

KASE STUDY#1

Are we witnessing a deglobalization?

First, it is important to understand what relies behind the concept of deglobalization. It is a movement towards a less connected world, characterized by powerful nation states, local solutions, and border controls rather than global institutions, treaties, and free movement¹.

Evidence of deglobalization: Case of China & USA

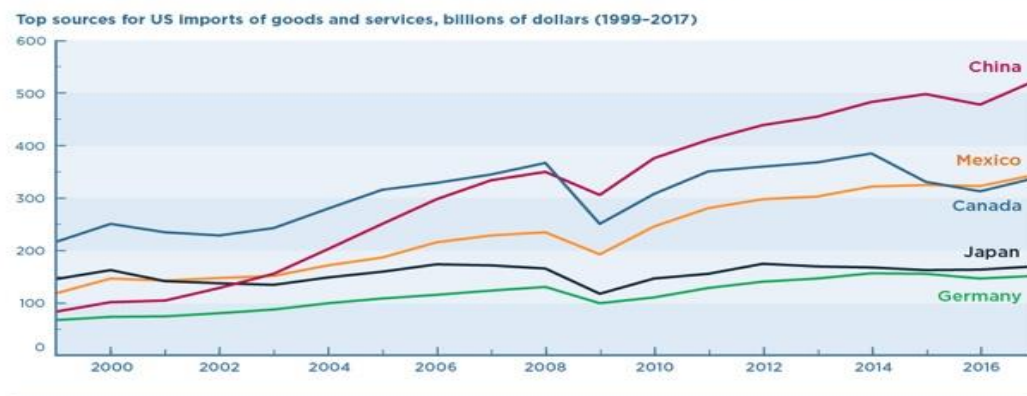
Technological progress has paved the way for international cooperation. Globalization is the word used to describe the growing interdependence of the world's economies, cultures, and populations, brought about by cross-border trade in goods and services, technology, and flows of investment, people, and information².

The effects of globalization are complex and politically charged.

From a macroeconomic point of view, the traditional relationship between China and the US that developed in the 1990's after the Cold War is disappearing.

The basis of this relationship was the following: the Americans had a huge external economic deficit towards China which resulted from the fact that they consumed a lot of Chinese products.

China has become the biggest source of US imports



Sources: US Census Bureau/Haver; top trading countries from US Census Bureau (<https://www.census.gov/foreign-trade/statistics/highlights/top/top1810yr.html>).

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And this deficit was subsequently filled by China which bought US Treasury securities in exchange, making it possible to refinance the deficit.

Economists back then called it *the Bretton Woods 2 Agreement*.

¹ <https://www.chathamhouse.org/2021/10/what-deglobalization>

² <https://www.piie.com/microsites/globalization/what-is-globalization>

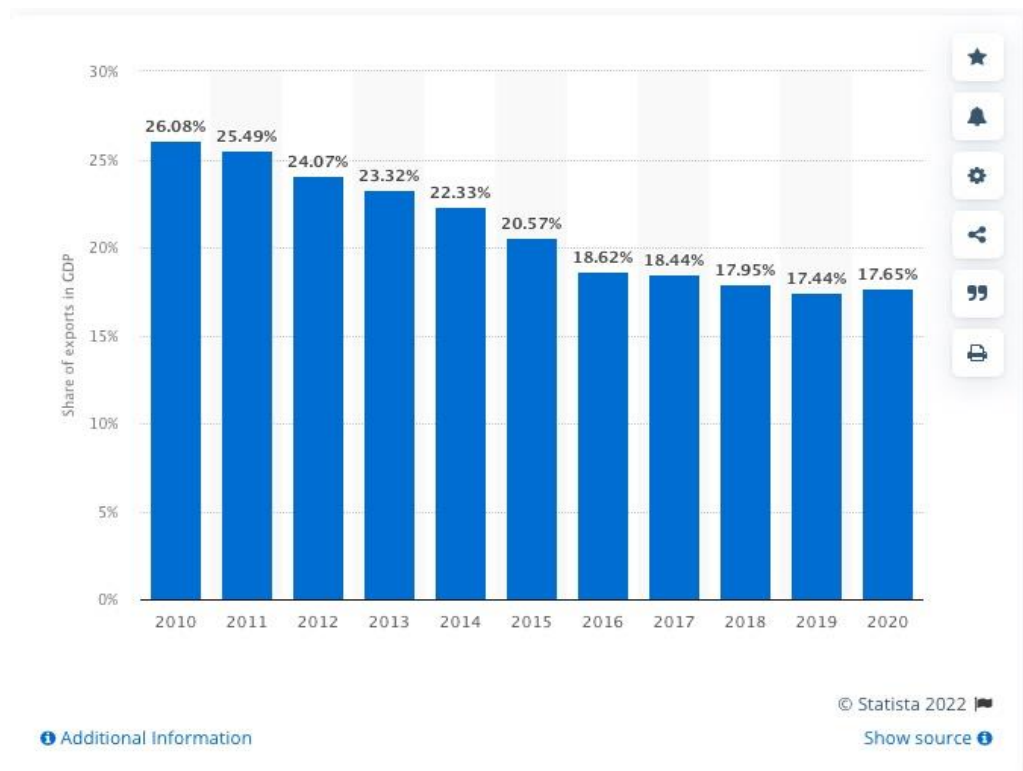
³ <https://www.census.gov/foreign-trade/statistics/highlights/top/top1810yr.html>

Basically, the Chinese continued to produce more, and the Americans continued to consume more. A sort of hybrid trend economic model. In other words, China was financing the US consumption. In 2021, China holds around 1.1 trillion\$ of U.S. Treasury securities⁴. Since 2013, this model tends to disappear as China stopped buying US Treasury securities and even started selling them on the market⁵.

This relationship between China and the US is being replaced by a new bilateral relationship between the US and Europe.

Except that President Trump does not seem to understand that this agreement between the US and Europe is very favorable to the American people because on one hand it is financed quite easily and on the other hand it allows American people to consume more.

From China's perspective, since 2013, the Chinese economy has become more closed. When we look at the chronological curve, the share of exports of goods and services in Chinese GDP is only 18% in 2020.



By way of comparison in France, this share represents 30%.

⁴ <https://www.forbes.com/sites/williampesek/2021/10/08/chinas-11-trillion-bet-on-us-treasuries-still-getting-trumped/>

⁵ <https://www.wsj.com/articles/china-sells-4-billion-of-dollar-bonds-borrowing-cheaply-once-again-11634668320>

⁶ <https://www.statista.com/statistics/256591/share-of-chinas-exports-in-gross-domestic-product/>

China's contribution to the world economy depends on how it is measured.

Accounting way: we take the Chinese GDP multiplied by the weight of the Chinese GDP.

The real impact of China in the world economy is the effect of China's imports on the growth of the rest of the world. Imports have stopped increasing for several years

In addition, the Chinese economy is a stagnant economy, which means that the growth of services is 6/7% per year. It is an economy that is becoming less and less dependent on world trade and more and more dependent on its domestic demand.

Deglobalization to Regional organization?

Since 2013, we have seen a return to regional value chains. FDI in China reached its peak in 2014 with more than 400 billion dollars.

Today, it fluctuates between 100 and 150 billion dollars depending on the quarter.

This decrease is not decelerating. We also must look at the weight of the OECD's imports from emerging countries which has not increased since 2007. We are no longer in a globalized trade order.

Global value chains are no longer economically advantageous:

- producing in China is not more economically advantageous than to produce for example in Central Europe
- it's complicated, and risky
- countries are pushing to manufacture locally

Example: to sell an aircraft in India, it must be manufactured in India. And to sell a car in China, it must be manufactured there.

Case Fact: Airbus has agreed to open a factory in Tianjin, China where A320 family aircraft are being assembled for its Asian airline clients.

This has been an ongoing negotiation fearing a transfer of technology that would benefit Asian countries allowing them to be able in the future to produce their own planes, which is the current case with Comac's⁷, first Chinese homemade plane, even though more than 40% of the parts suppliers are overseas⁸.

We are moving towards a regional trade organization. Moreover, China will evolve even more towards a closed economy, turned towards services and domestic demand.

It also means that there will always be multinationals but their factories in Asia will serve the Asian market and their factories in Europe will serve the European market and so on.

This organization of trade is important and is very unfavorable to countries which are significantly integrated into global chains such as Germany in Europe, China Korea, Japan in Asia that will at some point suffer from this situation.

⁷ <https://www.bbc.com/news/business-47689386>

⁸ <https://asia.nikkei.com/Business/Aerospace-Defense/China-develops-passenger-jet-but-40-of-parts-suppliers-are-overseas>

The pandemic and its consequences on the industry

The coronavirus pandemic has accelerated the perception of fragility.

We make an average car from parts that come from 40 countries.

If one country fails, it can have an impact on the entire production chain, compromising it and its logistics, even though the remaining 39 countries have managed to produce the rest of the parts. So, the risk is much greater, so the ideal would be to shorten the channels and make them more regional.

The pandemic has been very catastrophic for industries that lacked the following:

1. up to date Digital Information System
2. strong logistics partners => cost of 40ft container from China to Europe went from being priced at an average of 1700\$ before pandemic to reach an average peak of 10200\$ by end of 2021.



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It was mainly related to the Covid19 situation forcing ports to shut down operations and apply quarantine measures due to extreme governmental sanitary policy, but also the huge demand that followed up made containers unavailable for most of the time leading to high surge in prices. Moreover, most of the time most of the freight companies were overbooked, and it led to a grey market, where prices for containers reached a peak of 25000\$ for industrials that were desperate to have their cargo leave as soon as possible. These extra logistics costs will bear dramatic consequences for all the businesses, mostly it will weigh in on their margin

⁹ <https://www.drewry.co.uk/supply-chain-advisors/supply-chain-expertise/world-container-index-assessed-by-drewry>



throughout the balance of the year. Meanwhile, shares of A.P. Moller-Maersk A/S, the world's No. 1 container liner, hit a record high earlier this week. ZIM Integrated Shipping Services Ltd., an Israeli carrier that went public in late January, traded this month at more than triple its IPO price of \$15 a share¹⁰.

3. regional and local supply chains => a company must have different options to get its material and commercial items not only from suppliers that offer the best price, but the pandemic has proven that it is essential for a company's survival to also consider regional and local suppliers even though it bears an extra cost.
4. modern manufacturing tools => companies that have been able to overcome this lasting pandemic are the ones who have upgraded its manufacturing tools or have shifted from conventional to CNC machines. 4 important gains can be accounted for these companies which did that: boost productivity + increased level of quality + innovation + reduced production time cycle.
5. strategic stocking program => this has proven to be a critical point during the pandemic. Most companies have faced the absence of microchips that lead to various delays in different types of industries. Companies must elaborate a strategic plan to avoid a shortage in spare parts for its clients. Companies must target the most common spare parts and its best sellers to always have a stock available to its clients.

Can we say that company's growth will be weakened since the coronavirus pandemic took place?

The answer is yes. There is a major increase in business failures.

For example, in Q1 2020, the Chinese economy is hit by the health crisis and is losing growth enormously despite pressure from the government and the central bank to continue financing companies. It is always difficult to catch up with growth over the long term.

In addition, there will be fewer foreigners who will come to settle in China to produce, the weight of exports in the economy will drop and above all, many companies will have disappeared, and the accumulated capital will be lost and there will be savings that are no longer useful.

On top of that, the demographic capital is in decline because the population is aging.

There will be an acceleration of convergence towards lower growth within 5 years and which will show a growth rate between 3 and 4%.

For investors, what conclusion can be drawn from this major structural change?

Starting point: regionalization of production

We produce on a regional basis to the buyer of the goods.

Global multinationals change their organization but not their perspective.

¹⁰ <https://www.bloomberg.com/news/articles/2021-05-27/shipping-container-rates-top-10-000-from-asia-to-europe>



In a regional enterprise, the economic perspective will become that of the region. And this is bad news for Europe, because for example in Asia it is 5%, in the Americas it is 3%, but Europe is stagnant at 1%.

So when you are a strictly an EU company, the development prospect is low compared to companies from other regions. So it's not good in terms of capital allocation, we invest in the region where the growth prospect is strongest. Sometimes there is a methodology of reverse thinking saying that this is good news, and that it will lead to the relocation of companies to Europe. We are going to stop producing in Europe to sell in other regions of the world, so we are investing in Europe for the European market.