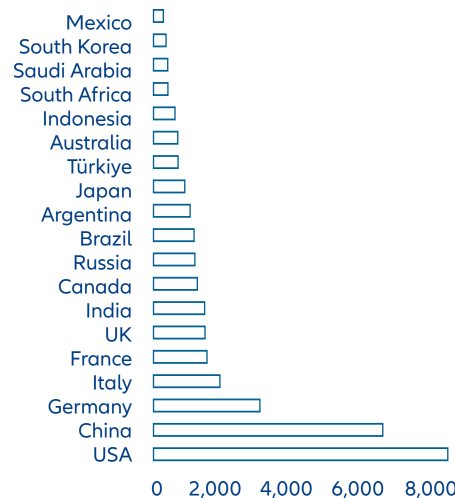


Fig. 4b:
Number of discriminatory interventions imposed by selected countries since November 2009



Source: 29th GTA report (globaltradealert.org) and AllianzGI Global Capital Markets & Thematic Research, 2022

Meanwhile, the COVID **pandemic** has exposed the vulnerability of global supply chains. If essential medicines, masks and vaccines are only produced in one region of the world and a crisis leads to a shortage in these items, then it is clear that there is a need for a greater diversification of manufacturing locations. This becomes even more obvious when looking at the "Global Supply Chain Pressure Index", which is compiled by the Federal Reserve Bank of New York. This index reflects the pressure on global supply chains and is based on a broad dataset of transportation costs and supply chain-related components from PMI (purchasing manager index) surveys. It is an extremely compelling indicator of the disruption caused by the COVID pandemic and, in particular, by China's zero-COVID policy.

The takeaway from this is clear: supply chains must become supply networks.

This is an opportunity for **digitalisation** as, according to a study by the global consultancy firm Deloitte[7], the cost of robots has fallen sharply. As a consequence, the attractiveness of offshoring, i.e. shifting jobs outside a company's domestic market, is steadily falling compared to that of "onshore" robots. As early as 2015, the study came to the conclusion that, while a worker in a low-wage country only costs 35% of an onshore, full-time employee, a robot can do the same work for 10% of this cost. The comparative locational advantages of low-wage countries have thus given way to advantages for onshore manufacturing.

With this is mind, why not produce the goods locally, in a company's domestic market, or wherever the customers are located? This would also make sense in respect of **decarbonisation,** as it would no longer be necessary to transport goods around the world, reducing the carbon footprint. At the same time, decarbonisation would lead to fewer supply chains because, for instance, electric cars need fewer parts than conventional vehicles with internal combustion engines. From an environmental perspective, the importance of near shoring – producing goods closer to a company's home base or nearer to their final destination – should also grow in future, as it lowers greenhouse gas emissions and their associated costs.[8] The reason for this is that, if a price is put on greenhouse gas emissions, as is the case under the EU's "European Trading Scheme" for example, then transportation costs will rise, resulting in the comparative advantages of offshoring being reduced or eliminated altogether.[9]

Having said that, deglobalisation is not a uniform phenomenon. While trade in goods is declining, there is an increasing trend towards the global trade in services, data and cloud-based solutions.[10]

The big picture of deglobalisation is that, at least to some extent, it makes sense from both an economic and an ecological perspective. It contributes towards mitigating the cost of environmental externalities and diversifying supply chain risks, while at the same time making locational advantages less profitable. In places where it stems from geopolitical concerns, it involves greater friction and comes at a political cost.

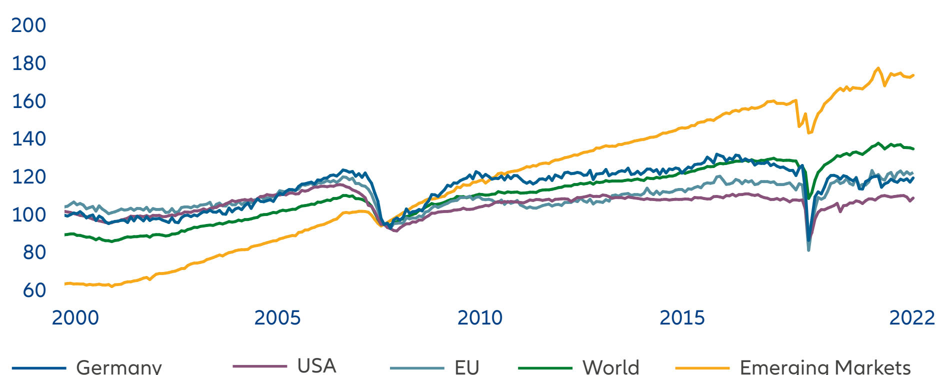
So, are we really facing the end of globalisation? Well, at least the end of globalisation as we know it. The trend is pointing towards more regionalisation and a shift from goods to services and data.

Key investment considerations

These developments suggest investors should bear a number of key issues in mind:

- Among other factors, the economic ascendency of China and emerging countries, whose importance has grown, is behind today's geopolitically multipolar world.
- While global trade is becoming more regionalised, including emerging regions in an investment would appear to be a prudent strategy. Not only for reasons of diversifying risk, but also because the economic significance of emerging markets has risen.
- As secular trends, decarbonisation, demographics and digitalisation should also be factored into any considerations for investing capital - but there will be more on this issue in subsequent studies.

Fig. 5: Production in the manufacturing sector
Selected countries, rebased (Feb. 2009 = 100)



Source: Refinitiv Datastream and AllianzGi Global Capital Markets & Thematic Research, 12.04.2023

[1] I drew inspiration for the "Dimensions of disruption" concept from Demary, Vera; Matthes, Jürgen; Plünnecke, Axel; Schäfer Thilo; "Gleichzeitig: Wie vier Disruptionen die deutsche Wirtschaft verändern"; studies by German Economic Institute (IW-Studien); 2021
[2] Ricardo, David; "On the Principles of Political Economy and Taxation"; 1817
[3] Global Trade Alert; "The 29th Global Trade Alert Report"; most recently verified on 12 April 2023
[4] UNCTAD statistics, most recently verified on 16 December 2022
[5] Deloitte, "The robots are coming"; 2015
[6] McKinsey Global Institute, "Globalization in Transition: The Future of Trade and Value Chains"; January 2019
[7] Deloitte, „The robots are coming"; 2015
[8] Barclays; „Deglobalisation: HOMECOMING"; special report on 13 July 2022; S. 16
[9] Vgl. Naumer, Hans-Jörg; „Grünes Wachstum. Mit „Green Growth" gegen den Klimawandel und für die Nachhaltigkeitsziele"; SpringerGabler; 2022
[10] McKinsey Global Institute; "Globalization in Transition: The Future of Trade and Value Chains"; January 2019

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