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Economic Watch

EAGLEs

Madrid, May 2013
Economic Analysis

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Asia-driven South-South trade intensifies specialization patterns in the rest of emerging regions

- **Rapid growth in emerging markets as the key driver, reinforced by trade liberalization and commodity flows**

  In the last 15 years, countries in the South have substantially increased their presence in international trade and South-South flows have climbed to a 15% of total global trade in 2012 from a mere 6% in the 80-90s. The key factors behind these developments are: first, and most obviously, much faster growth in the South; second, the creation of the Asian supply chain; and third, a much larger demand for commodities especially from Asia, which has also driven prices to record high levels.

- **Asia is at the gravity center of the South-South production network but with growing links with other emerging regions**

  During the last three decades, the share of Asia in South-South trade has increased steadily from less than 20% to more than 40% in 2012, boosted by intra-regional flows and led by China with a large contribution also from ASEAN countries. However, Asia's trade flows with other regions in the South are also very relevant, representing almost a 50% of total South-South trade.

- **Specialization patterns drive increasing trade flows between emerging economies**

  Around 80% of Asian exports to the South are concentrated in manufactured (including capital) goods, while the same share holds for commodity exports from the Middle East, Africa and Latin America. Intra-regional trade is also shaped by specialization patterns, including the development of manufacturing value chains in East Asia. In general terms, the relevance of basic goods have increased during the last decade and they have had a key role in the growing share of South-South trade. Among the EAGLEs, China and Korea are noticeable exceptions as they now sell a larger share of capital goods to the South.

- **Focus should turn on diversification and retaining value added**

  Commodity exporters should take advantage of current high historical prices to diversify their export structure. This does not really mean losing their comparative advantage but complementing it. For countries too dependent on manufacturing (mainly Asia but also Mexico) concerns turn to increasing the value added in their exports. China's rebalancing process, the increase in purchasing power and the middle class boom in the emerging world will challenge competitiveness in the South itself over the following years.

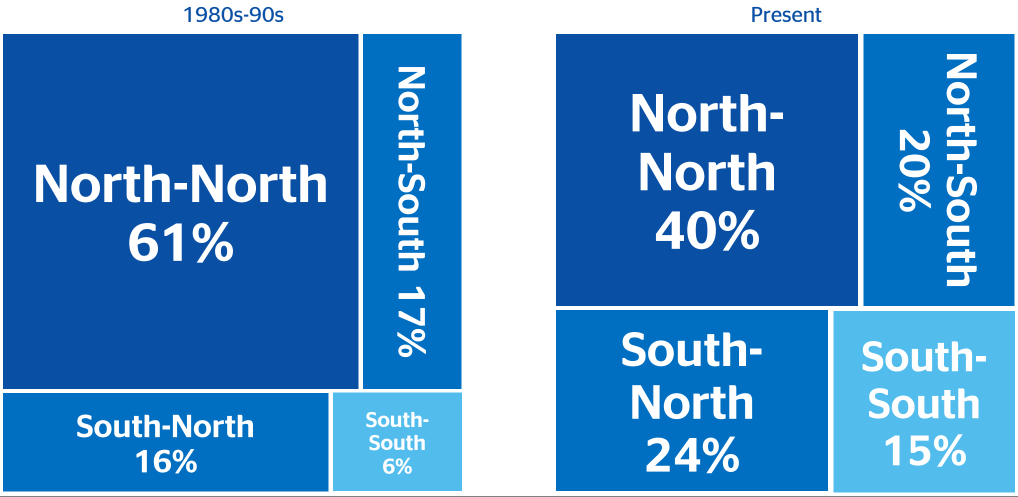
Rapid growth behind the increasing role of emerging markets in world trade

In the 80s and 90s, the so-called North (i.e. advanced economies) was involved in almost every single international trade flow, with a predominant role for North-North transactions (Chart 1)[1]. On the contrary, the South (i.e. emerging and developing countries) was involved in less than 40% of total world trade and, more importantly, South-South transactions were merely a 6% of the total.

At present, emerging and developing countries have increased their share in international trade to a 60% and South-South flows have climbed to a 15%:

- The main driver has been the **rapid growth of the South** during the last few decades. This has provided both a larger productive base for exports and a larger demand for imports, fostering trade flows with the North as well as intra-regional transactions. In nominal terms, the GDP of emerging and developing countries was equivalent to a 20% of the world aggregate during the 80s and 90s, whereas this figure has doubled in a decade and climbed to 40% in 2012.
- Trade openness for the North and the South has shown a pretty similar trend for decades, but further progress in **trade liberalization** has been one of the economic engines of emerging markets since the beginning of this century, in particular for Asia. China's entry into the WTO in 2001 has substantially increased the presence of this country in international world trade transactions, while the creation of a massive supply chain has been underway in the whole region, fostering competition and invigorating domestic markets.
- **Commodities' consumption** has grown substantially on rapid economic growth in the South. As production is still concentrated in the emerging world, increasing flows have made a significant contribution to South-South trade[2]. In addition to this volume effect, an increasing demand has pushed up prices to historically high levels.

Chart 1
Distribution of world exports according to origin and destination (% of total)



Note: 1980s-90s corresponds to the 1980-1999 average and Present to the 2010-2012 average
Source: BBVA Research and IMF/DOTS

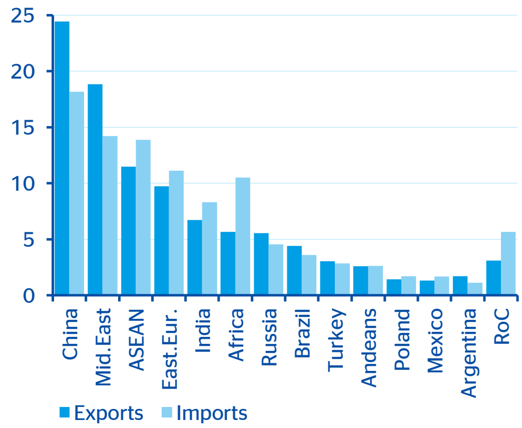
1: All trade flows in the report are measured from the export side and therefore on homogenous valuation terms.
2: "Latin American commodity exports concentration: is there a China effect?", Working Paper Number 13/06, BBVA Research, January 2013. www.bbvaresearch.com/KETD/fbin/mult/WP_1306_tcm348-370671.pdf?ts=1752013
"EAGLEs increasing demand turns energy security into a South-South issue", EAGLEs Economic Watch, BBVA Research, May 2013. www.bbvaresearch.com/KETD/fbin/mult/EW_EnergyMay13_i_tcm348-386066.pdf?ts=1752013

Asia at the gravity center of South-South trade

Both the starting point and the process have not been homogenous and the following developments are worth highlighting on a regional basis (Charts 2 to 5 and Map 1)[3]:

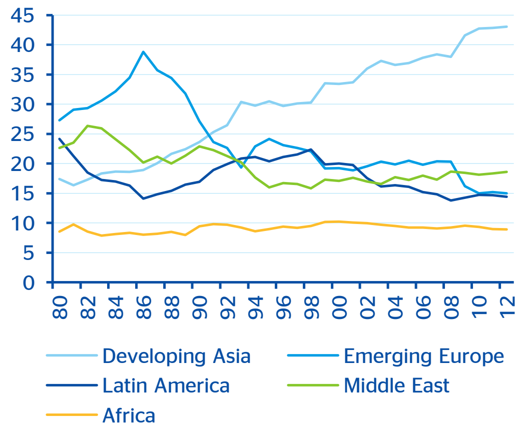
- **Asia is at the gravity center:**
  - The regional share in South-South flows has been steadily increasing during the last three decades, climbing from less than 20% in 1980 to more than 40% in 2012.
  - Intra-regional flows and transactions with the Middle East (mainly imports) constitute the bulk of Asian South-South trade network, while relations with Latin America are also significant.
  - By far, China has been the largest contributor to the boom in the last 10 years, adding more than ASEAN countries and India together (especially as an exporter).
  - Despite the large contribution in absolute terms and the significant increase, the ratio of Asian trade with the South is low relative to other emerging regions (40%). The same happens for China and some ASEAN countries.
  - On the contrary, Korea and India show a much higher reliance on South trade, with a share around 60%.

Chart 2
Contribution to the increase of South-South trade between 2000 and 2012 (%)



Note: Eastern Europe excludes Russia, ASEAN excludes Singapore, Andeans include Chile, Colombia and Peru; RoC = Rest of the Countries.
Source: BBVA Research and IMF/DOTS

Chart 3
Share of South-South trade flows by region (%) (1980-2012)

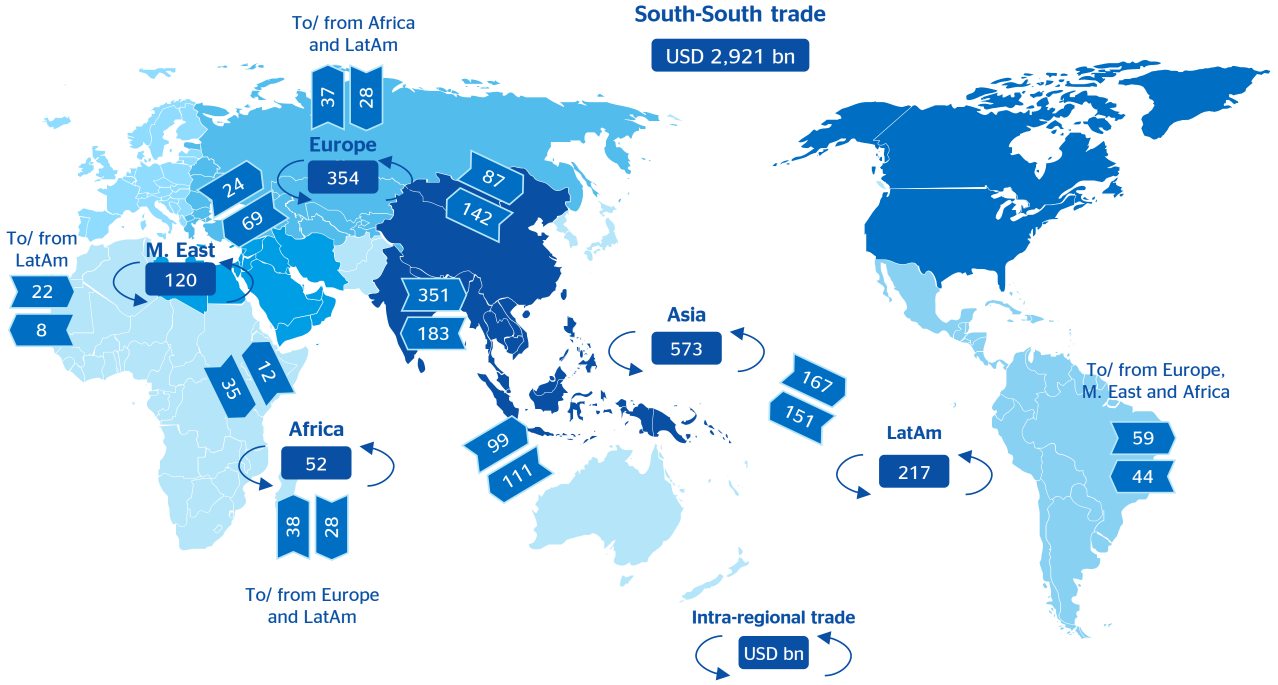


Note: The share is calculated on the sum of incoming and outgoing exports' flows.
Source: BBVA Research and IMF/DOTS

- **The Middle East gains relevance given its crucial role in energy supply:**
  - The share has been climbing during the last 15 years, becoming the second growth source of South-South exports since the beginning of the 21st century.
  - Exports to Asia are currently the main contributor to flows with the South (more than a 40% of the aggregate), followed by imports from Asia and intra-regional trade.
  - Reliance on Southern markets is the highest among emerging regions, representing almost a 50% of total trade. The effect is amplified on larger trade openness than the South aggregate (close to 70% of GDP vs. 50% respectively).

3: Regions correspond to those defined by the IMF/DOTS: www.esds.ac.uk/international/support/user_guides/imf/dotcty.pdf.

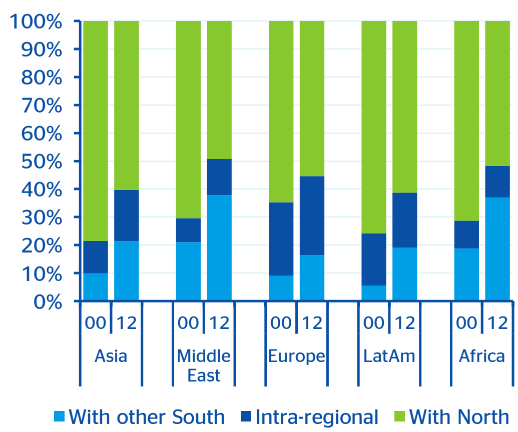
Map 1
South-South trade flows by regions (USD bn) (2012)



Source: BBVA Research and IMF/DOTS

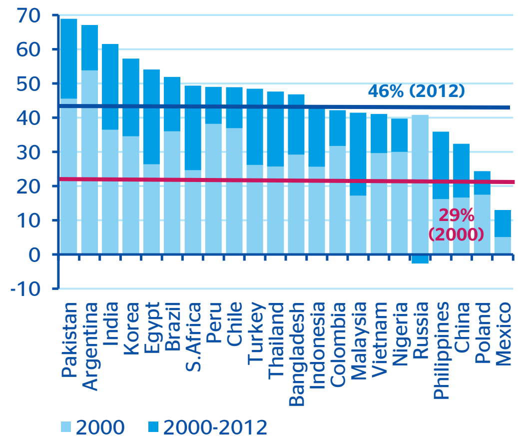
- **Turkey outperforms the rest of Emerging Europe, which in turn loses momentum:**
  - The share of the region declined substantially during the fall of Communism and more recently due to the Euro recession.
  - Intra-regional trade remains as the main contributor to relations with the South, followed by flows with Asia (53% and 38% respectively).
  - Russia and Turkey have had an important role in boosting South-South trade, although changes in partners have been much more relevant for Turkey, as trade with the South has almost doubled between 2000 and 2012 (from 26% to 48%).

Chart 4
Regional trade by partners (%) (2000 and 2012)



Source: BBVA Research and IMF/DOTS

Chart 5
South-South trade share for EAGLEs and Nest countries (%/pp) (2000 and 2000-12 change)



Note: Lines represent the simple average for each year.
Source: BBVA Research and IMF/DOTS

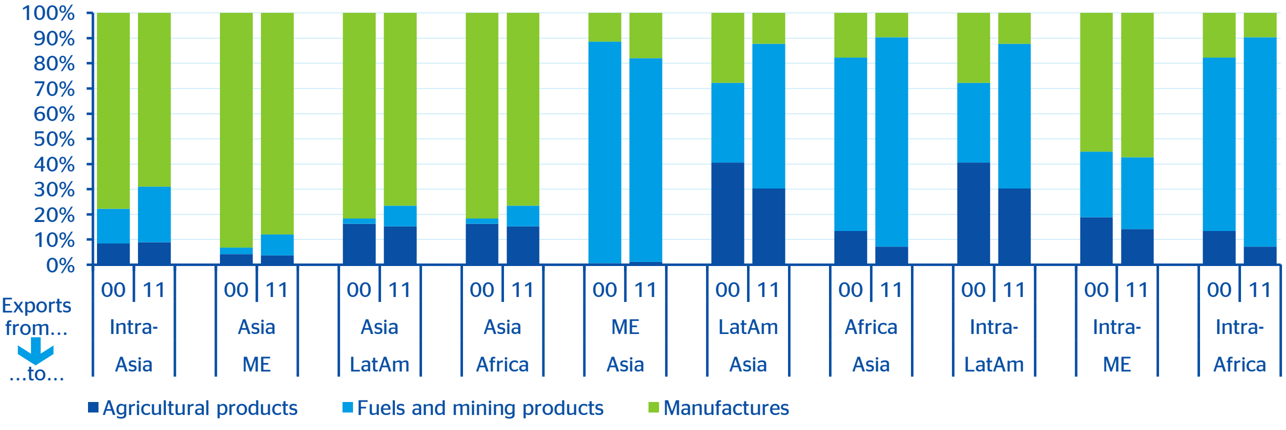
- **Asia, and especially China, has become Latin America's and Africa's driving force for South-South links:**
  - The share of Latin America in total South-South trade flows diminished considerably between 1998 and 2008 (from 22% to 14%), staying almost flat during the global crisis, while it has remained relatively stable for Africa around 10%.
  - Trade with Asia constitutes the most relevant flows for both Latin America (50%) and Africa (58%) after gaining share to the detriment of Northern partners.
  - Most EAGLEs and Nest countries in these regions show a ratio of trade with the South above the average, although the final effect is softened in Latin America due to its limited trade openness (below 40% of GDP).
  - Egypt and South Africa have more than doubled the trade ratio with the South in the last decade and is now around 50%. On the contrary, the lowest value in the sample is recorded in Mexico (13%).

Asia is behind important specialization patterns

In order to complete the picture of South-South relations, we now turn attention to product composition of trade. For that purpose, in this section we analyze the main regional export flows according to data provided by the WTO[4] (Chart 6):

- **Manufactured (including capital) goods predominate in Asian exports**, both on an intra-regional level, in which the development of value chains in the East stands out, and flows to the rest of the South world, with a share ranging from 70% to 90%.
- On the contrary, **exports received by Asia from other regions are mainly commodities** (agricultural, fuels and mining products); above 80% in most cases.
- **Commodity trade constitutes also the bulk of intra-regional flows in Latin America and Africa**, while manufactures are close to 60% in the case of the Middle East.
- In general terms, **commodity exports have gained ground in South-South trade** to the detriment of manufactures during the last decade (an average of 6pp).

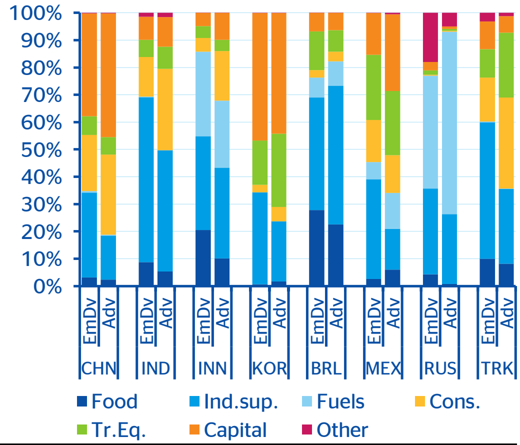
Chart 6
Distribution of regional exports according to product group (% of total) (2000 and 2011)



Source: BBVA Research and WTO

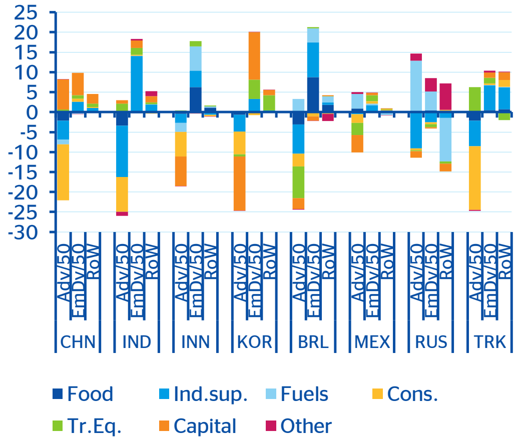
4 Europe is excluded from the analysis as no aggregate is available for non-advanced economies. For the sake of homogeneity, we subtract Japan from the Asian group and we add Mexico to South and Central America. Original composition of country groups are available at: http://stat.wto.org/StatisticalProgram/WSDBStatProgramTechNotes.aspx?Language=E#Composition_CG

Chart 7
Distribution of exports in EAGLEs by product groups and destination (2010)



Note: EmDv = Emerging and Developing; Adv = Advanced; CHN = China, IND = India, INN = Indonesia, KOR = Korea, BRL = Brazil, MEX = Mexico, RUS = Russia, TRK = Tukrey.
Source: BBVA Research and UN/COMTRADE

Chart 8
Change of exports' share in EAGLEs by product group and destination (pp) (2000-2010)



Note: EmDv = Emerging and Developing; Adv = Advanced; CHN = China, IND = India, INN = Indonesia, KOR = Korea, BRL = Brazil, MEX = Mexico, RUS = Russia, TRK = Tukrey.
Source: BBVA Research and UN/COMTRADE

We complement the regional approach with a country analysis for the **EAGLEs**[5] using more detailed data from the Broad Economic Categories (BEC) classification[6] (Charts 7 and 8):

- In general terms, the **exports' structure to the South is biased to basic goods**[7], while consumer and capital goods have a higher share in the case of the North[8]. This specialization pattern holds for Asian EAGLEs, Turkey and Mexico. On the contrary, Brazil and especially Russia, both relevant commodity producers, export a larger share of basic goods to the North than to the South.
- In most of the EAGLEs, **the increase of exports to the South has been concentrated on a higher participation of basic goods**, mainly to the relative detriment of consumer goods to the North. **China and Korea are the most noticeable exceptions**, as capital goods have been the main contributor to the increase of exports to the South as result of the respective substitution of products (consumer goods) and partners (North).

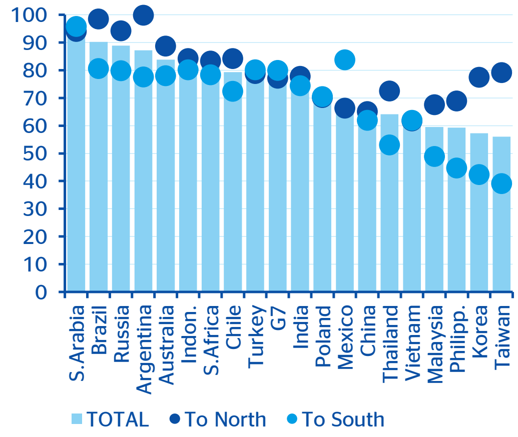
5: Korea has been excluded in previous sections as it is considered a developed economy by the IMF, but we now include it as an EAGLE member and part of the group of Emerging and Developing Economies.
6: 1/Food and beverages, 2/Industrial supplies, 3/Fuels and Lubricants, 4/Capital Goods, 5/Transport equipment, 6/Consumer Goods, and 7/Goods not elsewhere classified. Categories 4 and 5 include parts and accessories.
7: Basic goods are a wider concept than commodities, including food, beverages, industrial supplies, fuels and lubricants.
8: In this case we use data for the world largest 50 economies. The South (Emerging and Developing Economies) includes China, Brazil, Russia, India, Mexico, Korea, Indonesia, Turkey, Saudi Arabia, Iran, Argentina, Poland, South Africa, Thailand, Colombia, United Arab Emirates, Venezuela, Malaysia, Nigeria, Chile, Egypt, the Philippines, Pakistan, Algeria, Kazakhstan and Peru; the North (Advanced Economies) includes the United States, Japan, Germany, France, the United Kingdom, Italy, Canada, Australia, Spain, the Netherlands, Switzerland, Sweden, Norway, Belgium, Austria, Denmark, Singapore, Hong Kong, Greece, Finland, Israel, Portugal and Ireland.

Keeping value is an issue for Southern exporters

As we have pointed out in the last section, **product concentration** is an issue for some emerging economies. Putting all eggs in one basket is a very risky growth strategy and, without losing their comparative advantage, policies should drive a transition to a more diversified productive structure. Current high commodity prices and the expected incremental demand in the following years allow this transition to be implemented in a smooth way.

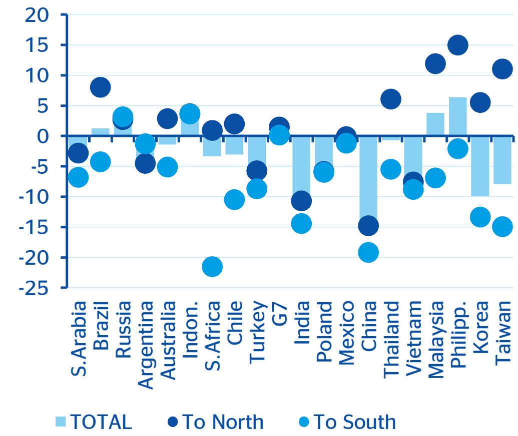
However, countries too dependent on manufacturing (mainly Asia but also Mexico) are not free of challenges. In this case, the focus should be on transitioning from competitive cost advantage in low-technology products to other sources of competitiveness linked to goods with more **domestic value added**. Some emerging economies are heavily dependent on foreign intermediate and capital goods and their exporting role is reduced to being an "assembly country", retaining a low share of value added at home.

Chart 9
Domestic value added embodied in foreign final demand as a % of gross exports (2009)



BBVA Research and OECD/WTO

Chart 10
Domestic VA embodied in foreign final demand as a % of gross exports (2000-09 pp change)



BBVA Research and OECD/WTO

On this point, we compare the domestic value added (VA) embodied in foreign final demand and gross exports using data provided by the OECD-WTO[9]. For analytical purposes and a wider comparison, in addition to the E-AGLES we extend the sample to Nest economies and take developed countries as a reference (Charts 9 and 10):

- **Commodity producers retain most of the VA of exports** as they exploit their own resources, although, as mentioned before, they face risks stemming from product concentration.
- Other emerging economies, which could be grouped as **manufacturers**, share the VA of their exports with suppliers of intermediate and capital goods. Turkey and India have records close to G7 standards, Poland and Mexico are a step behind, while **East Asian economies show the lowest ratios of domestic VA to gross exports**.
- In a significant number of cases, **the share of domestic VA is larger for exports to the North rather than to the South**[10], especially for commodity producers and South-East Asian manufacturers. The opposite situation is only remarkable in the case of Mexico.

9: Trade in Value Added (TiVA) database: www.oecd.org/industry/ind/measuringtradeinvalue-addedanoecd-wtojointinitiative.htm
10: 56 countries are included in the database. The South corresponds to Chile, the Czech Republic, Estonia, Hungary, Mexico, Poland, Slovakia, Slovenia, Turkey, Argentina, Brazil, Brunei, Bulgaria, Cambodia, China, India, Indonesia, Latvia, Lithuania, Malaysia, the Philippines, Romania, Russia, Saudi Arabia, South Africa, Thailand and Vietnam; the North includes Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Israel, Italy, Japan, Korea, Luxemburg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, the United Kingdom, the United States, Taiwan, Hong Kong and Singapore.

- The share of domestic VA in gross exports **significantly decreased between 2000 and 2009 for some countries**, such as China and India, both in flows to the North and the South, and Korea and Taiwan, with clear opposite trends for the regional aggregates.

Although further research is required, these results may suggest that a larger **South-South network has not provided a natural relief for general competitiveness challenges**. At the most, some progress has been recorded in exports to the North by East Asian countries, probably as a result of regional value chains.

China's rebalancing process, purchasing power gains and the middle class boom in emerging economies[11] will provide challenging tests for productive structures in the South. Demand patterns are changing fast towards products with more value added. **If the South wants to make the best of this new scenario, competitive actions on the supply side are required**. Complacency could eventually lead to middle-income traps.

11: "Emerging middle class in "fast-track" mode", EAGLEs Economic Watch, BBVA Research, January 2013.
www.bbvaresearch.com/KETD/fbin/mult/EWMiddleClasses_v24jan13_tcm348-371705.pdf?ts=2352013

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