Geopolitics, Fragmentation and the Future of Globalization

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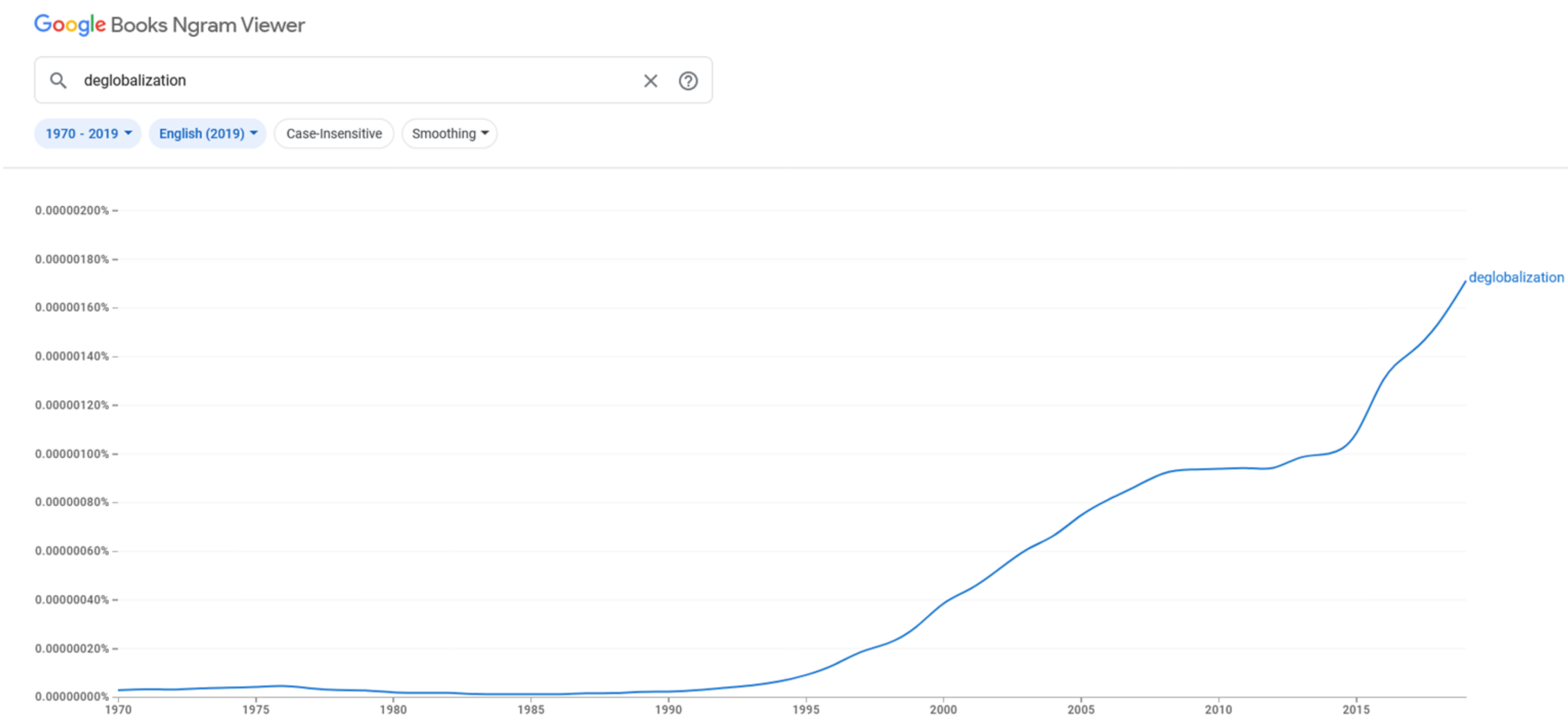
December 6, 2023

Worries about deglobalization are not new, although they have taken on new additional salience in light of recent events



But what exactly are we talking/worrying about?

- Globalization as a state or as an ongoing process?
- The end of globalization, or simply the end of hyperglobalization?
- De-risking or decoupling?
- Reshoring or near-shoring?
- A U.S.-China phenomenon, or more general?

I will argue that:

- We are seeing the end of hyperglobalization, but not of globalization per se.
  - Goods trade is no longer growing faster than GDP worldwide.
  - However, services trade continued to grow (slightly) faster than global GDP.
- We are seeing some restructuring of globalization:
  - Looser U.S.-China links.
  - But continued links of other countries to both hubs (to both the U.S. and China).
  - A consequence of which is that U.S. and China remain linked to one another indirectly.

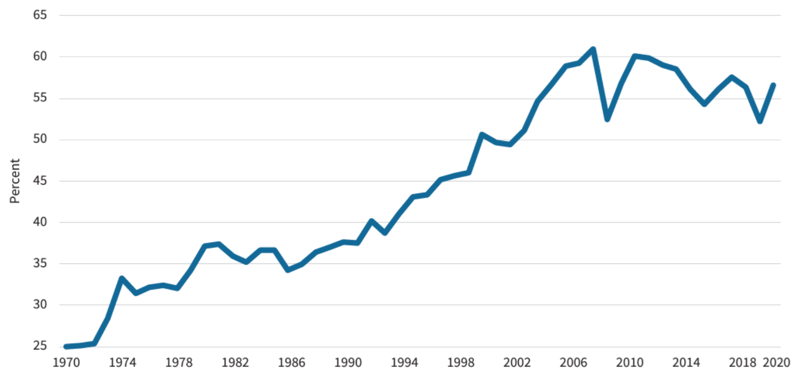
The question is whether this new configuration is stable

- I will suggest that under current geopolitical conditions it is.
- But if geopolitical tensions between the U.S. and China rise further, there is a risk of this new equilibrium breaking down:
  - With the U.S. and China taking steps that disrupt the operation of their new indirect links.
  - And other countries being forced to choose between trade and financial relations with one camp or the other.

First proposition: end of hyper-globalization, not end of globalization

- We can see this here for trade.
- Up until roughly the GFC, trade grew faster than global GDP.
- Since, the two have grown roughly in parallel.
- Any recent decline in trade/GDP is de minimis.

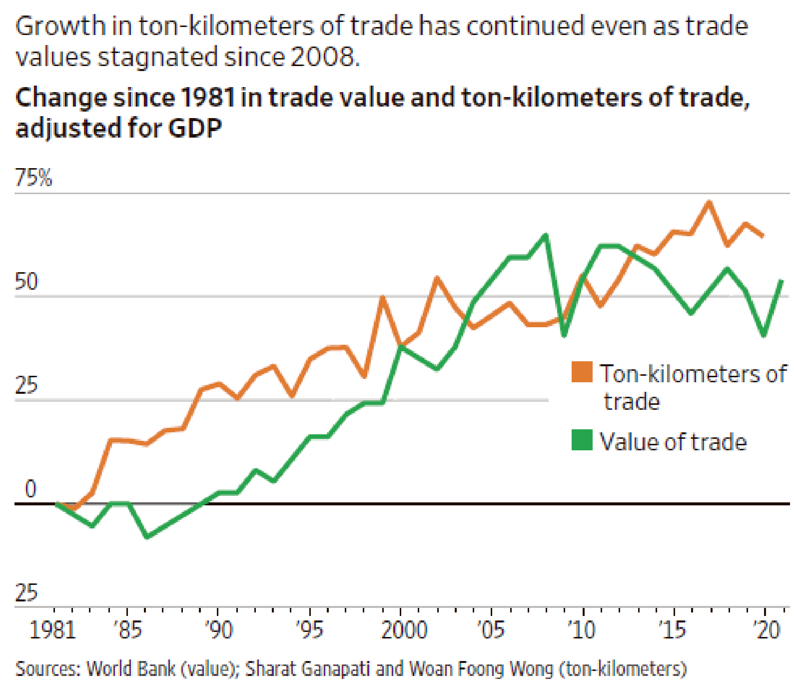
Global Trade Integration: World Exports plus Imports as a Percentage of World GDP



Source: World Bank

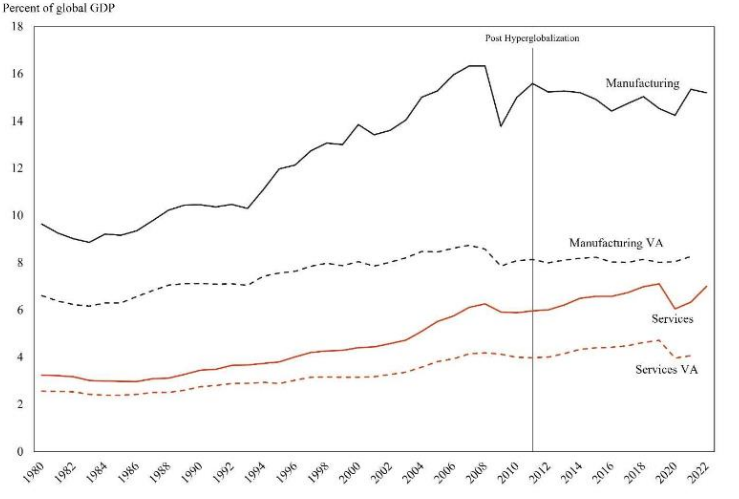
And any slight decline since the GFC goes away when we adjust for prices

- Here the green line is same as before.
- But orange line takes out the shift toward lower priced commodities.
  - Lithium instead of iPhones.
  - More trade in bulk goods such as agricultural produce and refined petroleum.



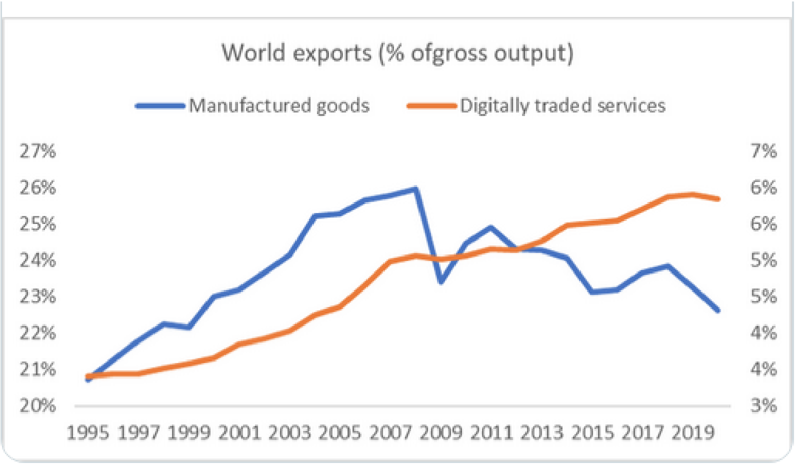
Again, distinguishing goods from services paints a more nuanced picture

- While trade in manufactures as a share of global GDP has leveled off…
- …trade in services as a share of global GDP has continued to rise, albeit modestly.



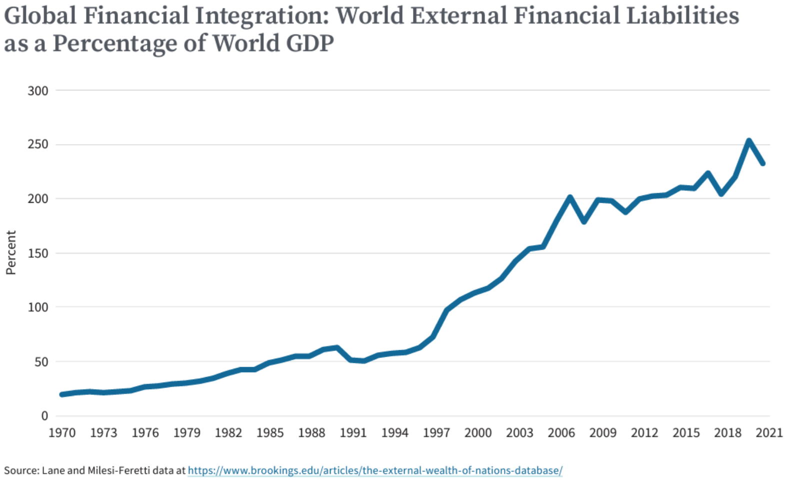
Again, distinguishing goods from services paints a more nuanced picture

- While trade in manufactures as a share of global GDP has leveled off…
- …trade in services as a share of global GDP has continued to rise, albeit modestly.
  - Digitally traded services in particular (though notice the 2 scales).



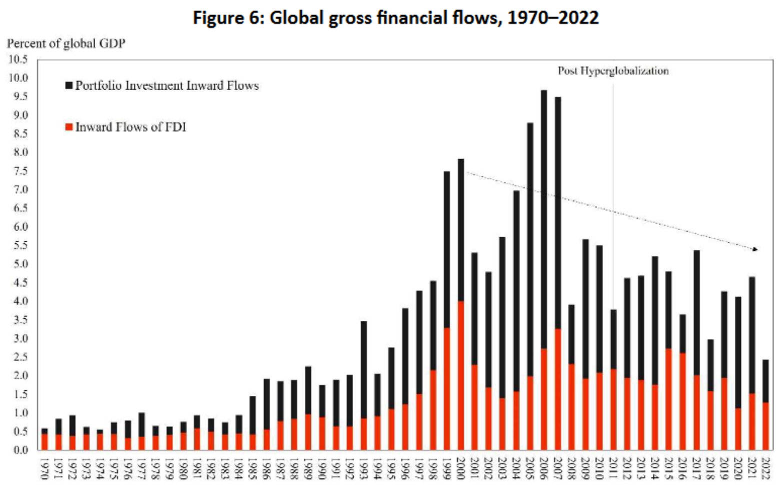
End of hyperglobalization, not end of globalization

- We can see this here for finance.
- Again, the GFC looks like a break point.
- Two differences from trade are that:
    - Hyperglobalization begins later.
    - If anything, there remains a slight uptick rather than a slight downtick thereafter.



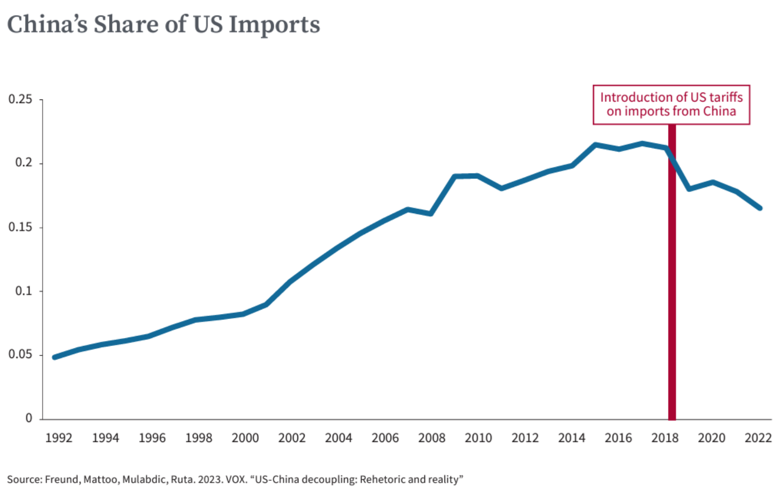
Here is another view of the same phenomenon

- This one looking at financial *flows* rather than stocks.
- Showing slower growth than before the GFC, but still faster growth than in the late 20th century.



But if no generalized deglobalization, the US-China relationship is changing

- China now supplies a smaller share of total U.S. imports.
- The introduction of Trump's tariffs has something to do with this.
- But China's share had already leveled off some years earlier (in 2015 or so), reflecting slower Chinese economic growth.

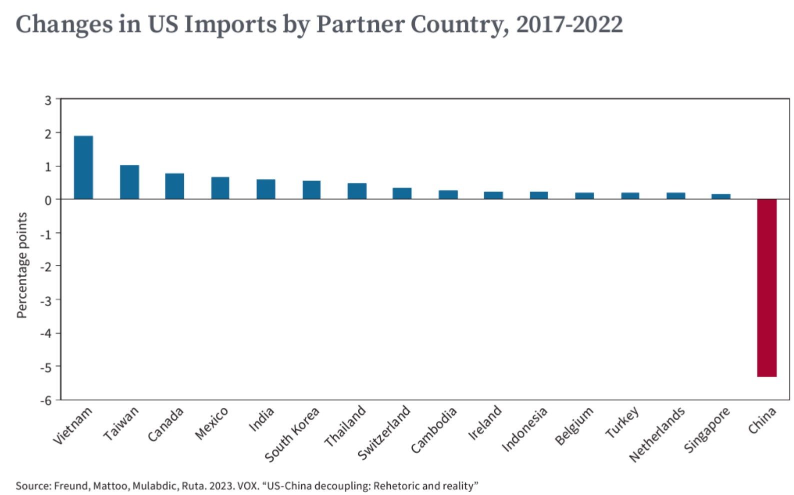


Here’s that near-shoring aspect

- As Mexico has overtaken China as a source of U.S. imports.

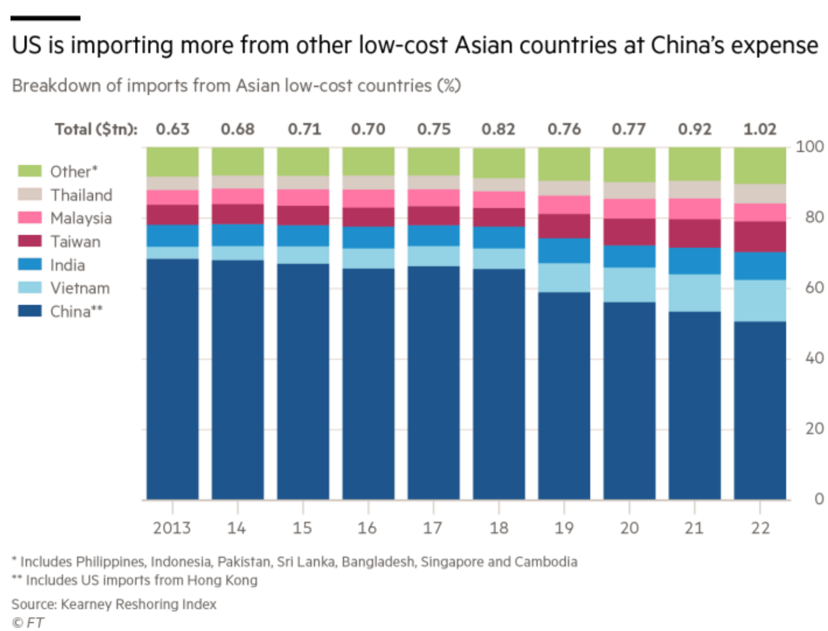
But the shift is more general. Here we see:

- Canada and Mexico.
  - Nearshoring
- Taiwan
  - Semiconductors
- Vietnam
  - Substitution away from China?
  - Or re-routed Chinese exports?



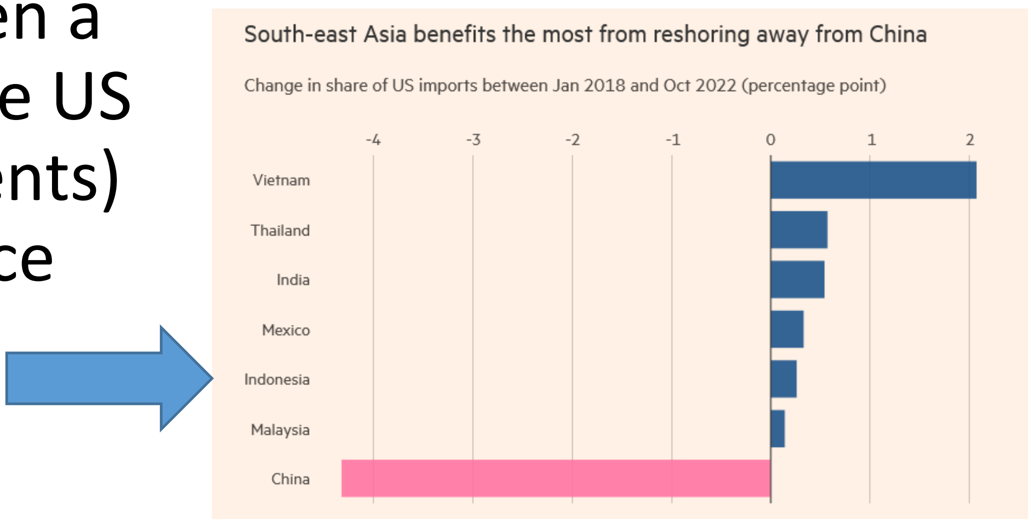
And it is not only Vietnam and Taiwan

- You can see here how other South and South-East Asian economies…
  - Thailand, Malaysia, India and others (in green
- …also account for a growing share of Asian exports to the U.S.



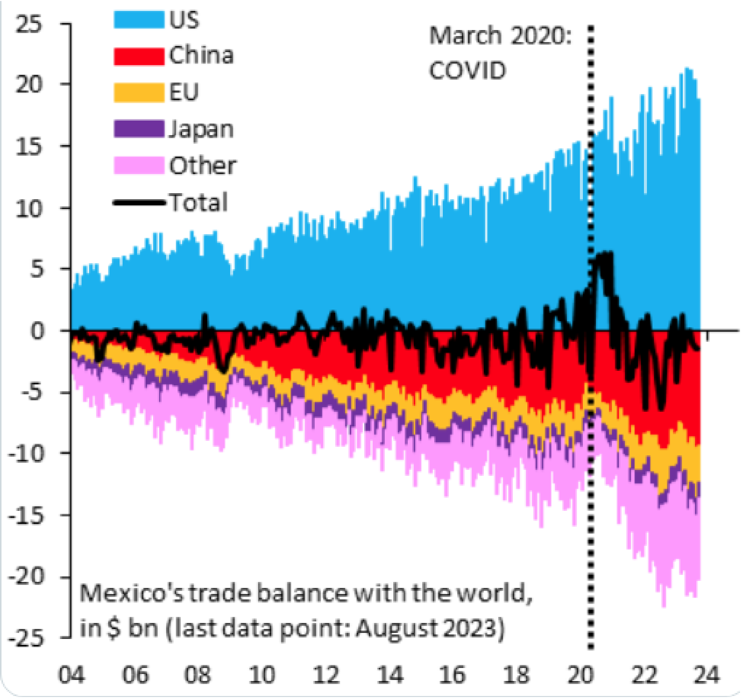
Indeed, Southeast Asia has benefited more than Mexico overall

- When we look not just at levels (Mexico already having been a major export to the US prior to recent events) but at changes since 2017.



But is near-shoring really simply re-routing of existing trade?

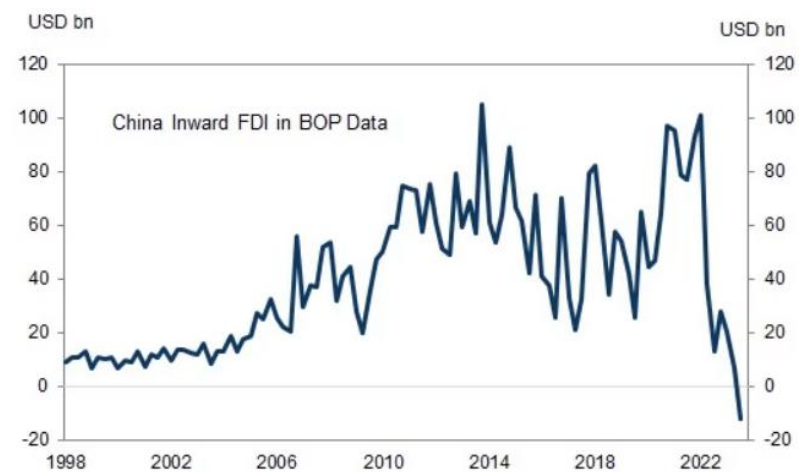
- There is suggestive evidence to this effect.
- Yes, Mexico is now running a larger trade surplus with the US, but it is also running a larger deficit with China.
- And Chinese FDI in Mexico has been rising noticeably for the last 2 or 3 years.



And if no financial deglobalization

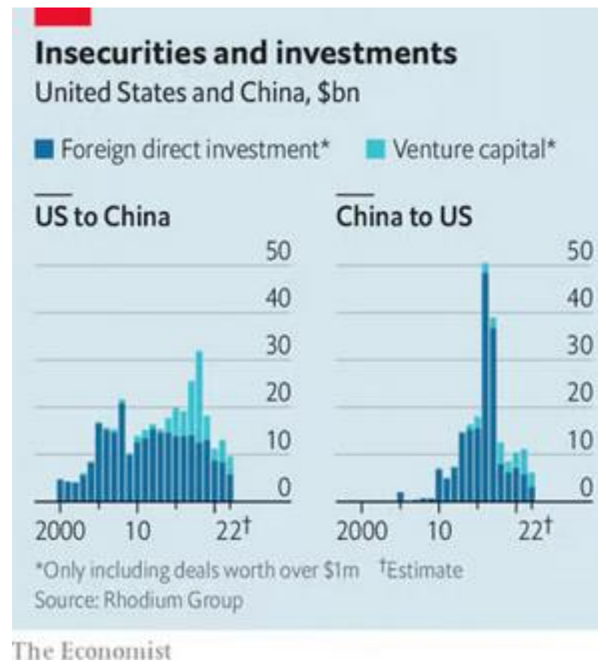
- Then some evidence of lower financial flows toward China.
- In general (shown here) and from the U.S. in particular.
  - Although different sources differ on the level (not on the rate of change).
- Reflecting:
  - Slower Chinese growth.
  - Debt problems in the property sector especially.
  - Political tensions.
  - U.S. investment controls (“Outbound U.S. FDI Program”).

China's BOP data showed the first negative inward FDI on record in Q3



Here you can see the collapse of US FDI into China

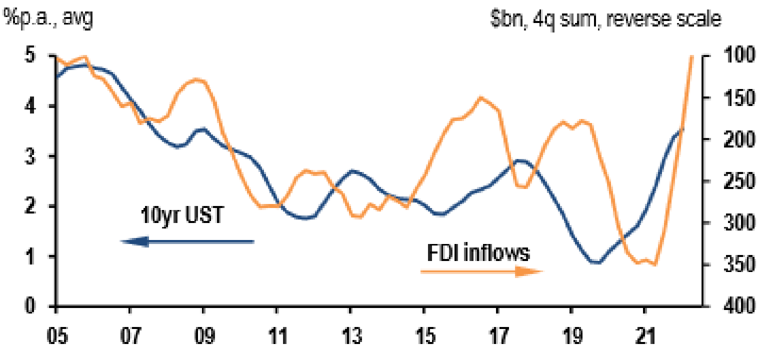
- Venture capital (US investment in existing Chinese companies) has all but disappeared.



Here you can see the collapse of US FDI into China

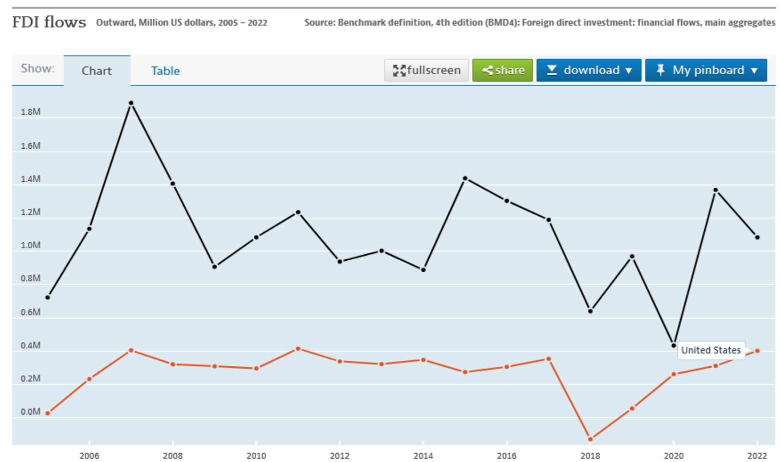
- However, some of this may simply be that higher yields at home make investing in China more expensive/less attractive.
- (Note that FDI inflows at right is on an inverted scale.)

Figure 7: China FDI inflows and US Treasury rates



Although outward US FDI has remained robust overall

- Outward FDI flow in millions of US dollars, from OECD.
- (Black line is OECD total…)
- And outward FDI is going mainly to friends (“FDI friend-shoring?).
- This makes it seem as if it is *not* just a higher-Treasury-yields story, but rather China specific.

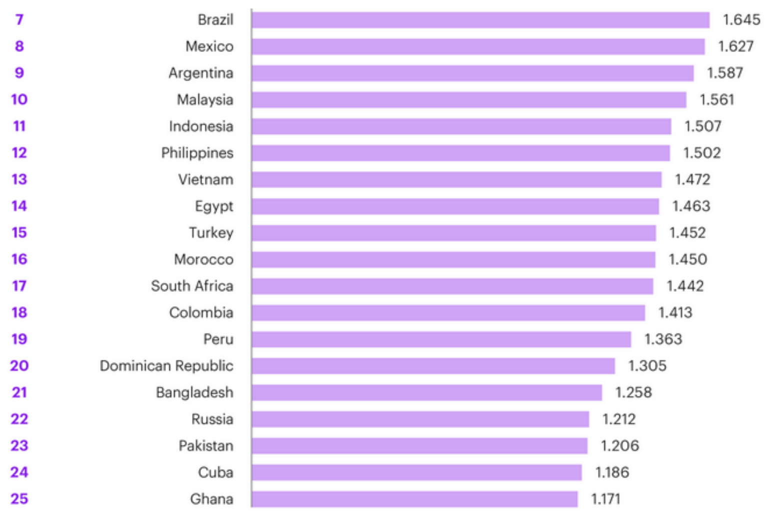


Top destinations of U.S. outward foreign direct investment

	Outward FDI	
Destination	**(USD bn.)**	**(% of total)**
United Kingdom	$1,005	15%
The Netherlands	$885	14%
Luxembourg	$716	11%
Ireland	$557	9%
Canada	$406	6%
Top-5 Subtotal	$3,569	55%
Total outward FDI	**$6,489**	

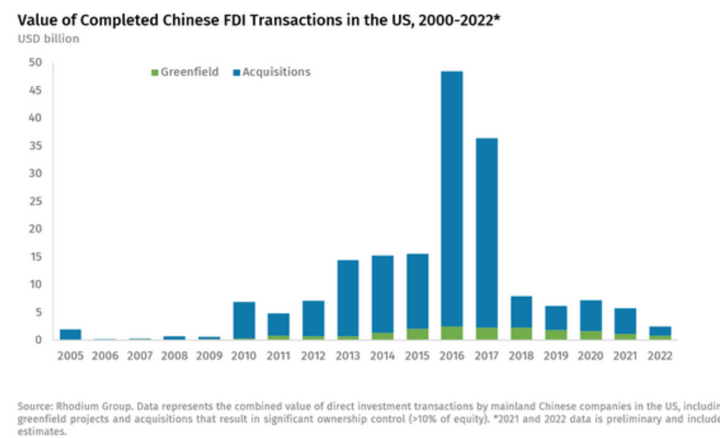
As yet, it is unclear where investment diverted from China will go

- I haven't seen a good analysis of this question.
- Kearney's ranking of emerging markets as attractive destinations for investment (based on a survey of business executives) show Latin America and Southeast Asia as the most attractive destinations, which is suggestive.



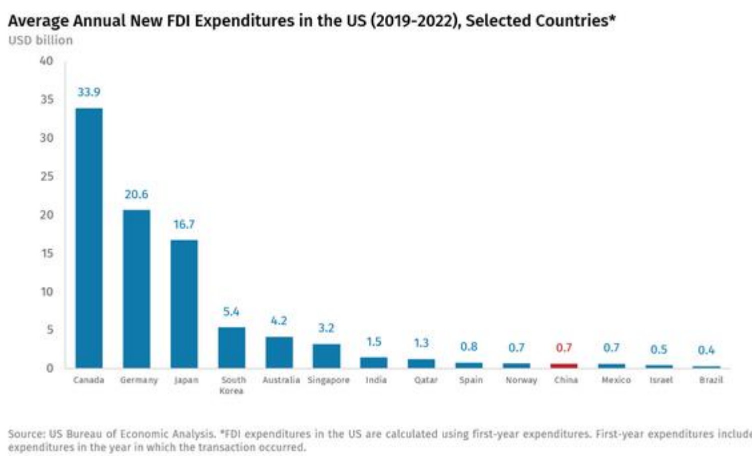
Here you can see the collapse of Chinese FDI in the US

- Collapse that appears to have proceeded in two stages:
    - First, in 2018, a year into the Trump Administration.
    - Then most dramatically in 2022, with heightened geopolitical tension and new U.S. review procedures.



Here you can see the collapse of Chinese FDI in the U.S.

- Leaving China’s new FDI spending in the US behind that of even Norway, Spain, Qatar and India.



Though in overall terms

- FDI inflows into the US (shown here in millions of nominal dollars) remain robust.
- But they are coming mainly from friends ("FDI friend-sourcing"?) rather than China.

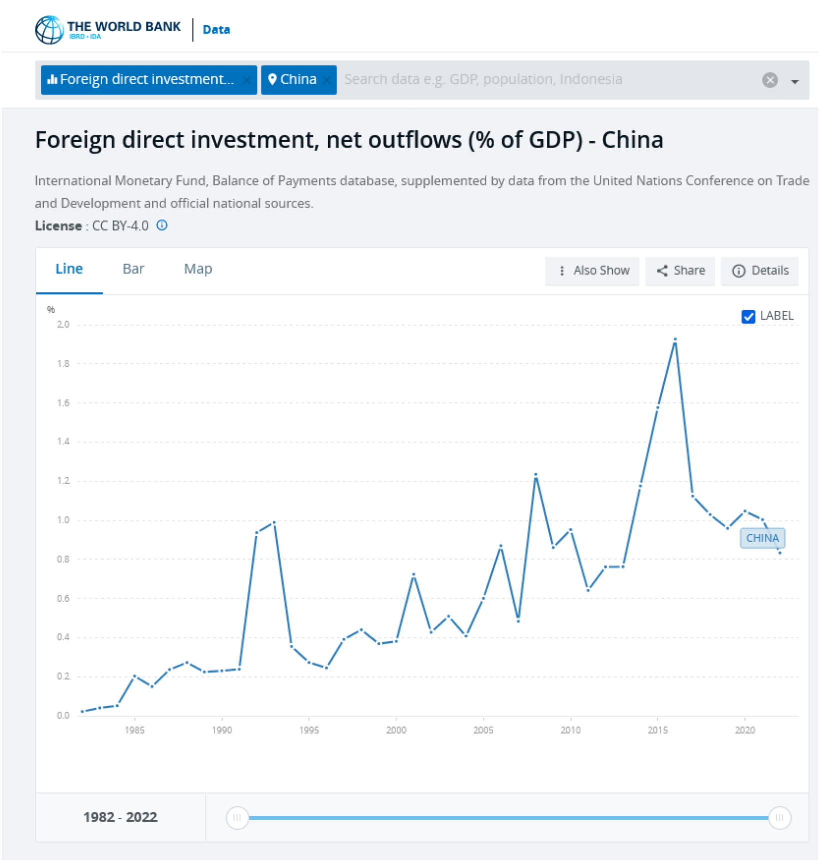
Top sources of U.S. inward foreign direct investment

	Inward FDI	
Origin	**(USD bn.)**	**(% of total)**
Japan	$690	14%
The Netherlands	$630	13%
Canada	$528	11%
United Kingdom	$512	10%
Germany	$404	8%
Top-5 Subtotal	$2,764	56%
Total inward FDI	**$4,977**	

Source: IMF; Coordinated Direct Investment Survey; RSM

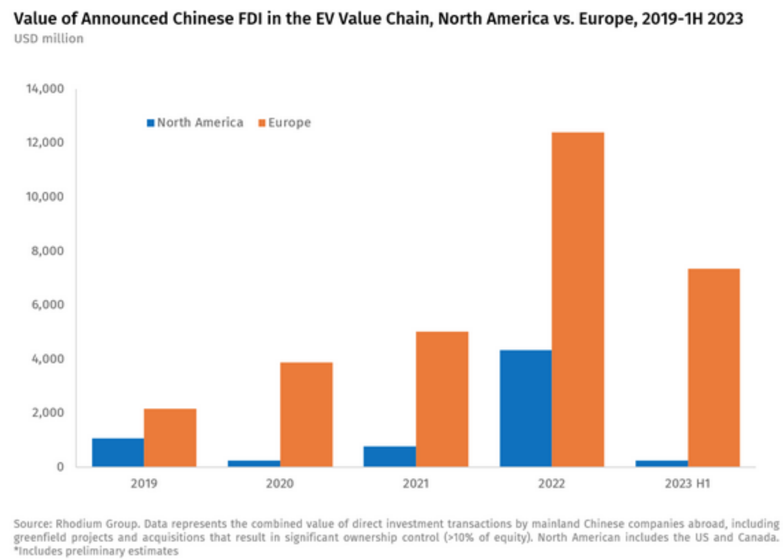
This doesn't mean of course that China is investing less abroad

- Here we can see that FDI as a share of GDP is down very slightly relative to 2019, the last pre-pandemic year.
- And in value terms it is up, since the economy has continued to grow.



This doesn’t mean of course that China is investing less abroad

- Here is China’s EV related investment, comparing the US (or more precisely the NAFTA countries) and Europe.

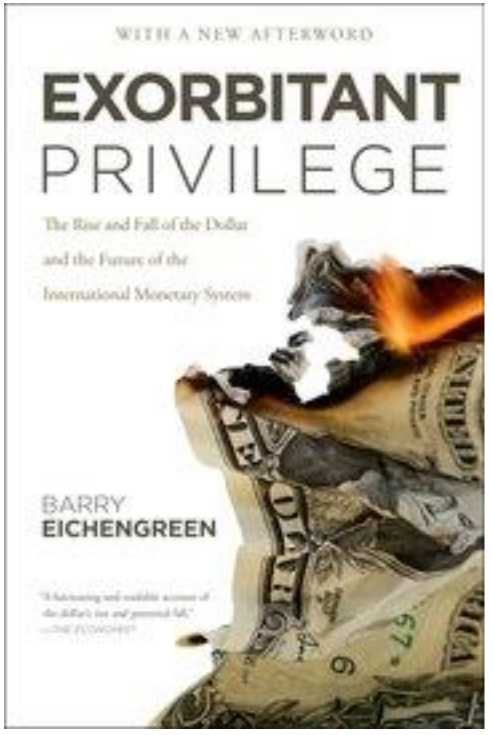


Interim conclusion on trade and investment

- End of hyperglobalization, but not end of globalization.
- Loosening links between the US and China.
- Though both economies remain outward oriented.
- Mexico and Canada benefit from trade US near-shoring.
- But Asia appears to benefit even more, from some combination of friend-shoring and re-routing of Chinese exports.
- On the investment side, diversion of investment from China appears to benefit mainly South and Southeast Asia (although some investment may also be diverted to Latin America, notably Mexico).

The monetary side

- I have a “house view” that stretches back to the beginning of the 2010s.
  - Two forecasts.
  - One of which has turned out to be right, one of which has turned out to be wrong.



Gradual erosion of dollar dominance

- Here for reserves.
- Something similar is evident for trade invoicing.

Ongoing Diversification of FX Reserves Away from USD

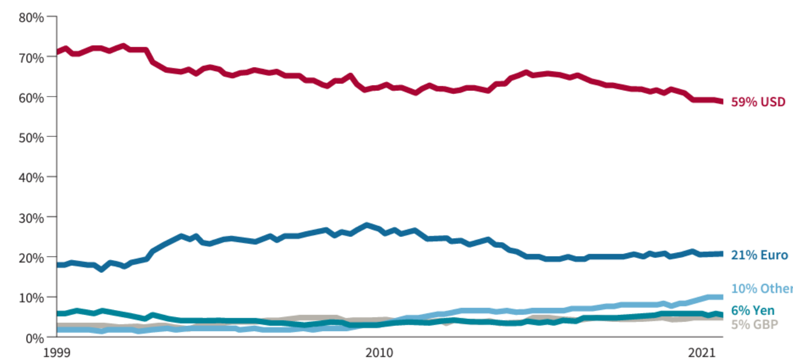


Figure: IMF Currency Composition of Official Foreign Exchange Reserves (COFER). The “other” category includes RMB, at 2.7% in Q42022. See, also, Arslanalp, Eichengreen, and Simpson-Bell (2022). https://data.imf.org/regular.aspx?key=41175

But favoring the currencies of the other two economies?

- Not in the case of the euro.

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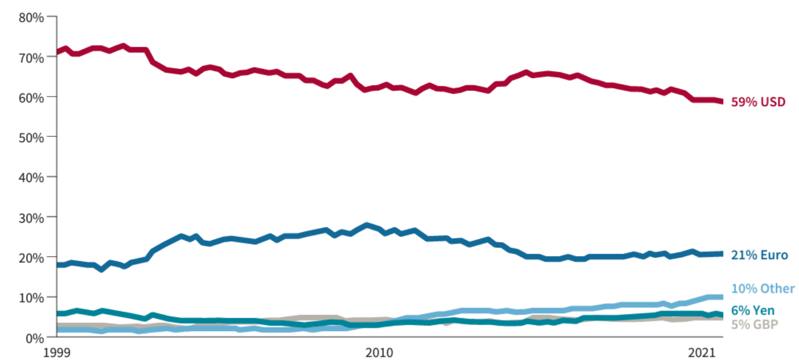

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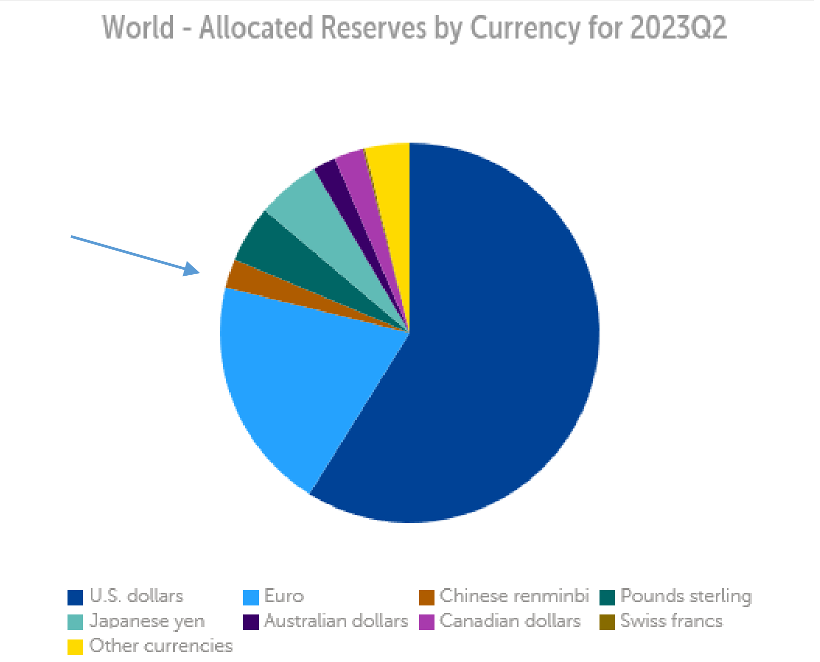
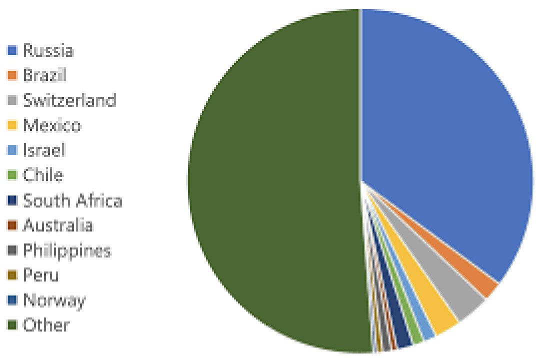
But favoring the currencies of the other two economies?

- Not in the case of the renminbi.



And as for who holds RMB reserves

- Answer, to a first approximation, is Russia…



But favoring the currencies of the other two economies?

- And we see the same in terms of share of goods trade settled in the currency (even for China itself, as here).
- And little evidence of renminbi-denominated trade settlement that doesn’t not directly involve China, except in the special case of Russia.

What is going on?

- Euro held back by a shortage of safe and liquid AAA-rated public-label safe assets.
- China held back by capital controls and absence of political checks and balances.
- 21st century digital technology reduces the advantages of a large platform, so that much of the movement away from the dollar has been movement into "nontraditional" or "subsidiary" international and reserve currencies.

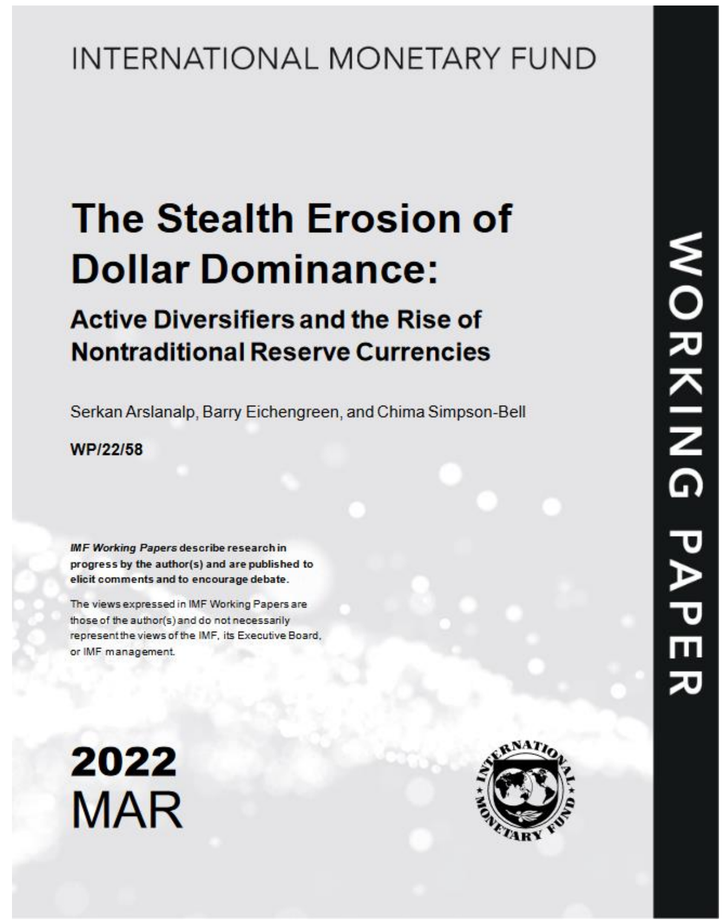
Table 5. Nontraditional Currencies in Global Foreign Exchange Reserves, end-2020

	in bil US$	as % of Total
Total	1070	100%
Australian dollar	217	20%
Canadian dollar	247	23%
Chinese renminbi	272	25%
Swiss franc	21	2%
Other	315	29%
Korean won	81	8%
Swedish krona	63	6%
Singapore dollar	51	5%
Norwegian krone	49	5%
Danish krone	47	4%
New Zealand dollar	12	1%
Hong Kong dollar	11	1%

Sources: IMF, COFER and CPIS.
Note: The size of "other" currencies is estimated based on Arslanalp and Tsuda (2014).

What about the effect of sanctions? (So-called "weaponization of the dollar")

- We found little evidence of movement from the dollar to other currencies here.
- Not surprisingly, perhaps, because issuers of most of the obvious alternatives are on board with U.S. sanctions.


INTERNATIONAL MONETARY FUND

The Stealth Erosion of Dollar Dominance:

Active Diversifiers and the Rise of Nontraditional Reserve Currencies

Serkan Arslanalp, Barry Eichengreen, and Chima Simpson-Bell

WP/22/58

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2022
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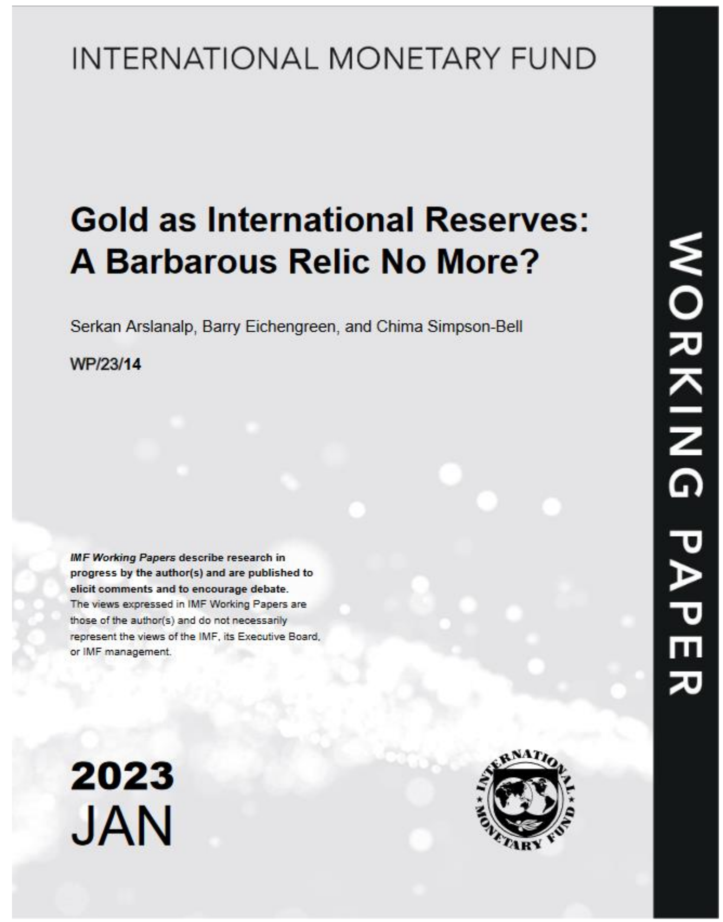
WORKING PAPER

What about the effect of sanctions? (So-called "weaponization of the dollar")

- However, we did find evidence of movement from currencies to gold here.
- Because gold vaulted at home is insulated from seizure/freezing (though it doesn't have much utility for transactions).
- And the effect is relatively small.


INTERNATIONAL MONETARY FUND

Gold as International Reserves: A Barbarous Relic No More?

Serkan Arslanalp, Barry Eichengreen, and Chima Simpson-Bell

WP/23/14

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Interim conclusions

- We are moving toward a more multipolar international monetary system that better matches our more multipolar global economy, but slowly, slowly.
- More aggressive/widespread use of sanctions could conceivably accelerate that transition.
- But, to repeat, we haven't seen much evidence of reserve diversification away from the dollar yet.
    - China may have trimmed its holdings of U.S. Treasuries, but it has mainly substituted U.S. agencies, which are attractive for their higher yields.
- And movement away from the dollar doesn't automatically imply movement toward the RMB (or the euro).

Final takeaways

- Hyperglobalization is dead, but globalization is very much alive.
- Globalization as we know it is being reconfigured by a loosening of links between the U.S. and China.
  - Despite Biden and Xi meeting last month in San Francisco, it is hard to see this being reversed anytime soon.
- Rerouting trade and finance in this way entails some additional costs, but arguably has some security benefits to the countries driving these changes. Whether the benefits exceed the costs is as much a political as well as an economic calculation.
- This loosening of links benefits Southeast and South Asia, as well as (to an extent) Latin America.
  - Not all countries, even within these regions, will benefit equally, since some are better placed to step up and fill the vacuum created by China's partial exit from U.S. import markets, while others will suffer from the slowdown in global growth resulting from this efficiency/security tradeoff.

- Thank you.