Global Economy Watch

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Whisper it, but global trade is becoming more local

CEOs tend to focus on short-term economic news as a useful predictor of business performance. Meanwhile, strategists tend focus on medium- to long-term economic trends. These tend to be slower moving, but can determine whether a business thrives or dies. In this edition of Global Economy Watch (GEW), we focus on how the global trading system is quietly changing. This is important for businesses, particularly multi-nationals, who are plugged into the international trading system.

The US and EU are trading more closely with their neighbours

Our analysis shows that trade is becoming more local than global, compared to the early 21st century. For example, for the US and large European economies, the trade weighted distance to their key trading partners is shrinking. This means that economies geographically closer to these economies are likely to benefit. Economies not likely to benefit from geographic proximity will need to ensure their competitive edge across a variety of measures is enhanced.

Global trade becoming more local is part of the broader Megatrends we are increasingly witnessing. In order to make trade patterns less unpredictable, countries are focusing inwards, prioritising their national resilience and localisation. Policymakers are responding by devising and implementing sophisticated industrial strategies. Businesses are following suit by responding to policymakers' choices.

Growth outlook more positive, services inflation sticky

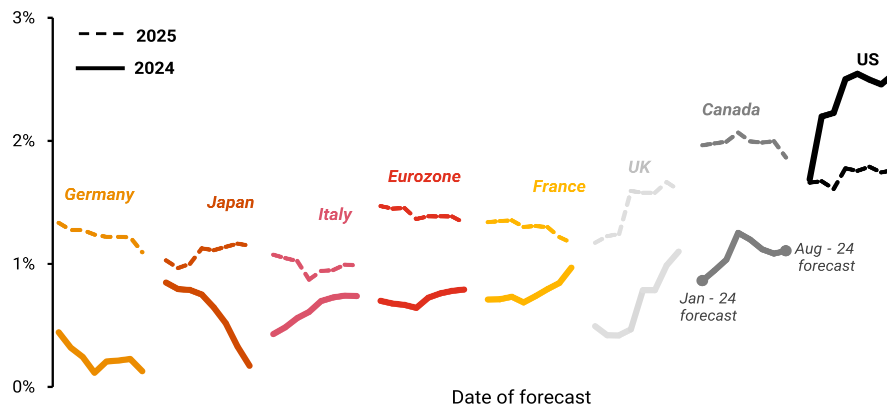
In terms of the broader economic outlook, even though the short-term projection remains stable, there has been some underlying change in the contributions. We expect the global economy to grow by 2.7% in market exchange rate terms for this year.

Figure 1 shows that the Eurozone's slowdown appears to have bottomed out, UK growth has started to pick up momentum, and US economic activity has slowed sooner than our initial expectations. Onto emerging markets, Chinese economic performance and in particular exports, are faring better than anticipated. India continues to boom, in part due to a trend for multinationals to establish a presence in a growing market but also a trend to 'friendshore' and diversify supply chains. In a turn of events, the peripheral European economies are now growing stronger than the core economies.

Momentum for global disinflation is slowing

Finally, headline inflation in the Organisation for Economic Cooperation and Development (OECD) economies has subsided from a peak of 10.7% in October 2022 to around 5.6% in June 2024. Yet services inflation remains sticky. European Central Bank (ECB) members have warned that the last mile of disinflation is likely to be the hardest to achieve now we are past the quick wins (base effects, falling energy prices, improvements to global supply chains, etc.). For most economies, such as the UK and the Eurozone the rate cutting cycle has already begun. The US has not yet cut interest rates, but the likelihood of a rate cut in September has increased in recent weeks, as the July jobs report showed that the labour market is cooling at a faster rate than expected.

Fig 1: GEW projections for 2024 and 2025 real GDP growth, by month of forecast, select economies



Sources: IMF, OECD, S&P Global, PwC analysis

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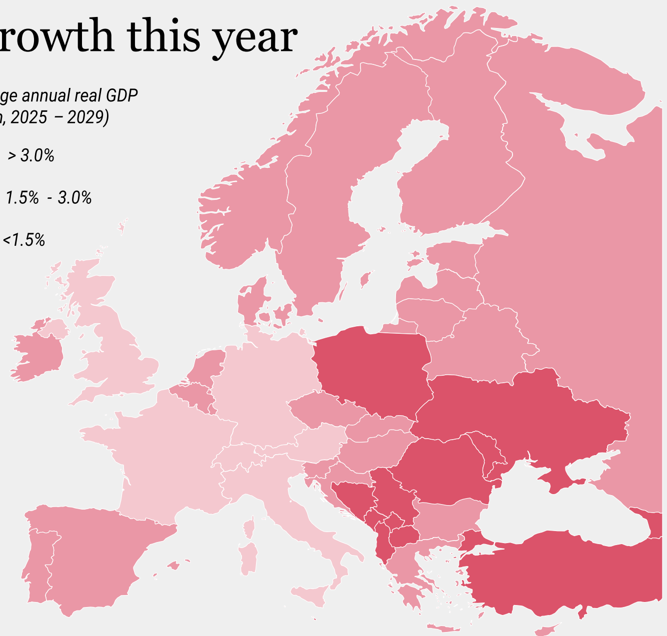
Peripheral European economies to drive growth this year

The European Commission upgraded its forecasts for European Union (EU) economic growth in 2024 to 1.0% in May, slightly above our projection of 0.8%. The Commissioner declared that the bloc has probably "turned a corner", with inflation falling and economic growth picking up. His statement is supported by the latest data which shows that the bloc grew by 0.3% in Q2, matching the growth posted in Q1.

Most of the economic growth across the continent is expected to come from the peripheral economies. In our main scenario projections, the peripheral European economies will grow at an average rate of 2.0% a year over the next five years, compared to a growth rate of 1.3% for the core economies.[1] For instance, Albania, Poland and Cyprus are projected to grow by 3.5%, 3.4% and 3.0%, respectively, compared to less than 1.5% projected growth for France and Germany.

To some extent, this represents a policy success. The EU has used the Recovery Fund and the Instrument for Pre-Accession Assistance to drive economic growth in exchange for structural reforms, with the peripheries the main beneficiaries. For instance, Greece and Croatia by 2026 will have received investment through the Recovery Fund equivalent to 16% and 13% of their GDP, respectively.



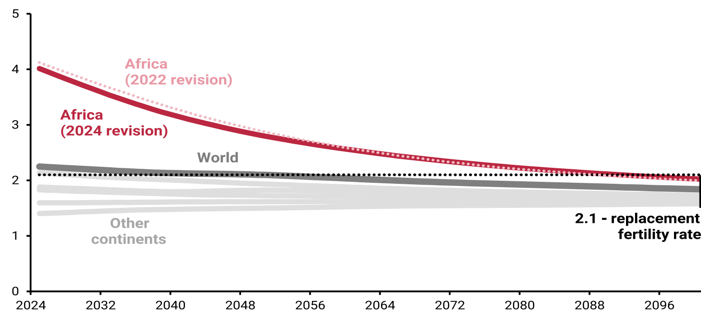
Sources: IMF WEO, S&P Global, PwC analysis

Will Africa's population dynamics drive future global economic growth?

The world is facing a dramatic demographic shift. By the end of the decade, Africa is expected to be the only continent with a fertility rate over 2.1. This is known as the 'replacement rate', whereby population growth is self-sustaining. According to the United Nations (UN), Africa's population growth is forecast to be much higher than the rest of the world. Their most recent 'medium' estimates show that by 2100, the population of Africa could make up one third of the global population, compared to less than one-fifth today.[2]

However, fertility rates in Africa are trending downwards. The UN now expects that they will fall at a slightly faster rate than the 2022 edition of their projections, in line with the continent's continued economic development and greater availability of contraception. By early 2090, Africa's fertility rate could dip below 2.1.

Fig 2: Projected fertility rates, Africa and other continents



Sources: UN, PwC analysis

Africa will soon have a larger working-age population than Europe & North America

The UN expects that the share of 25-64 year olds in Africa, as a proportion of the total population, will be higher than Europe and North America by the late 2050s and through the 2060s. The working age population share is expected to increase even in the region's largest economies, such as Egypt and South Africa. This should have obvious economic benefits. The old and young draw on the economic activity of the working-age population. With fewer dependents, each should get a larger share of the pie.

Theoretically, a larger pool of workers should also increase tax revenues, enable more specialisation, and increase productive capacity. However, clearly it is not that straightforward. Not only must new jobs be created, but workers need to be adequately qualified to fill them. According to data from the World Bank, in 2023 Sub-Saharan Africa had a literacy rate for individuals aged over 15 of 68%, 19pp below the global average. Corruption, conflict, and high levels of public debt also continue to constrain the region's growth prospects and threaten to hold the continent back over the long-term.

The agricultural sector still accounts for 15% of African GDP. Moving away from farming, mining, and commodity-based economies and towards manufacturing and industrialisation is the pattern by which most advanced countries became rich. Embarking on this transition now, through introducing new policies to tackle low education levels and corruption, would enable the continent to make the most of its demographic advantage.

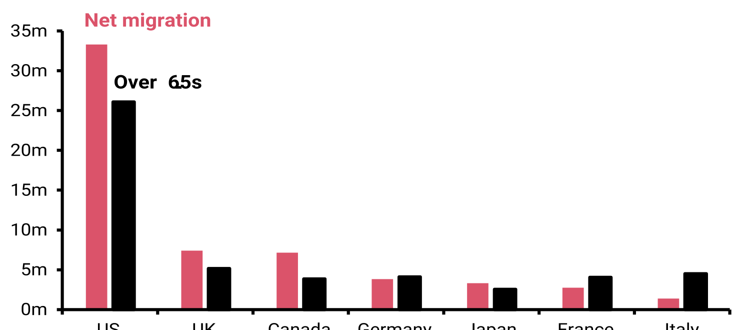
Could African immigration be part of the solution to drive growth in the advanced economies?

The richest 15 countries in the world all have fertility rates under the replacement rate, with many far below. The advanced economies are faced with populations that are ageing dramatically; Europe's share of over-65s is projected to increase 11pp to 32% by 2100.

One option to sustain economic growth is to look overseas for workers. In their latest update, the UN have revised up their net migration forecasts for most of the G7 economies over the next decades. As a result, net migration could help make up for the increase in the number of individuals over-65 in almost all the G7 economies (see chart below), with the obvious caveat that only some of these immigrants will be of working age.

With demographic ageing, there is also likely to be even more focus on leveraging advanced technologies like Generative Artificial Intelligence (AI) to drive productivity enhancements and therefore economic growth. PwC UK's report, the AI Jobs Barometer, provides some early evidence that sectors more exposed to AI are starting to see faster-than-average productivity growth.

Fig 3: Net migration and change in over-65s, G7 economies, 2024 to 2050



Sources: UN, PwC analysis

[1] Core economies include: Austria, Belgium, Switzerland, Germany, Denmark, France, UK, Ireland, Italy, Luxembourg and the Netherlands

[2] United Nations, World Population Prospects 2024, Link

The global trading environment is quietly becoming localised

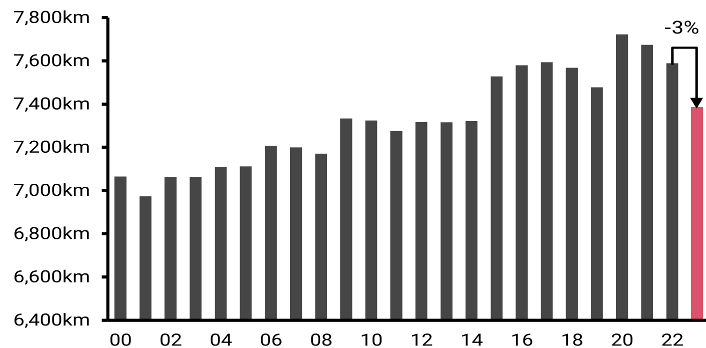
In a previous edition of the Global Economy Watch, we predicted that 2023 would be a defining year for global trade as we entered a new phase of globalisation that we call 'slowbalisation'. At a high level, we predicted a trend towards a combination of reshoring, nearshoring and friendshoring, particularly in sectors of the economy that are deemed strategic or sensitive. This refers to either bringing operations back home or the gradual alignment of supply chains to countries that are closer geographically or closer in terms of their economic, political and institutional systems. Is there evidence of this shift occurring, or will business-as-usual prove too good to give up?

Trade is coming closer to home, again

The gravity theory of international trade suggests that the volume of trade between two countries is proportional to the size of their economies and the physical distance between them. However, in recent decades, the importance of distance in the gravity equation has started to diminish due to global trends. The combination if rising services trade, improved communications technology, and more predictable and common markets in the global trading arena, have all made long-distance trade easier.

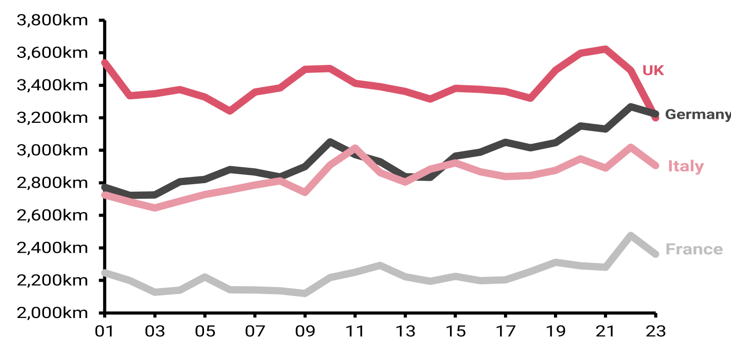
However, our analysis of bilateral trade data[3] suggests that distance is starting to play a bigger role in trade once again. Although the average distance between a country and its import partners is clearly volatile, it seems that in recent years there has been a material downward trend for most of the countries in our sample. For example, we find that the average distance between the US and its major import partners was around 3% lower in 2023 relative to the previous year. This is the largest annual decline for over 20 years and brings this measure of interconnectedness to its lowest level since 2014. The picture is similar for the UK, where the average trade-weighted distance is down 8%, again the largest decline for two decades. This trend is consistent amongst major EU economies with France and Italy seeing declines of -5% and -4%, respectively.

Fig 4: Average trade-weighted distance between the US and its import partners, by year (y-axis truncated)



Sources: US Census Bureau, PwC analysis

Fig 5: Average trade-weighted distance between the UK, Italy, Germany and France and their import partners, by year (y-axis truncated)



Sources: ONS, Eurostat, Statistisches Bundesamt, PwC analysis

What is driving this? For one, the world's largest economies have significantly reduced their exposure to Russia since the invasion of Ukraine. The US and the UK have also reduced their trade with China, with goods imports falling in real terms since 2019 by -19% and -3%, respectively.

The major economies are also increasingly importing from countries that are closer to them. For instance, in 2023 imports from Mexico accounted for 15% of all US imports, the highest for over 20 years and, for the first time since 2002 a larger share of imports compared to China. The trend is similar in Europe, with Italy, France and Germany all increasing their proportion of imports from within the EU in 2023 by 11%, 8% and 7%, respectively.

Government incentives are also accelerating the onshoring agenda, particularly in the US. Congress has now passed three bills (Inflation Reduction Act, Infrastructure Act, CHIPS Act) in the space of two years that will make $2tn available to re-industrialise. The EU have responded in kind, providing over three-quarters of a trillion dollars in loans and grants to businesses and individuals to promote a green transition through the Recovery and Resilience Facility, which is hoped to reduce their reliance on energy imports over the long-run.

Sharing the spoils from trade fragmentation

As these trends continue, the key question is, who stands to benefit. In the first instance, we expect that the initial beneficiaries will be the immediate neighbours of the major economies. We have started to see initial signs of this in the case of the US, with imports from Mexico in 2023 up 12% since 2021 in real terms.

However, business leaders that are considering relocating their operations are likely to look beyond proximity alone. In Table 1, we show a high-level assessment of the trade attractiveness of some of the world's largest emerging markets based upon the strength of their economic, political and institutional systems.

We find that China will be a difficult market to replace, with close to a billion people of working-age, competitive infrastructure and a stable political climate. India is the closest match in terms of sheer size, but it lags behind China on skills and infrastructure. Others, such as Malaysia, boast a competitive offering on skills, political climate and infrastructure, but cannot compete in terms of the size of their labour force. Businesses looking to make changes to their operations or to find new trading partners will need to balance these trade-offs.

Table 1: Assessment of trade attractiveness for emerging markets, where 1 = best

	Pool of workers	Skills of workers	Political risk	Infra-structure
1	CHN	MYS	VNM	MYS
2	IND	BRA	MYS	CHN
3	IDN	THA	IDN	TUR
4	BRA	RUS	BRA	RUS
5	RUS	IDN	CHN	MEX
6	MEX	MEX	IND	IND
7	VNM	CHN	THA	THA
9	TUR	TUR	TUR	IDN
8	THA	VNM	MEX	VNM
10	MYS	IND	RUS	BRA

Sources: IHS Markit, WEF, Barro-Lee, PwC analysis

[3] Data from US Census Bureau, Office of National Statistics, Eurostat, and Statistisches Bundesamt

[4] We have assessed the attractiveness of emerging markets using the following indicators: *working age population, average years of schooling, political risk, and infrastructure quality from the World Economic Forum Competitiveness report*

Projections: August 2024

	Share of 2023 world GDP		Real GDP growth			Inflation		
	PPP	MER	2024p	2025p	2026-2029p	2024p	2025p	2026-2029p
Global ("MER")		100%	2.7	2.6	2.5	3.3	2.7	2.6
Global ("PPP" rate)	100%		3.2	3.0	2.9	3.3	2.7	2.6
G7	30.1%	44.7%	1.7	1.6	1.6	2.6	2.1	2.1
E7	38.1%	28.3%	4.6	4.2	3.9	4.1	3.4	3.3
United States	15.6%	26.1%	2.5	1.8	1.9	2.8	2.1	2.2
China	18.8%	16.9%	5.0	4.5	4.0	0.5	1.4	2.0
Japan	3.7%	4.0%	0.2	1.1	0.7	2.3	2.1	1.9
United Kingdom	2.2%	3.2%	1.1	1.6	1.4	2.3	1.9	2.0
Eurozone	10.2%	12.9%	0.8	1.3	1.4	2.3	2.0	1.9
Germany	3.2%	4.3%	0.1	1.1	1.4	2.4	2.0	1.9
France	2.2%	2.9%	1.0	1.2	1.3	2.4	1.9	1.8
Italy	1.9%	2.2%	0.7	1.0	0.7	1.3	1.9	1.9
Spain	1.4%	1.5%	2.3	1.9	1.7	2.9	2.2	1.8
Netherlands	0.7%	1.1%	0.5	1.5	1.6	2.9	2.2	1.9
Ireland	0.4%	0.5%	0.7	2.9	2.4	2.0	2.0	1.9
Portugal	0.3%	0.3%	1.7	1.9	1.8	2.5	2.0	1.9
Greece	0.2%	0.2%	2.0	2.3	1.6	2.8	2.2	1.9
Poland	1.0%	0.8%	3.0	3.7	3.3	3.9	4.5	2.8
Russia	3.0%	1.9%	3.2	1.4	1.7	7.4	5.1	4.1
Türkiye	2.1%	1.1%	3.5	2.9	3.7	56.3	28.8	19.7
Australia	1.0%	1.7%	1.4	2.2	2.2	3.4	2.8	2.6
India	7.6%	3.4%	6.8	6.6	6.4	4.7	4.5	4.5
Indonesia	2.5%	1.3%	5.1	5.1	5.0	2.7	2.7	3.1
South Korea	1.7%	1.6%	2.5	2.2	2.1	2.5	2.0	1.9
Brazil	2.3%	2.1%	2.1	2.2	2.4	4.1	3.4	3.1
Canada	1.4%	2.0%	1.1	1.9	1.8	2.5	2.0	2.0
Mexico	1.9%	1.7%	2.0	1.7	2.2	4.5	3.6	3.4
South Africa	0.6%	0.4%	1.0	1.7	1.8	4.9	4.5	4.6
Nigeria	0.8%	0.4%	2.9	3.2	3.0	31.3	21.5	14.8
Saudi Arabia	1.3%	1.0%	1.5	4.4	3.3	2.0	2.1	1.8

e: Estimate, p: Projection
Sources: PwC UK and global analysis, national statistical authorities, EIKON from Refinitiv, IMF, Consensus Economics, the OECD, EBRD and The Economist Intelligence Unit. Our projections are a weighted average of projections from these sources. They also incorporate inputs from select teams across the PwC network. 'MER' refers to market exchange rates and 'PPP' is purchasing power parity. All inflation projections refer to the Consumer Price Index (CPI) unless otherwise stated. The table above form our main scenario projections and are therefore subject to considerable uncertainties. PwC recommends that our clients look at a range of alternative scenarios particularly for economies where there may be a high degree of volatility and uncertainty.

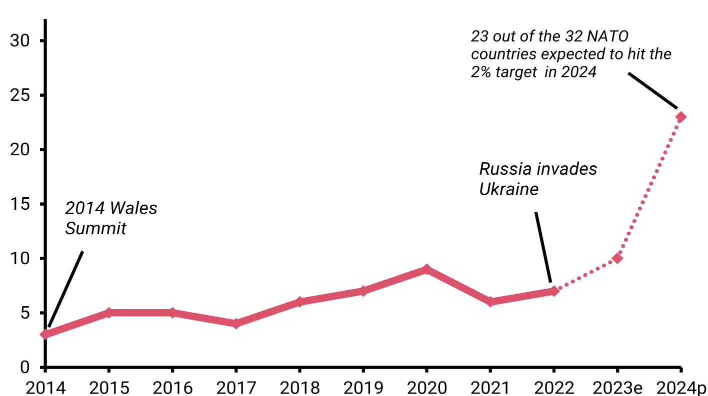
	Current rate (Last change)	Expectation	Next meeting
Federal Reserve	5.25-5.50% (July 2023)	Cuts expected in H2 2024	September 17-18
European Central Bank	4.25% (June 2024)	Cuts expected in H2 2024	September 12
Bank of England	5.00% (August 2024)	Cuts expected in H2 2024	September 19

Top of the charts

In 2024, for the first time ever, over two-thirds of NATO countries are expected to meet or exceed the target of investing at least 2% of GDP on defence. This compares to only three countries at the time of the 2014 Wales Summit, when the Alliance's then-28 leaders agreed to reverse the trend of declining defence budgets and raise them over the next decade.[5]

Since then, Russia's invasion of Ukraine, combined with a general perception that geopolitical volatility has increased in recent years, appears to have created a consensus amongst the world's political leaders that Europe in particular needs to spend more on its armed forces. Many have already made significant commitments. In France, Emmanuel Macron has pledged to reach the 2% target this year. Meanwhile, Germany plans to meet the target immediately, having created a fund of $108bn to bolster its armed forces.[6]

Fig 6: Number of NATO countries meeting the 2% of GDP defence spending target



Sources: NATO, PwC analysis

[5] NATO, Wales Summit Declaration, Link
[6] Reuters, Germany pledges to make its military 'the backbone of defence in Europe', Link

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