

Investment viewpoint

Facing a less global globe: the next decade

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Need to know

- Globalisation has moved in waves, helping to create disinflationary forces that shaped the modern economy. The Next Decade looks set to inaugurate a new era of de-globalisation that could spur higher structural inflation
- The shift will probably involve a mix of reshoring at domestic and regional levels. In addition, geopolitical issues are likely to be a focal point in the rewinding of supply chains
- The Next Decade is also on course to be more investment driven, focusing on clean technology, energy efficiency, automation and robotisation – all inherently more domestic-focused

What led to globalisation?

In modern history, the world has been through several waves of globalisation.

The first lasted from the end of the Napoleonic Wars in the early 19th century to the First World War. During that period, the value of exported goods climbed from approx. 10% of global GDP to 15%. Key drivers were the Industrial Revolution and the surge in trade among European countries, which then collapsed in the period between the world wars.

The second wave occurred from the end of the Second World War to the mid-1970s, helped by both political and technology-driven factors. The Treaty of Paris in 1951 created the European Coal and Steel Community with six initial countries, which morphed over time into the European Economic Community and ultimately the European Union (now with 27 members). In 1947, 23 countries signed the General Agreement on Tariffs and Trade, which became the World Trade Organization in 1995 (now with 164 members). These political initiatives led to a consistent drop in trade-weighted tariffs and lifted barriers to trade.

The development of efficient commercial civil aviation and merchant marines and the democratisation of telecommunications have also been cited as key contributors to the second wave of globalisation. During this period, the exchange of goods moved from 5% back to 15% of GDP. Globalisation paused from the mid-1970s to the late '80s – a decade of instability, floating exchange rates and rising/volatile oil prices.



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The third wave

The disintegration of the Soviet Union and the integration of China in the WTO in 2001 then kickstarted the third wave, with companies benefiting from the [availability of cheap labour](#) from Eastern Europe and China. The US, as the dominant world power, aimed to promote economic interdependence among countries. With Europe aligned through NATO, the US encouraged a new relationship with Russia. In Asia, the US sought the integration of China in the global economy, building on ties with allies Japan and South Korea. China then started its enormous [Belt and Road](#) global infrastructure project.

At the same time, the development of the internet and the shift to a knowledge-based economy in developed markets encouraged further integration. Global trade of goods moved from 15% to 25% of GDP. China became the factory of the world.

Key international [agreements](#) that helped shape trade – including the North American Free Trade Agreement (NAFTA) and the ASEAN Free Trade Area (AFTA) – were struck in this period. Foreign direct investment flows to emerging markets also surged in the 1990s.¹

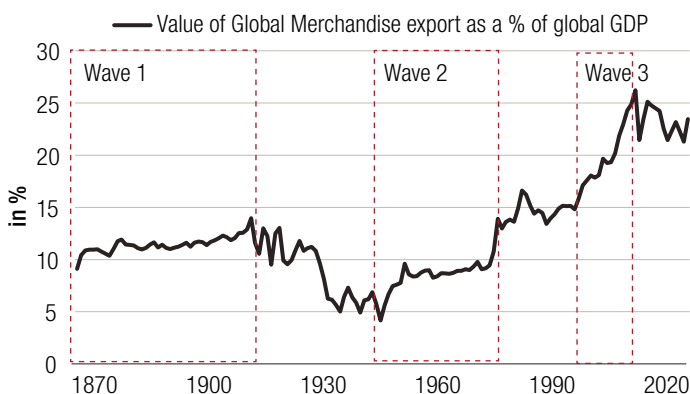
Since the Global Financial Crisis (GFC), global trade has been plateauing.

How did globalisation contribute to lower inflation?

As trade barriers dropped and globalisation expanded, competition between domestic and foreign producers increased. These reductions in barriers to market access fuelled price competition and led to more imports.

Production also shifted to countries with cost advantages, specifically access to raw materials and/or cheap labour. This de-localisation trend was key in allowing companies to remain cost-efficient amid fiercer competition.

FIG 1. GLOBALISATION AND ITS SUCCESSIVE WAVES



Source: Michel Fouquin & Jules Hugot , 2016. "Two Centuries of Bilateral Trade and Gravity Data: 1827-2014," CEPII Working Paper 2016- 14 , May 2016 , CEPII.

¹ [IMF](#), 2003.

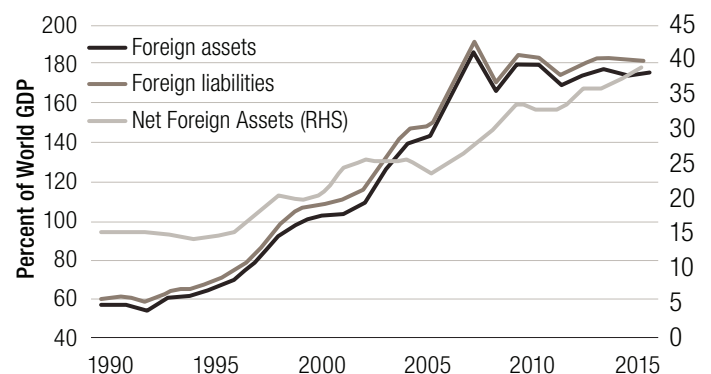
To illustrate this: in 1960, the average US household was spending about 9% of its annual budget on clothing, and 95% of it was produced in the US. By 2021, clothing had dropped to 3% of the average budget, and only about 3% of it is now produced in the US.

Globalisation is credited with boosting productivity because larger domestic and global markets allowed for economies of scale. At the same time, it helped certain countries develop areas of specialisation, enabling them to command a disproportionate market share in specific products (e.g., Taiwan commands 60% of global chipmaking) and to gain huge competitive advantage. The international transfer of knowledge and human capital also drives productivity gains. According to the ECB, that typically contributes to lower prices.

Consequently, globalisation has led to more financial integration, as illustrated by the increase in net foreign assets as a percentage of GDP (Figure 2). According to the IMF, persistent trade imbalances have driven growth in global net foreign asset positions (in absolute values) in recent decades. These positions have effectively acted as insurance against both domestic and global income shocks. More specifically, globalisation has reduced sensitivity to fluctuations in domestic production and probably contributed to a global economic harmonisation or stabilisation.

Finally, a last characteristic of globalisation has been the homogenisation of monetary policies. Over the last 20 to 30 years, central banks in each of the main advanced economies have shifted to targeting inflation specifically (Figure 3). Furthermore, the nature of monetary policy has changed dramatically since the 1970s, with central banks in almost all advanced economies and many emerging ones becoming independent.

FIG 2. GLOBAL FINANCIAL INTEGRATION



Notes: NFA are expressed in absolute value. Data from Lane and Milesi-Ferretti database (2017).

FIG 3. MONETARY POLICIES TARGETING INFLATION AROUND THE WORLD

Monetary policy frameworks in advanced economies

Country	Central bank	Policy framework	Definition of inflation target/objective	Target/objective point/range	Rerference price index	Commodity exporter
Australia	Reserve Bank of Australia	Inflation targeting	1996	2-3	CPI	Yes
Canada	Bank of Canada	Inflation targeting	1991	2 (1-3)	CPI	Yes
Switzerland	Swiss National Bank	Other	1999	0-2	CPI	
Euro area	European Central Bank	Price stability	1998	Below, but close to, 2%	HICP	
United Kingdom	Bank of England	Inflation targeting	1992	2 (1-3)	CPI	
Japan	Bank of Japan	Inflation targeting	2013	2	CPI	
South Korea	Bank of Korea	Inflation targeting	1998	2	CPI	
Norway	Norges Bank	Inflation targeting	2001	2	CPI	Yes
New Zealand	Reserve Bank of New Zealand	Inflation targeting	1989	2 (1-3)	CPI	Yes
Sweden	Sveriges Riksbank	Inflation targeting	1993	2	CPI	
United States	Federal Reserve System	Other	2012	2	PCE	

Source: International Monetary Fund.

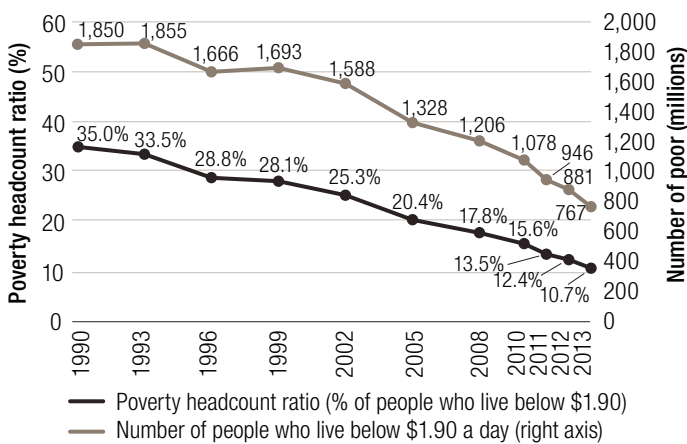
Widening cracks in globalisation will drive the Next Decade

In recent years, three main cracks emerged that threaten to undermine globalisation:

Crack 1: intra-country inequalities and protectionist bait

In recent decades, global poverty fell across the globe (Figure 4) as globalisation contributed to higher employment and income across developing countries, creating a growing middle class. At the same

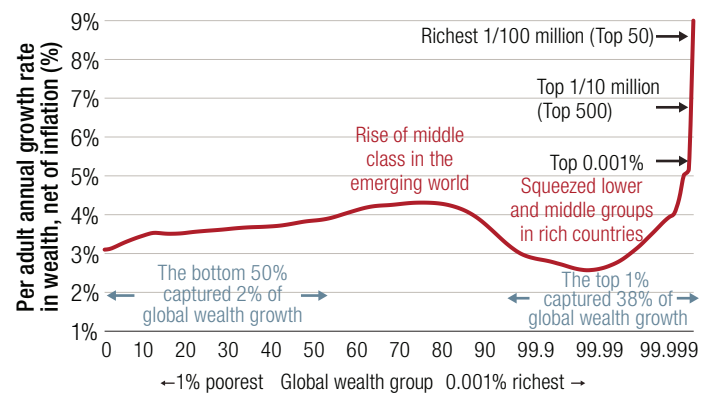
FIG 4. FALLING GLOBAL POVERTY



Sources: Balatti, M., "Inflation volatility in small and large advanced open economies", Working Paper Series, No 2448, ECB, 2020 and Annual Report on Exchange Arrangements and Exchange Restrictions 2019, International Monetary Fund, August, 2020.

time, however, lower and middle-income groups in rich countries have been squeezed, according to work by economist Thomas Piketty and others (Figure 5). Combined with a cultural backlash against progressive values, this growing income inequality helped fuel populism and protectionist mantras – contributing to events such as the Brexit referendum in Britain, the election of Donald Trump in the US and the so-called gilet jaune (yellow vest) protests in France.

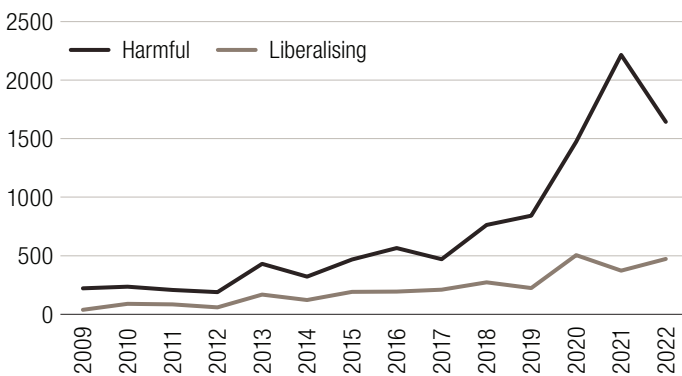
FIG 5. SQUEEZED LOWER AND MIDDLE IN RICH COUNTRIES



Source: World Inequality Report 2022.

Increased populism has already led to more protectionist trade measures globally, as reported by the Global Trade Alert. Since Trump's inauguration in 2017, followed by Brexit in early 2020, the number of "harmful" trade measures implemented has multiplied by 3.5x, outstripping by a factor of almost 4x the number of "liberalising" ones.

FIG 6. ASSESSMENT OF THE IMPLEMENTATION OF NEW TRADE MEASURES



Source: Global dynamics (globaltradealert.org).²

Crack 2: pandemic, supply chain disruption and regionalisation

Most recently, the pandemic exposed the limitations of elongated supply chains and a just-in-time management of inventories on a global basis. Lockdowns were the initial catalyst for a shortage of semiconductors from Taiwan that reverberated across industries. Maritime freight shipping costs surged as a lack of containers due to Covid-related transportation inefficiencies hit a breaking point. Port congestion caused widespread delivery delays.

A review of earnings call transcripts from members of the MSCI World (1,500 companies) shows that references to the term "supply chain" jumped 65% in Q2 '20 from the same period a year earlier. In Q2 '22, the number of mentions doubled from Q2 '20.³ Boardroom focus on the issue is red hot. Some 59% of companies say they adopted new supply-chain risk management practices over the past year, including diversifying to reduce reliance on China.

In some cases, countries will shift part of the supply chain back to domestic markets – so-called onshoring. But the solution to globalisation's cracks could also mean adopting a more regionalised approach to produce a greater proportion of key goods in the area where they are consumed.

² [Global dynamics \(globaltradealert.org\)](http://Global dynamics (globaltradealert.org)).

³ Source: LOIM, Bloomberg.

North America might benefit from shifting labour-intensive work from China to Mexico and Central America. To supply Western Europe with items used there, companies could increase their reliance on eastern EU countries, North Africa or Turkey. Chinese firms that want to protect their global market share are already looking to Egypt, Ethiopia, Kenya, Myanmar and Sri Lanka for low-tech, labour-intensive production, according to the Harvard Business Review.

Crack 3: increased geopolitical risk, friend-shoring and energy independence

Geopolitical risks have recently increased due to the conflict in Ukraine and heightened tensions between China and Taiwan. The war in Ukraine had multiple effects across value chains, through either disruptions or sanctions – from soft commodities (wheat, corn, sunflower seed) to metals (steel, nickel, copper) and energy prices (oil, gas, coal).

In June, NATO approved its 2022 Strategic Concept, the first update since 2010. The organisation clearly points to Russia as being a "major direct threat" and notes that China might be another threat.

Over the summer, US Treasury Secretary Janet Yellen proposed a move toward "friend-shoring" as way to create more resilient supply chains. This term was first coined in a report from the White House published in June 2021. The idea is to favour and support companies that deploy their supply chains across countries that share the same values.

In early 2022, the European Commission outlined a proposed plan, REPowerEU, to make Europe independent from Russian fossil fuels well before 2030. Diversifying energy sources, boosting efficiency, and accelerating investment in renewables and electrification are key solutions being put forward. Such investment would ultimately be focused on domestic markets, favoring local employment and helping to address issues related to "Crack 1" outlined above.

More recently, the US Inflation Reduction Act (IRA) has gone further in the direction of reshoring, along with the Infrastructure Investment and Jobs Act, and the CHIPS and Science Act. They are intended to more than triple the average US annual spending on climate and clean energy for this decade compared with the 2010s, while helping boost domestic employment and localise some key strategic industries in the US. The IRA's emphasis on domestic supply chains and new content requirements (for example, in electric vehicle components) in some respects mirrors the CHIPS Act, which boosts US semiconductor manufacturing.

Filling the cracks by unwinding globalisation

The third wave of globalisation is probably coming to an end.

In the decades before Covid, the world was shaped by increased competition between domestic and foreign companies, outsourcing to low-cost countries, product specialisation acquired by some nations, and increased financial integration and harmonisation of central bank policies against inflation.

These trends are now being challenged by the open cracks discussed above. Income inequality, increased populism, reconsideration of supply chains and inventory management, and rising awareness of geopolitical risks are key drivers for reshoring parts of supply chains into, or near, consumer countries. Resilience and independence are growing in importance.

Unwinding key aspects of globalisation will likely contribute not only to a higher level of inflation. It will also relaunch a wave of domestic investment, supported by public policies (REPowerEU, the US Inflation Reduction Act) that could help domestic industries, while benefiting clean technologies and infrastructure.

The end of globalisation also has a role to play in the move to increased automation and robotisation, which we explored in a [previous](#) instalment of our Next Decade series about demographic changes. Companies may look to these innovations as ways to control costs that could otherwise spiral in a de-globalised world.

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