BERENBERG
Markets

FOCUS

04 December 2019

Globalisation has passed its peak

Within *Focus* we comment on extraordinary market events and analyse capital market related special topics.

Globalisation has shaped economies, societies and the capital markets over the past few decades. In our view, however, the current wave of globalisation is coming to an end and an agreement in the trade dispute between the US and China will not change that. An end to the positive effects of globalisation will also have noticeable consequences for the capital markets in the medium term.

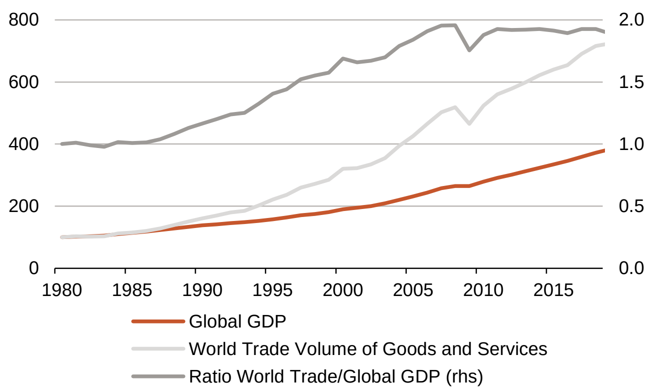
Waves of globalisation have historically led to increasing populism and protectionist politics.

However, this is not an unusual development. Innovations in transport and communication technologies as well as political liberalisation have historically brought the world closer together in stages: in the 15th century, for example, it was the development of the carrack, the first regular oceangoing vessel, which allowed Christopher Columbus and Vasco da Gama to carry out their famous overseas expeditions. In the 19th century it was the development of steam ships made of iron, alongside telecommunications, the reduction of tariffs, particularly in Europe and the US, and the adoption of the gold standard that triggered waves of globalisation. Yet there are always globalisation winners and globalisation losers. This then leads to populism, protectionist politics and a national focus, a focus that increases when the economy is weak. Examples of such turning points are the Russian Revolution in 1917 and the world economic crisis in the 1930s. The Second World War, the Cold War, and systems of import substitution in India and Latin America were among the factors that prevented another strong wave of globalisation for a long time despite technical progress across the world. As a result, regions across the globe developed very differently.

The current wave of globalisation began in the 1990s, triggered in particular by the collapse of the Soviet Union, the subsequent expansion of the EU and economic reforms in China, India and Latin America. Tariffs in the industrialised countries were more than halved. India joined the WTO in 1995 and China followed in 2001. Resources that were previously inaccessible to western economies, such as the labour forces in these countries and markets, were tapped. From an economic point

Fig. 1: Trade recently increased just in line with economic growth

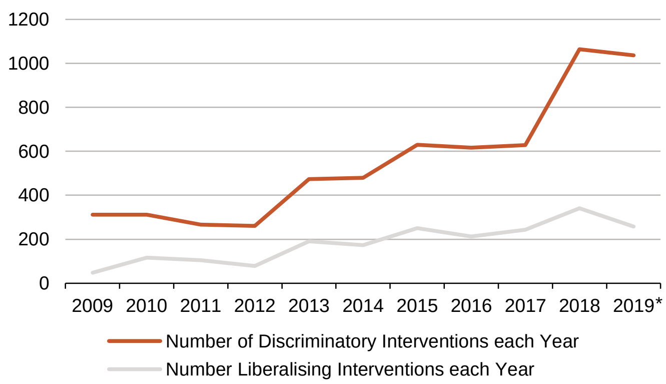
Global trade volume of goods and services and global GDP at constant prices, indexed to 100 in 1980



Time period: 01.01.1980-31.12.2018, annual data
Source: Bloomberg, IMF, own calculations

Fig. 2: Protectionism has dominated since the global financial crisis

Number of discriminatory and liberalising interventions implemented each year after the global financial crisis, *as of October 2019



Time period: 01.01.2009-31.10.2019, annual data
Source: Global Trade Alert

of view, this caused a supply shock in the labour market, resulting in a shift in factor prices to the detriment of labour and in favour of capital. The introduction of huge container ships and the widespread adoption of international container-shipping standards, falling costs for train and truck transportation, and advances in communication through the development of the internet further fuelled this wave of globalisation. For example, the real cost of a three-minute telephone call between London and New York fell by 99.9% between 1930 and 2000. The cost of one tonne of air freight per kilometre fell by 95% between 1940 and 1990.

Economic integration and business-friendly reforms boosted corporate profitability.

From 1985 to 2007, the volume of world trade grew twice as fast as global GDP (Figure 1). Increasing economic integration led to stronger economic growth, especially in emerging markets, lower inflation and lower central bank interest rates. Companies on average significantly increased their profitability. Governments implemented business-friendly reforms as states increasingly competed to attract companies. This provided additional support for companies. Since 1995, corporate profits in the developed world have risen by about three percentage points more than nominal GDP each year. This supported the price development of equities, bonds and, at least until the global financial crisis, commodities as well. The strong investment activity in the emerging markets and the development of their infrastructure, especially in China, were very commodity intensive. However, increasing economic integration also raises the risk of a global financial crisis through rapid cross-border contagion – as happened in 2008/09.

Current wave of globalisation is coming to an end

The general populations in many countries feel that they are the losers of globalisation.

Since the global financial crisis, world trade has grown only in line with GDP (Figure 1). In many cases, the global financial crisis has broken society's confidence that the free market economy will deliver socially acceptable developments. The general populations of many western countries felt that they were the losers of globalisation, for example, as more and more production was off-shored, while capital owners profited greatly from rising asset prices and low interest rates. Inequality in the distribution of wealth and income across countries has increased steadily. This has provided the breeding ground for the emergence of populist, protectionist politicians and created the danger that the integration of economies and markets will be partially curtailed. Examples include the success of populist parties in many European countries, the Brexit decision and the trade dispute between the US and China. Trade protectionist measures have dominated liberalisation measures since the global financial crisis – to an increasing extent (Figure 2). Rising migration from poorer countries to western states or an economic crisis could further aggravate the mood in the developed world against globalisation.

Digitisation and automation are reducing the already shrinking labour cost advantage of emerging markets.

In addition, the easily achievable returns from economic integration have already been harvested. The member states of the WTO represent 93% of the world's population. Technological progress, especially digitisation and automation, reduces the share of labour costs in production. Shrinking labour cost differences between industrialised countries and emerging markets are making local production more attractive again, with transport and communication costs no longer falling. New technologies, such as 3D printing, simplify local production and consumers are increasingly demanding local products for ecological reasons. Many companies are trying to reduce the complexity of their supply chains and shorten them. Global trade is, therefore, becoming less important.

Moreover, the trade dispute between the US and China is only the current scene of a new global geopolitical rivalry. As China grows stronger, it will ultimately be a question of global technological and military supremacy, and competing social models: liberal democracy versus authoritarian surveillance state. Even a "phase-one deal" or another US president will not change this. We therefore expect that global trade will grow more slowly than the economy in the coming years. This is already the case in 2019. While global economic output continues to grow at a nominal 5-6%, global trade is already declining (Figure 3).

The trade dispute between the US and China is only the current scene of a new geopolitical rivalry.

Lower earnings to be expected on the capital markets in the medium term

A permanent separation between a US and a China-led trading bloc with an iron curtain on technology would significantly reduce global economic growth. High uncertainty about the future world order (Figure 4) and the fate of globalisation are already weighing on the investment activities of western companies. Against the backdrop of increasing de-globalisation, multinational companies' established value chains are losing their value. This poses a threat of high depreciation. As a result, growth prospects are likely to be limited in the coming years.

An increasing rivalry between the US and China is threatening international value chains.

The capital markets are unlikely to generate returns comparable to those of the past three decades in the next 10 years, especially in the case of bonds. Equities from their current level are also likely to generate lower returns than the historical average due to de-globalisation. However, given the current low bond yields, they should perform better than bonds. Populist western governments are increasingly likely to rely more on fiscal stimuli and tariff barriers, which could raise inflation and interest rates in the medium term.

Despite the adverse effects on corporate profitability, equities should beat bonds in the coming decade.

In particular, emerging economies that have not already made significant progress in economic development and do not have a large domestic sales market are likely to suffer from de-globalisation. On the one hand, they are likely to attract fewer foreign investments and, on the other, their sales markets are dwindling.

The current wave of globalisation is coming to an end. The prosperity gains of the past three decades will not be repeated any time soon.

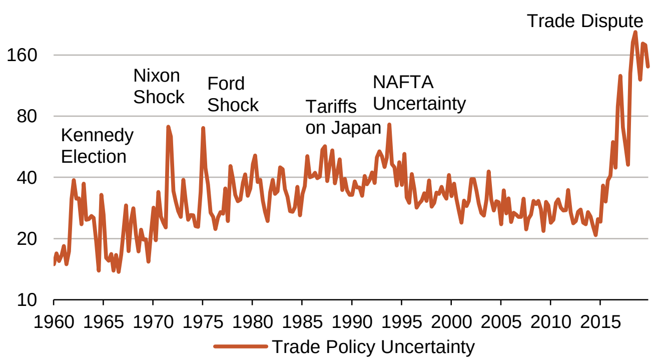
Fig. 3: Economy is growing, trade has declined since last year

3-month average growth in global trade volume year over year in percent since 2000

Time period: 01.01.2000-31.10.2019, monthly data
Source: CPB, Bloomberg, own calculations

Fig. 4: Trade policy uncertainty reaches record levels

Quarterly trade policy uncertainty index based on the frequency of certain keywords in newspaper articles since 1960



Time period: 01.01.1960-31.10.2019, quarterly data
Source: Caldara et al. (2019). The Economic Effects of Trade Policy Uncertainty.

PUBLISHING INFORMATION

PUBLISHER

Prof Dr Bernd Meyer, CFA | Chief Investment Strategist

AUTHORS

Prof Dr Bernd Meyer, CFA | Chief Investment Strategist
Head of the Multi Asset division and responsible for the capital markets opinion of Wealth and Asset Management
+49 69 91 30 90-500 | bernd.meyer@berenberg.de

IMPORTANT NOTICES

This document is a marketing communication. This information and references to issuers, financial instruments or financial products do not constitute an investment strategy recommendation pursuant to Article 3 (1) No. 34 Regulation (EU) No 596/2014 on market abuse (market abuse regulation) nor an investment recommendations pursuant to Article 3 (1) No. 35 Regulation (EU) No 596/2014, both provisions in connection with section 85 (1) of the German Securities Trading Act (WpHG). As a marketing communication this document does not meet all legal requirements to warrant the objectivity of investment recommendations and investment strategy recommendations and is not subject to the ban on trading prior to the publication of investment recommendations and investment strategy recommendations.
This document is intended to give you an opportunity to form your own view of an investment However, it does not replace a legal, tax or individual financial advice. Your investment objectives and your personal and financial circumstances were not taken into account. We therefore expressly point out that this information does not constitute individual investment advice. Any products or securities described may not be available for purchase in all countries or only in certain investor categories. This information may only be distributed within the framework of applicable law and in particular not to citizens of the USA or persons resident in the USA. The statements made herein have not been audited by any external party, particularly not by an independent auditing firm.
The statements contained in this document are based either on the company's own sources or on publicly accessible third-party sources, and reflect the status of information as of the date of preparation of the presentation stated below.
Subsequent changes cannot be taken into account in this document. The information given can become incorrect due to the passage of time and/or as a result of legal, political, economic or other changes. We do not assume responsibility to indicate such changes and/or to publish an updated document. Past performance, simulations and forecasts are not a reliable indicator of future performance and custody fees may occur which can reduce overall performance.
Please refer to the online glossary at www.berenberg.de/glossar for definitions of the technical terms used in this document.
Date: 4 December 2019

BERENBERG
PARTNERSHIP SINCE 1590

The following publications are part of the series Berenberg Markets:

- Monitor
- ► Focus
- Investment Committee Minutes

www.berenberg.de/en/publications

Joh. Berenberg, Gossler & Co. KG
Neuer Jungfernstieg 20
20354 Hamburg (Germany)
Phone +49 40 350 60-0
Fax +49 40 350 60-900
www.berenberg.com
MultiAssetStrategyResearch@berenberg.de