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BLOG

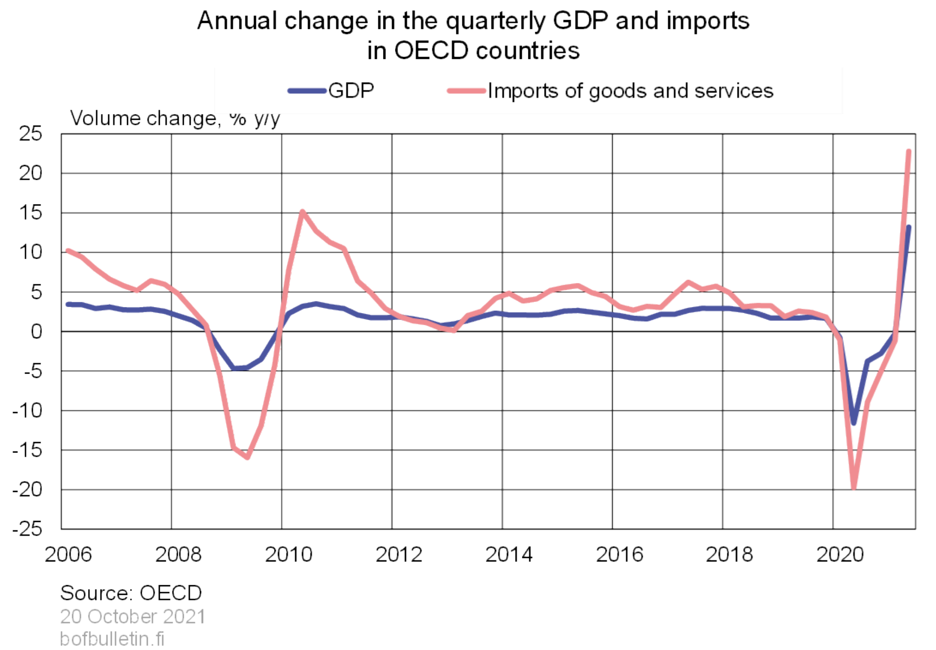
Consumption and service sectors key factors in the global trade collapse during the COVID-19 crisis

Today – Blog

AUTHOR
Heli Simola
Senior Economist

The global economy and global trade flows have been hit hard by the COVID-19 crisis. The trade collapse in the second quarter of 2020 was even more severe than during the trough of the global financial crisis (GFC) in 2009. However, taking into account the substantial fall in the GDP of most countries during the COVID-19 crisis, the relative trade contraction seems milder compared with the GFC. During the GFC, the combined volume of the GDP in OECD countries contracted by about 5%, and the combined volume of imports of goods and services by 17% from peak to trough (Figure 1). The corresponding figures for the COVID-19 crisis were -12% and -20%, respectively. Trade has also recovered rapidly since the trough in the second quarter of 2020. Trade was almost back at pre-crisis level by the end of the year.

Chart 1.



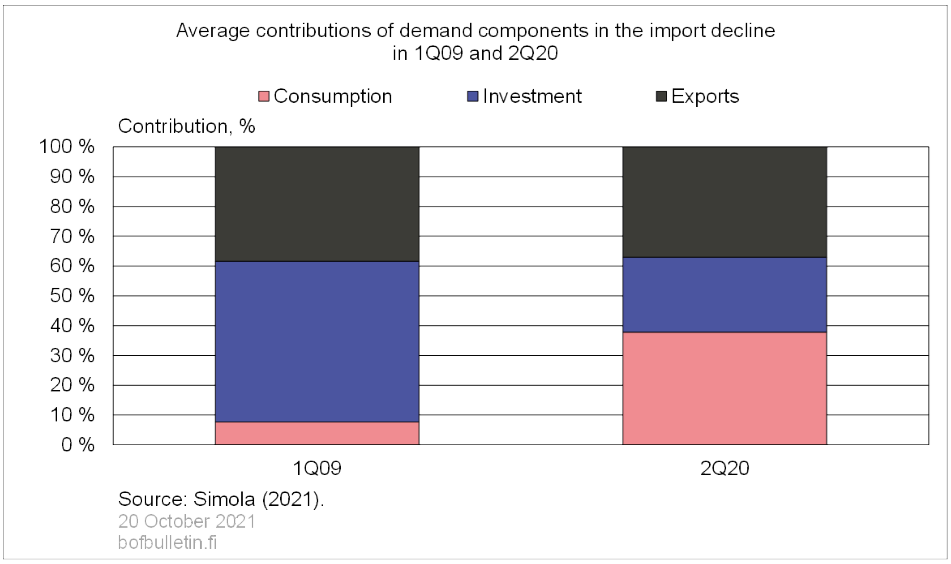
To shed light on potential factors that may explain this development, I examined the role of demand side factors in the COVID-19 trade collapse and the GFC in a recently published BOFIT discussion paper [1]. A simple explanation for the relatively mild trade collapse could be a decline in the global demand elasticity of trade after the GFC. We cannot, however, find support for this hypothesis either for advanced or for emerging economies. This is in line with the results of several previous studies finding that the demand elasticity has not declined in past decades [2].

Another factor behind the relatively milder trade collapse could lie in the structure of demand changes. The literature suggests that compositional effects associated with changes in final expenditure explain most of the contraction in trade during the GFC [3]. Our findings imply that demand factors indeed played a key role also in the COVID-19-induced trade collapse. Import-intensity-adjusted demand that takes into account the varying share of imports in different demand components (consumption, investment and exports) explained an even larger share of the import contraction than during the GFC.

The compositional effect of demand changes was, however, very different during the COVID-19 crisis and the GFC. The trade collapse in 2020 was in most countries led by decline in import demand for consumption, while in 2009 it was much more strongly associated with a decline in import demand for investment (Figure 2). Decomposing the total demand effect shows that in 2020 the average contribution of consumption demand to the import collapse was 38%, while it was only 6% in 2009. In contrast, the contribution of investment demand was 25% in 2020 compared with 55% in 2009. The trends are similar across advanced and emerging economies, although in emerging economies the import decline was even more pronouncedly consumption-led during the COVID-19 crisis. Consumption is typically less import-intensive than investment. Thus, the relatively milder import contraction during the COVID-19 crisis is compatible with the decline in demand when adjusted for import intensity.

Chart 2.

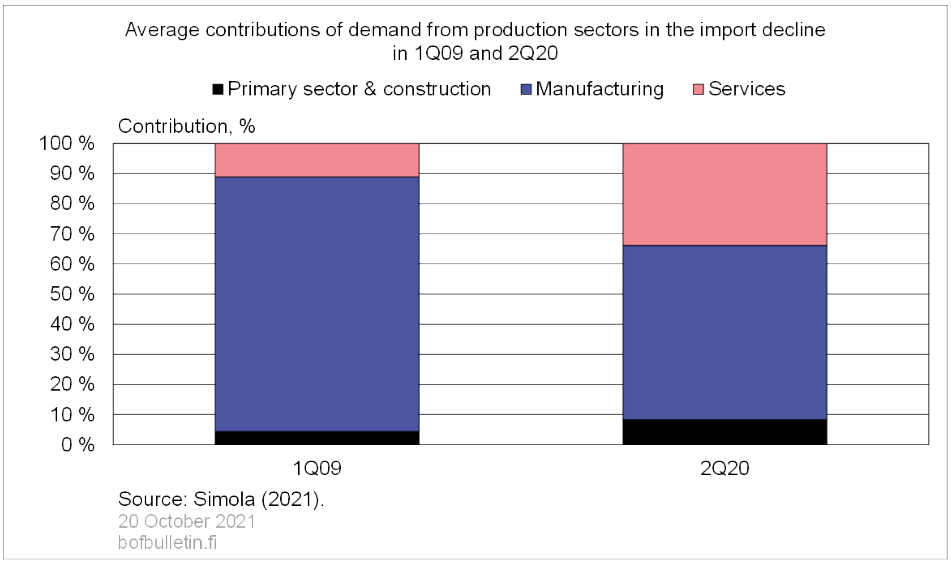
1. Simola, H. (2021). Trade collapse during the COVID-19 crisis and the role of demand composition. BOFIT Discussion Paper 12/2021.
2. See e.g. Aslam, A., Boz, E., Cerutti, E., Poplawski-Ribeiro, M. and Topalova, P. (2018). The slowdown in global trade: A symptom of a weak recovery? *IMF Economic Review*, 66(3), 440–479; Auboin, M. & Borino, F. (2017). The falling elasticity of global trade to economic activity: Testing the demand channel. WTO Working Paper ERSD-2017-09, April 2017.
3. Baldwin, R., ed. (2009). The great trade collapse: causes, consequences and prospects. VoxEU Report. Centre for Economic Policy Research, November 2009; Bems, R., Johnson, R. C. and Yi, K.-M. (2011). Vertical Linkages and the Collapse of Global Trade. *American Economic Review*, 101(3), 308–312.



The picture of the COVID-19 trade collapse can be further complemented with analysis on demand component effects arising from the production structure of the economy. Final demand in manufacturing and primary sectors is typically more heavily oriented to imports than final demand in the service sector and construction. The current crisis has hit the service sector particularly hard with the strict restrictions imposed e.g. on the gathering and movement of people. This could also be reflected in the milder contraction in trade than in GDP, as service sector demand is less import-intense.

Decomposing the import decline during the crisis into sector contributions once again shows interesting differences between the COVID-19 crisis and the GFC. Although the manufacturing sector accounted for the majority of the import decline in 2020, the service sector also made a significant contribution (Figure 3). The contribution of the manufacturing sector was nevertheless still notably higher in the import collapse of 2009, while the role of the service sector was correspondingly much smaller. This picture is similar for both advanced and emerging economies, but the contribution of the service sector is higher for advanced economies. This highlights the unique nature of the COVID-19 crisis compared with previous crises in its strong focus on the service sectors.

Chart 3.



While the trade collapse during the COVID-19 crisis was stunning in its magnitude, in relative terms it was actually milder than during the GFC. Compositional effects associated with changes in final expenditure were a key factor also in the COVID-19 crisis, as during the GFC. The contribution of demand from consumption and the service sector in the trade collapse was notably larger in 2020 compared with 2009. Consumption and services are less import-intensive than investment or manufacturing. Thus, the relatively milder trade contraction during the COVID-19 crisis than during the GFC probably reflects changes in demand composition. Global trade has also recovered much more rapidly from the COVID-19 crisis than from the GFC, supported by the massive fiscal and monetary policy measures that were rapidly introduced across the world.

Tags

BOFIT, COVID-19, financial crisis, international trade