Swiss Re Institute

Issue 1/2018

Economic Insights:
Protectionism on the rise, and here to stay

Key takeaways

- Protectionism is nothing new: non-tariff trade barriers were on the rise well before the escalation of current US-China trade tensions.
- What is new is a move to bi-polar and regional trade arrangements from multi-lateral agreements.
- So far, the economic and insurance impact of tariff increases has been limited given the small trade volumes involved. Development of a global trade war, however, would be very damaging and bring the global economy close to recession.
- Over the long-term, *sigma* estimates a 1% decrease in global trade growth would impact marine and trade credit premiums growth the most: a reduction of 0.7-0.9%.

About Economic Insights
Analysis of key economic developments and their implications for the global re/insurance industry.

Managing Editor
Jérôme Jean Haegeli
Swiss Re Group Chief Economist

Author
Finn Krüger
Senior Economist

Astrid Frey Kaufmann, Irina Fan, Caroline de Souza Rodrigues Cabral and Beat Habegger also contributed to this report.

We welcome your feedback. For any comments or questions, please contact: institute@swissre.com

In a nutshell

Protectionism is on the rise. So far the impact on the global economy and insurance has been negligible, but we believe a global recession could result if current actions morph into a fully-fledged trade war. A longer-term decline in trade will hit marine and trade credit insurance premium growth hardest.

The decade-long trend of falling global tariffs, facilitated by the formation of the World Trade Organization in 1995 and China's accession in 2001, has stalled. Despite lower explicit tariffs on goods (see Figure 1), protectionism has increased with rising non-tariff barriers for a few years.[1] The financial crisis of 2008-09 was the turning point: since then countries have responded to growing dissatisfaction with rising inequality and globalisation by engaging in stealth protectionism, mostly through non-tariff barriers. The Global Trade Alert recorded over 10 000 state protectionist interventions between November 2008 and 2017, versus just over 3000 liberalising policies.[2]

Recent years have seen a return of explicit tariffs too. By pursuing unilateral protectionism (ie, "America First"), the US no longer promotes the global multilateral trading system it helped build and protect. Once the tariffs announced this week (an additional 10-25% tax on USD 200 billion of imports from China) come into effect starting 24 September 2018, tariffs on imports into the US would rise to levels last seen in the 1970s.[3] Tariffs on US goods exports to the EU and China are also rising as these countries retaliate. The use of tariffs as political and economic lever sets a potentially dangerous precedent that could strain international relations. However, we should also keep in mind that the current US-China confrontation could lead to a more positive eventual outcome of fairer trade in the longer term.[4]

How will economies respond to the use of tariffs as the supply and demand of imports and exports adjust? US tariffs on imports from China, which will amount to USD 435 billion (2.3% of global exports and 0.5% of global GDP),[5] will hit semiconductors and reverberate across Asia, as electronic parts account for a significant portion of intra-regional trade. In turn, this will disrupt the operations of global companies, reduce dynamism and slow innovation as competition decreases. Additionally, heightened uncertainty will hamper economic growth, directly affecting investment decisions. These effects are not adequately captured in conventional economic models.[6] We also believe that tariffs could drive up inflation if higher costs are passed on to consumers, although this would be a one-time increase only.

[1] Tariffs barriers are tariffs placed on goods coming into a country. Non-tariff barriers are regulatory, technical or quantity control measures on imports. They represent higher compliance costs and can lead to lower trade.
[2] The Global Trade Alert, launched in 2009, attempts to hold countries to account on "no protectionism" pledges
[3] *Global Economics Analyst: Trade Wars: The Big Picture*, Goldman Sachs, 11 March 2018.
[4] M. A. El-Erian, "A "Reagan Moment" for International Trade?", *Project Syndicate*, 9 July 2018.
[5] The USD 435 billion total includes expected retaliatory measures from China.
[6] B. Eichengreen, "The Economic Consequences of Trump's Trade War", *Project Syndicate*, 12 July 2018.

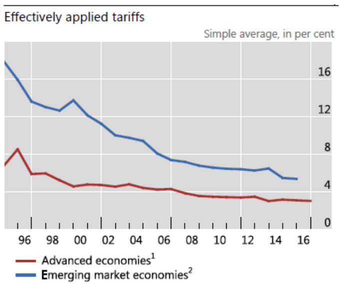
19 September 2018

Issue 1/2018

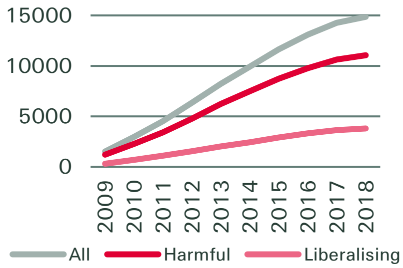
Economic Insights:
Protectionism on the rise, and here to stay

Figure 1(lhs)
Average tariffs by region (%)

Figure 2 (rhs)
Cumulative interventions (number)



Source: BIS/World Bank



Source: Global Trade Alert

There will be a lag before 2018 tariff increases start to show up in economic data. High-frequency data from the [CPB's World Trade Monitor] shows world trade growth slowing from 1.2% q-o-q growth in 1Q 2018 to stagnant in 2Q 2018. For the period 1H 2017 to 1H 2018, trade accelerated by 4%. Export orders of sentiment indicators, a proxy for uncertainty, have started to weaken in the US and Europe, may be due to increasing fear of a global trade war.

We expect current tariffs will have limited negative impact on global growth in the short-run. We attach a likelihood of 30% to development of a global trade war scenario with a significant global growth impact. A severe scenario with a 10% tariff on all goods trade could lead to global recession, with a cumulative loss of global GDP of up to 1.5%-2.5% over the next three years.[7] China, the US and Mexico would be most affected. Europe would suffer too.

With respect to insurance premiums, to date the impact of higher tariffs has been negligible. In the short term, rates are the most important driver of premium volumes but over time, we believe global premium growth will be negatively hit by higher tariffs, particularly in marine and trade credit lines. *sigma* finds that a 1% decrease in world trade reduces marine cargo premium growth by 0.89%, and for marine hull premiums by 0.80%. For trade credit, a 1% drop in trade would reduce premiums by 0.67%. Controlling for domestic demand and other factors, this declines to 0.32%.[8] An area of potentially stronger demand as a result of rising protectionism is political risk protection.

Finally, the current trend towards bilateral rather than multilateral trade agreements fragments regulation internationally. This poses challenges for international re/insurers by making cross-border transactions more costly and reduces the benefits of diversification of global companies, with detrimental implications for re/insurers' ability to close protection gaps.

[7] Capital Economics estimates that "if all governments imposed blanket tariffs of around 25% on all imports, world GDP would decline by 2-3% compared to a no-conflict scenario. See *Global Economic Focus*, Capital Economics, 9 July 2018. Meanwhile, Oxford Economics estimates a cumulative loss of global GDP of 0.7% by 2020. See *Global Scenarios: How great is the treat from a Trump trade war*", Oxford Economics, May 2018.
[8] *sigma* 3/2016: World Insurance in 2015, Swiss Re.