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Canada-UK Chamber of Commerce
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Rewired, recast and redirected: Global trade and implications for Canada

Introduction

The last time a Bank of Canada governor spoke to the Canada-UK Chamber of Commerce it was 2018. My predecessor, Stephen Poloz, spoke to you about low global interest rates, the steady reduction of inflation risks and the successful conclusion of the North American trade negotiations. Brexit was in motion but not yet a reality.

How the world has changed in just six years.

The pandemic, Russia's unprovoked invasion of Ukraine, and a global battle against inflation have altered the economic landscape. Concerns about national and economic security are changing trade, investment, and business decisions. Accelerating digitalization, particularly artificial intelligence (AI), is creating new competition for economic power. Geopolitical tensions are shifting economic relationships, and industrial policy is making a comeback.

In my time with you today, I'll talk about how trade is changing in response to these forces, both globally and for Canada. I'll also discuss what international financial institutions and the Bank of Canada can do to safeguard stability and prosperity as the global economy shifts beneath our feet. While there are many uncertainties, one thing looks clear: international trade will be different in the years ahead. Canada needs to be ready for the opportunities and the disruptions.

The benefits of open trade

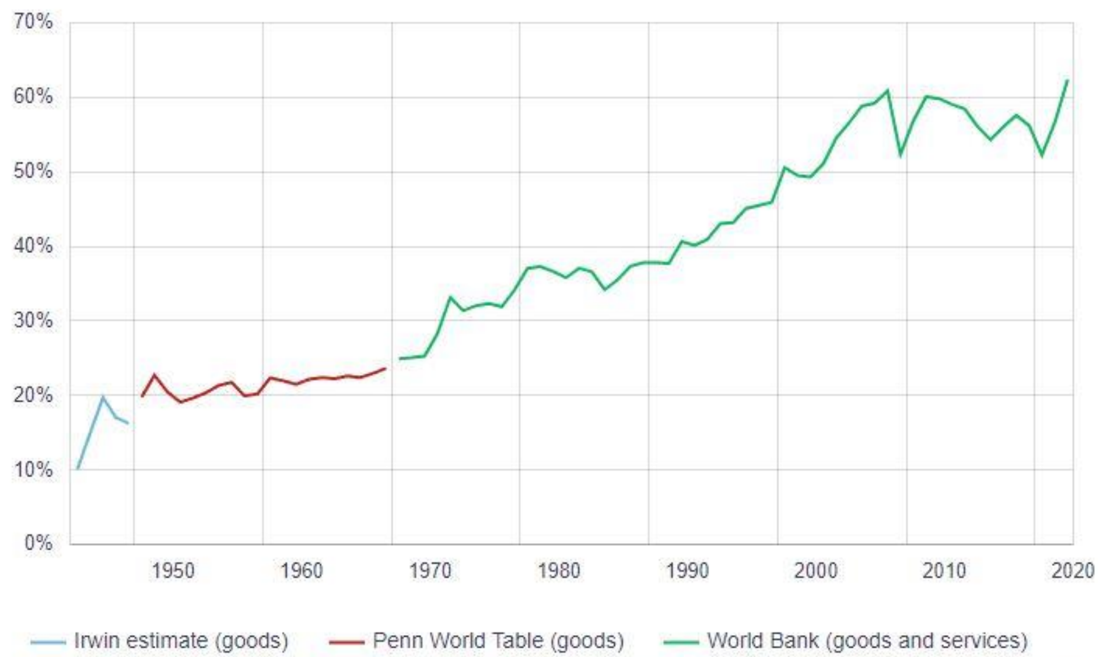
As World War II was ending, allied nations created the Bretton Woods institutions—the International Monetary Fund (IMF), the World Bank and what would eventually become the World Trade Organization (WTO). They wanted to avoid the protectionism and instability of the Great Depression. And they believed economic cooperation, including open trade, was the best way to sustain peace and build prosperity.

I would like to thank Patrick Alexander, Daniel de Munnik, Jessica Lee, Olena Senyuta and Ben Tomlin for their help in preparing this speech.

For roughly the next 65 years, rising global trade and economic growth went hand in hand. Open trade brought specialization, innovation and economies of scale. It drove investment, efficiency and productivity. For consumers, open trade increased selection and lowered prices. Trade spurred income growth across countries, lowered global poverty and raised standards of living.

Trade grew faster than GDP until about the global financial crisis in 2008–09.[1] Now, some think we've entered a new period of "deglobalization." Others see it as a slowdown in globalization—a "slowbalization." The enormous disruptions caused by the pandemic make the recent trend hard to discern, but there's no question global trade growth has at least slowed (**Chart 1**).

Chart 1: Trade as a share of GDP



Note: The Irwin estimate is from D. A. Irwin, "**Globalization is in retreat for the first time since the Second World War**," Peterson Institute for International Economics (October 2022). Penn World Table refers to A. Heston, R. Summers and B. Aten, Penn World Table Version 6.3, Center for International Comparisons of Production, Income and Prices, University of Pennsylvania (August 2009).
Sources: Irwin (2022), Penn World Table and World Bank
Last observation: 2022

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[1] S. Aiyar, J. Chen, C. H. Ebeke, R. Garcia-Saltos, T. Gudmundsson, A. Ilyina, A. Kangur, T. Kunaratskul, S. L. Rodriguez, M. Ruta, T. Schulze, G. Soderberg and J. P. Trevino, "Geoeconomic Fragmentation and the Future of Multilateralism," International Monetary Fund Staff Discussion Note No. 2023/001 (January 2023).

That’s a big concern, especially for open economies like Canada and the United Kingdom.

To some extent, a slowdown in global trade growth was inevitable. Once tariffs were substantially reduced and most economies were participating in global markets, the potential to expand trade by lowering tariffs further and including more countries became more limited.

But recent events have exacerbated this slowdown. New global tensions have added trade frictions between competing countries. Public and political support for open trade is also waning, in part because the benefits have not been evenly shared. We’ve all benefited from a wider selection of goods and services at lower prices. But when low-cost importers undercut domestic producers, workers who lost their jobs lost more than they gained. With changing economics, new security threats, and waning support, global trade is being rewired, recast and redirected.

Trade is being **rewired** by shifting international economics. China is no longer the lowest-cost global supplier of consumer goods. Production of many manufactured goods is moving elsewhere. As China moves up the value chain, it’s competing more directly with advanced economies. At the same time, the pandemic, Russia’s invasion of Ukraine, geopolitical conflict and climate change have all made supply chain resilience a greater priority, even at the cost of efficiency.

Trade policy is being **recast** to encompass national and economic security and to foster leadership in strategically important industries. Trade and industrial policy are being used to make the supply of critical inputs more secure and protect and promote domestic production in key industries.

Globally, trade is being **redirected** by import and export restrictions, tariffs and conflict. Trade in high tech is constricted by geopolitical concerns. The shift to cleaner growth is accelerating trade restrictions on raw materials needed for green energy. Climate change and conflicts threaten food security, prompting export restrictions on key staples. And Russia’s invasion of Ukraine has led to a multilateral expansion of the scope and reach of economic sanctions.

How does an open economy like Canada best navigate this changing trade landscape? That’s a big question, so let me break it down into some manageable bites.

Trends in global trade

There are three global trends to highlight. First, global trade growth has slowed, and this slowdown is concentrated in advanced economies. Second, the growth we are seeing in trade is shifting from goods to services. And third, trade is fragmenting as China’s role changes. In sum, trade routes and trade partners are shifting, and the implications for our prosperity could be significant.

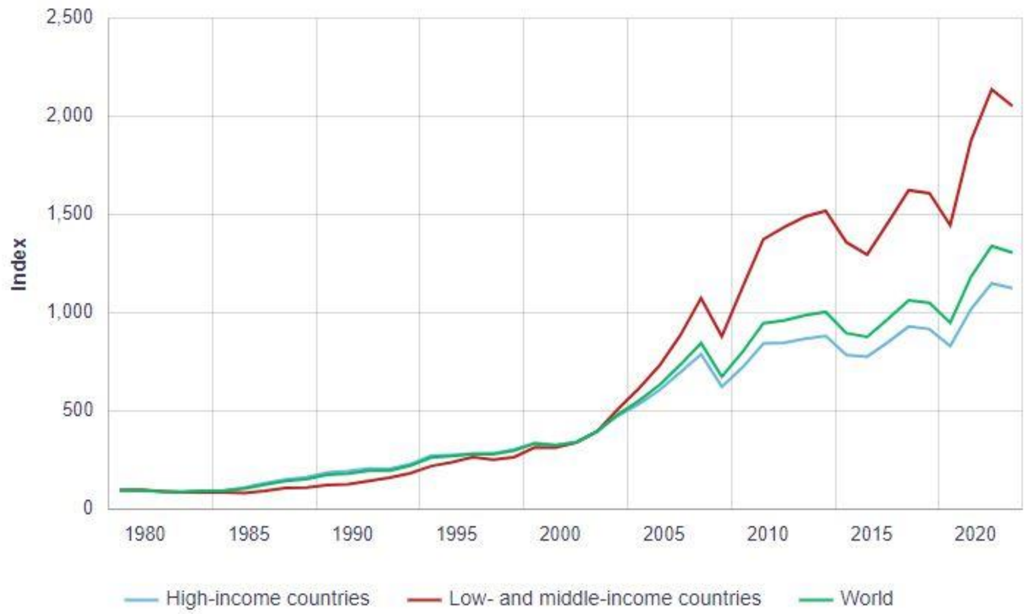
Let me take each of those in turn.

Advanced economies are driving the slowdown in global trade

First, trade growth in advanced economies has slowed in the last decade, and this has pulled down global trade growth. But trade by and between emerging and developing countries has continued to grow (**Chart 2**).

Chart 2: Trade is growing faster in emerging and developing economies

Annual data, index: 1980 = 100



Note: High-income countries are defined by the World Bank as economies with a gross national income per capita of more than US$14,005. For more detail, see the **World Bank Country and Lending Groups** list.
Sources: World Bank and Bank of Canada calculations
Last observation: 2023

WTO Director-General Ngozi Okonjo-Iweala believes trade has entered a new, "more inclusive" phase, which she calls "reglobalization." Over 25 years, the share of global trade among developed countries has declined, while the share among developing economies has more than doubled.[2] As Dr. Okonjo-Iweala has stressed, preserving open trade is critical to raising incomes in developing economies and narrowing the gap with more advanced countries.

Services trade is picking up as goods trade slows

The second trend is that trade in services is picking up, even as goods trade is slowing. Globally, goods trade is a much bigger piece of the pie—more than three times larger than trade in services. So strong growth in services doesn't fully offset weak growth in goods. But trade in services is gaining share.

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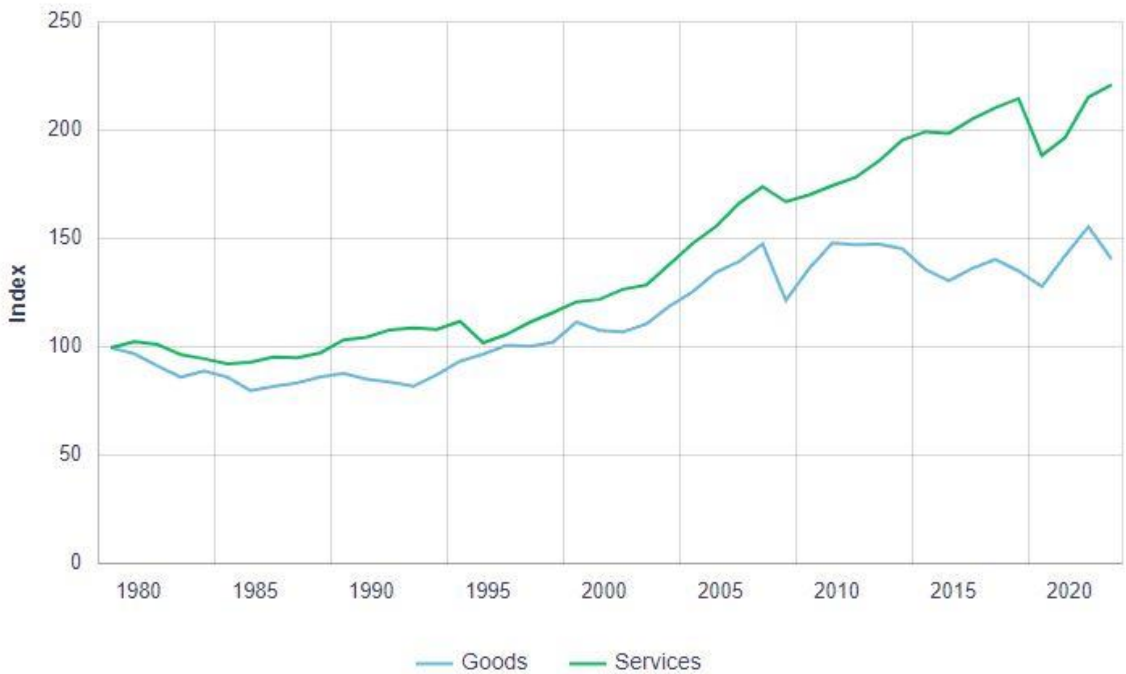
[2] United Nations Conference on Trade and Development, *Trade and Development Report 2023: Growth, Debt, and Climate—Realigning the Global Financial Architecture* (2024).

Since about 2000, growth in services trade has outpaced goods, though the impact of the pandemic skewed both (**Chart 3**). Global demand for goods soared early in the pandemic when we were all stuck at home. Then when economies reopened, consumers turned to services, particularly all the ones we'd missed during lockdowns.

Chart 3: In high-income countries, trade in services is growing faster than goods

Share of GDP, annual data, index: 1980 = 100



Note: High-income countries are defined by the World Bank as economies with a gross national income per capita of more than US$14,005. For more detail, see the **World Bank Country and Lending Groups** list.
Sources: World Bank and Bank of Canada calculations
Last observation: 2023

But the pandemic may have also provided a more durable boost to trade in services. Because customers had to be served digitally during lockdowns, businesses invested in digital delivery, adding to supply along with demand. Increasingly, exporters deliver services through computer networks—via the internet, apps, emails, voice and video calls, and digital intermediation platforms. Trade volumes for commercial services have risen about 20% since 2019. Remote training, teaching and management services have risen sharply, as have financial and travel services.

And digitalization continues—especially as AI creates new services and changes the way they're delivered. Whether growth will continue at this rapid pace is an open question, but the seemingly vast potential of digitalization suggests future growth in trade will tilt to services.

Global relationships are shifting

The final global trend is the shift in global relationships. China is a big part of that story. Its exports have moved up the global value chain, and geopolitical tensions are altering key relationships.

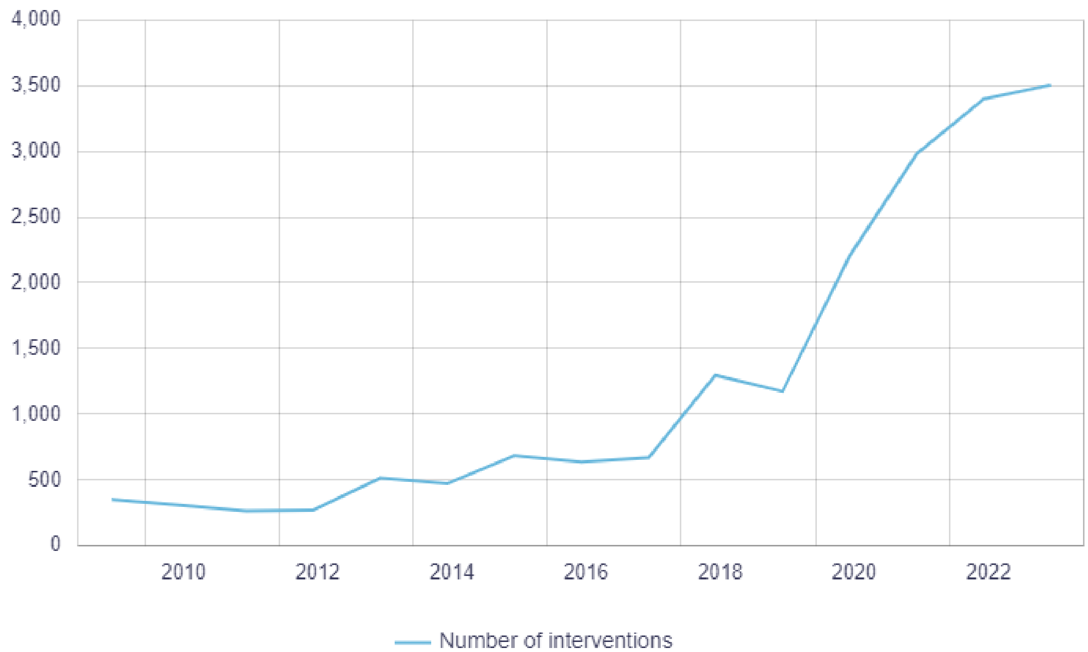
Rising wages, increased expertise and deliberate government policy have all pushed China into higher-tech electronics and advanced products. China is now the world's biggest exporter of broadcasting equipment, computers, solar power and electric batteries. Its electric vehicle (EV) industry is the largest in the world, with over half of global production.[3]

These advances have sparked concern that Chinese technology could both displace local industry and compromise national and economic security. The United States has banned the use of some Chinese products and restricted the exports of leading technologies to China. Other countries, including Canada and the United Kingdom, have taken similar actions. In May, the United States announced it will quadruple its tariffs on Chinese EVs to 100%. Canada is following suit. The European Union is also applying higher tariffs on EVs.

But the increased use of trade restrictions is much broader than China (**Chart 4**).

Chart 4: Trade restrictions have increased sharply

Number of interventions worldwide, annual data



Source: Global Trade Alert
Last observation: 2023

[3] International Energy Agency, "Electric Vehicles" (June 6, 2024).

Trade restrictions increased sharply around the world starting in about 2018. So did industrial policy to bolster domestic players against imports and respond to security concerns. Security risks are real and need to be addressed, but it is important they not become a pretext for inefficient protectionism.

Trade is also being rerouted as businesses try to diversify supply chains and find friendlier partnerships.[4] But the combination of more trade restrictions and shifting trade routes means supply chains have actually gotten longer—with products detouring through other countries such as Vietnam instead of going directly from China to the United States.[5]

Fragmentation has economic costs. Businesses have to focus on national security and geopolitical uncertainties, not just efficiencies and productive partnerships. The IMF estimates that costs of trade fragmentation could range from 0.2% to 7% of global GDP.[6] But costs go beyond trade—and the losses are unlikely to be distributed evenly. The loss of knowledge spillovers, high-tech partnerships, critical imports and capital flows affect low-income economies in particular. The potential for trade and innovation to continue to lower global poverty will decline.[7]

Trends in Canada's trade

So those are the global trends. In many ways, Canada is a microcosm of these global shifts. Our overall trade growth has slowed in recent years. Our export growth has been coming increasingly from services. And global fragmentation is presenting new challenges and opportunities.

Slowing trade growth

Canada is a very open economy. Over the last decade, trade as a share of GDP has been about two-thirds—the second highest in the G7 and the fourth highest in the G20. We rely on exports for roughly one-third of our income. Imported components feed our industry, and imported final goods and services improve the lives of Canadians.

The United States is, by far, Canada's biggest trading partner—accounting for roughly 75% of Canada's exports. Thanks in part to the Canada-US Free Trade Agreement in 1989, and updates in the years following, Canada and the United States benefit from the largest bilateral trade relationship in the world (**Chart 5**). Our biggest exports to the United States are oil and gas, and motor vehicles and parts.

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[4] See L. Alfaro and D. Chor, "Global Supply Chains: The Looming 'Great Reallocation'," paper prepared for the Jackson Hole Economic Policy Symposium: Structural Shifts in the Global Economy, August 24–26, 2023. Jackson Hole, Wyoming: Federal Reserve Bank of Kansas City.

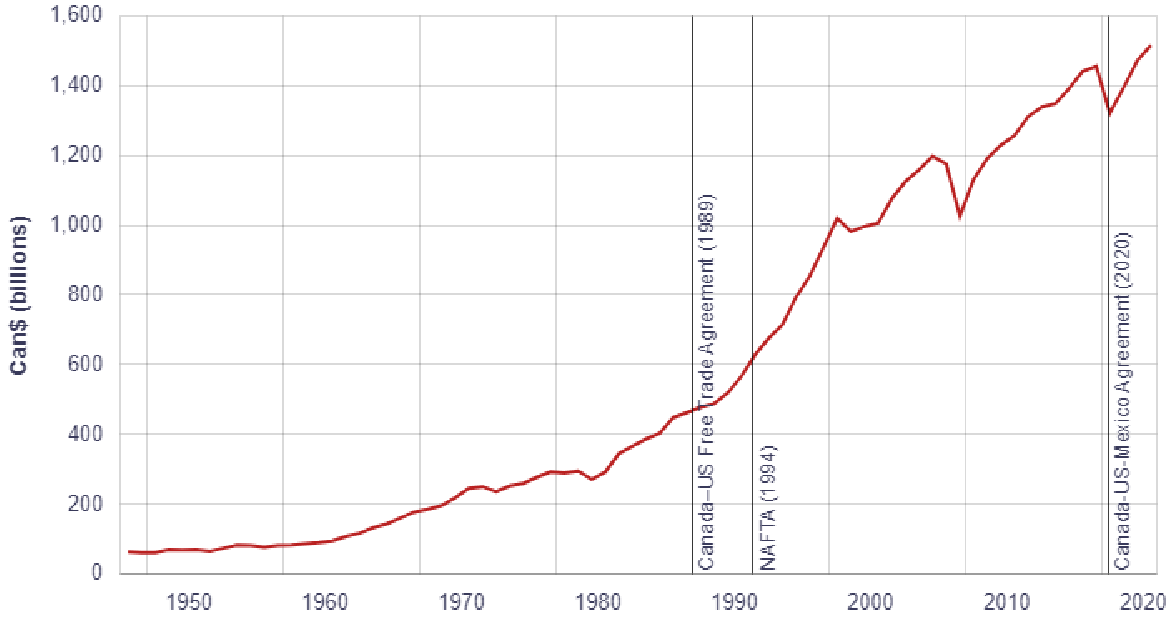
[5] H. Qiu, H. S. Shin and L. S. Y. Zhang, "Mapping the realignment of global value chains," Bank for International Settlements Bulletin No. 78 (October 3, 2023).

[6] These are long-term costs estimates. See G. Gopinath, "Geopolitics and its Impact on Global Trade and the Dollar," (speech delivered to the Stanford Institute for Economic Policy Research, Stanford, California, May 7, 2024) and Aiyar et al. (2023).

[7] See Aiyar et al. (2023).

Chart 5: Canada-US agreements have boosted trade

Total Canadian real international trade, annual data, chained 2017 dollars



Sources: International Monetary Fund, Statistics Canada and Bank of Canada calculations
Last observation: 2023

But our trade agreements go well beyond the United States: in total, Canada has 15 trade agreements covering 51 countries and about two-thirds of world GDP.[8] Together, these agreements cover 1.5 billion consumers worldwide.

But even with this broad market access, growth in Canada's exports has slowed over the past 10 years. The pandemic obscures the overall trend, but it's clear that goods exports have not kept up with economic growth in Canada's two biggest markets—the United States and the European Union (**Chart 6**).

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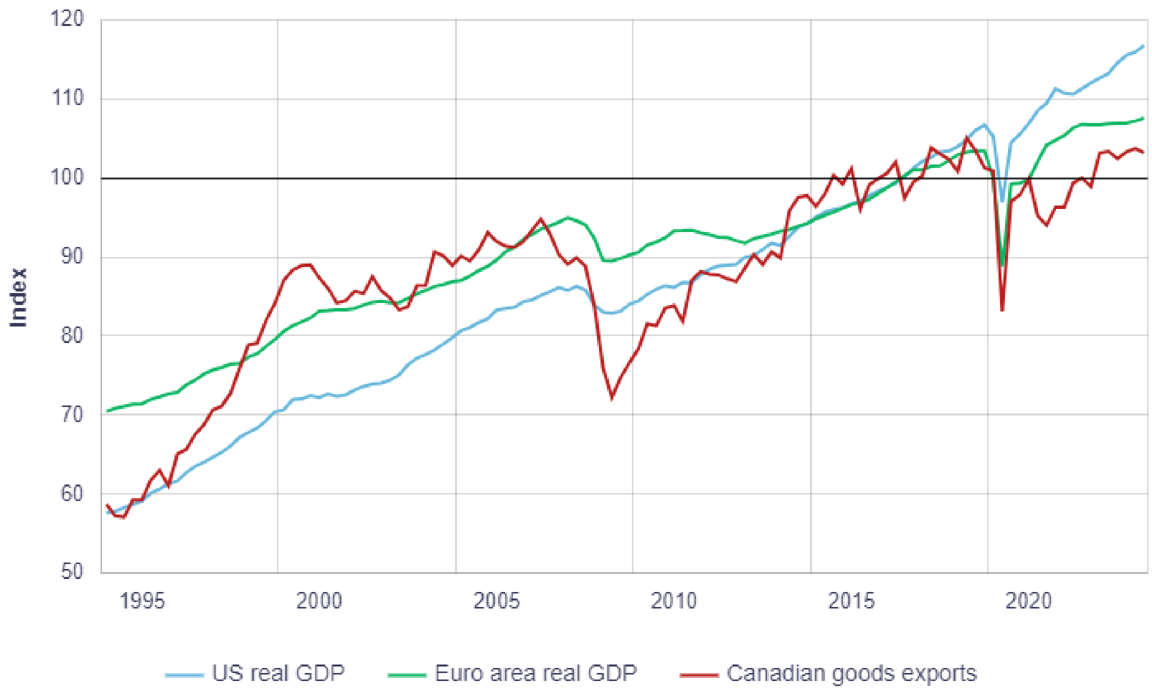
[8] The Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) is a free trade agreement in place between Canada and 10 other countries in the Indo-Pacific region: Australia, Brunei, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam. On July 16, 2023, CPTPP members signed an Accession Protocol with the United Kingdom. The Canada-European Union Comprehensive Economic and Trade Agreement is a bilateral agreement between Canada and the European Union. The agreement covers virtually all sectors and aspects of Canada-EU trade with the goal of eliminating or reducing barriers.

Chart 6: Canadian goods exports lag economic growth in major markets

Quarterly data, index: 2017 = 100



Sources: Statistics Canada, Eurostat and US Bureau of Economic Analysis
Last observation: 2024Q2

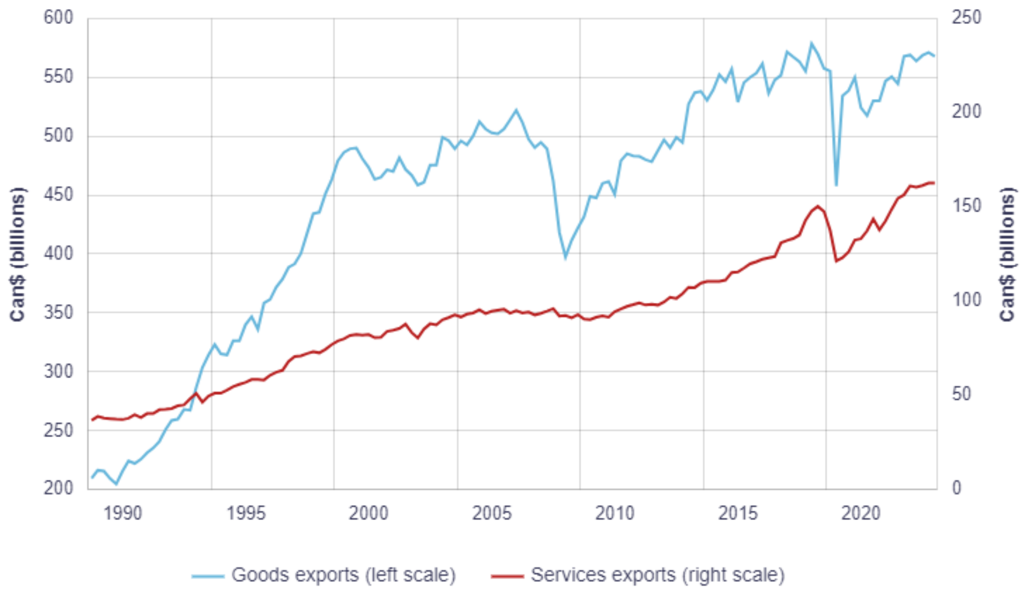
The slowdown is fairly widespread. Production and exports of machinery and equipment, motor vehicles and other non-energy goods have not expanded in more than a decade.

Increasing strength in services

Just as we've seen globally, where we have seen growth in Canada is in exports of services. As goods growth began to stall around the time of the global financial crisis, growth in services exports picked up (**Chart 7**).

Chart 7: Canadian services exports have picked up, while goods are flat

Quarterly data, seasonally adjusted at an annual rate, chained 2017 dollars

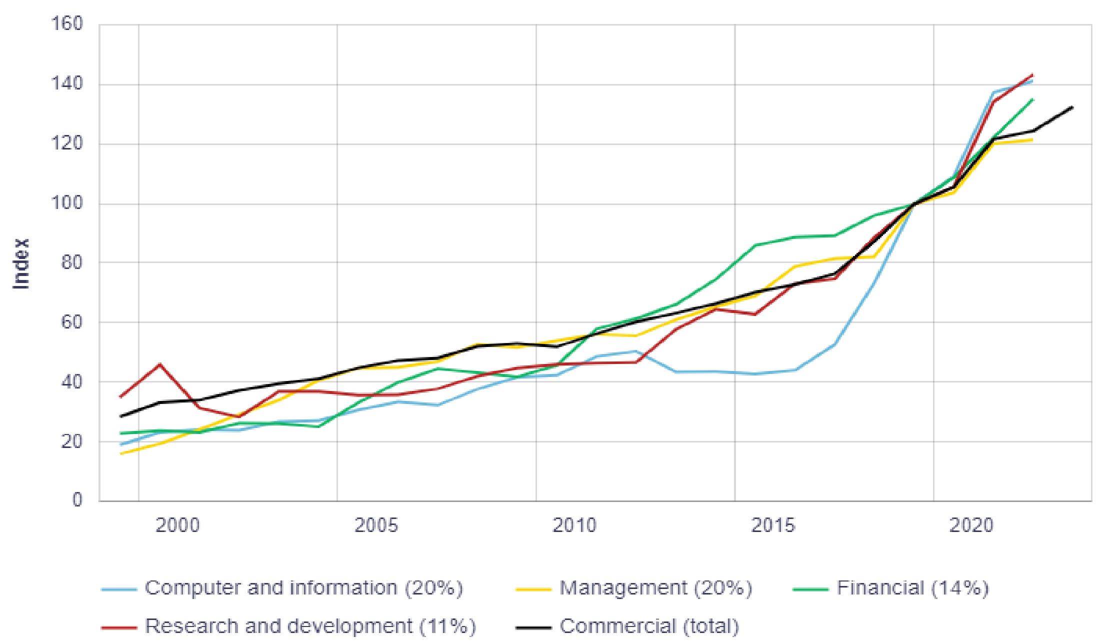


Sources: Statistics Canada and Bank of Canada calculations
Last observation: 2024Q2

As in other countries, digital delivery has helped drive Canada's services exports—particularly computer, management and financial services, as well as research and development (**Chart 8**).

Chart 8: Commercial services export growth is driven by computer services

Annual data, nominal, by services type, index: 2019 = 100



Note: Numbers in parentheses show each service type's nominal share of total commercial services.
Sources: Statistics Canada and Bank of Canada calculations
Last observation: 2023

That plays to Canada's strengths, including our highly educated work force. Since 2019, real exports of commercial services have grown 17%, adding more than $15 billion to real Canadian GDP.

Global fragmentation

Canada is somewhat insulated from the third global trend—fragmentation—because so much of our trade is with the United States. But shifting supply chains present risks as well as opportunities for Canadian business.

At the start of the millennium, Canada had the biggest share of US goods imports, at about 20%. By 2017, China had the largest share, and Canada had fallen to third place. As the United States finds new partners to supply the goods it once got from China, Canada is starting to reassert itself. In the first quarter of 2024, Canada was the second-largest source of US goods imports after Mexico, and exports were ticking up.

Navigating the future

That brings me to the challenge ahead. The trade landscape is shifting. How should Canada respond?

We need to seize opportunities to secure our place in a rewired trade system. We need to be effective at the international table to influence how trade is recast and redirected. And we have to manage the shocks that are bound to come.

Smart regional trade

Fortunately, geography and history have given Canada significant advantages in global trade. With the Canada-United States-Mexico Agreement, we have a strong relationship with the biggest and richest market in the world—which sits right next door. Despite the shifting trade winds, 77% of Canadian goods exports still flow to the United States. And Canada is also the number one export destination for the United States, and the largest destination partner for 32 of its 50 states. The continued success of this trade relationship is in the interest of both countries.

Beyond the United States, Canada has strong market access around the world, thanks to the trade agreements I mentioned earlier. But holding our ground won't be enough. We need to build better relationships, produce the products people want to buy, build and maintain the infrastructure to get those products to market, and boost our productivity to compete globally.

The Canada-UK relationship is an important one. The United Kingdom is Canada's third-largest trading partner, with two-way trade of more than $50 billion. We've made progress toward a bilateral trade agreement. But sticking points remain—and until they are resolved, too many goods and services will remain outside the competitive, tariff-free supply chains we've established with other economies. There are benefits to getting this done for both our countries.

Canada needs to be able to sell the products people want. We are a stable, responsible and technologically advanced energy producer. Our auto sector is globally competitive. And we have new and emerging areas of strength, including in green technology and electricity.

To leverage these strengths, we need to invest in trade infrastructure and reduce trade barriers so that integrating Canada into the North American value chain is more attractive for businesses. This includes investing in our electricity grid and transportation infrastructure. And businesses need to invest in new equipment and innovation to be globally competitive.

As trade is recast for security or strategic reasons, Canada is a trusted and reliable trading partner. Canada is not going to be the cheapest alternative. But we have a highly skilled labour force, reliable energy and transportation networks and solid financial institutions. Moreover, Canada has a stable democracy and strong rule of law. And we provide a reliable and important voice at the global table.

Effective multilateral institutions

That brings me to our second priority. We need to invest in effective multilateral institutions—they are more important than ever in this fragmented world. And they will be only as effective as members want them to be.

It has never been easy to attain international economic cooperation, and open trade has come under particular pressure. But the trends I've just outlined increase the urgency. Our common interest is shared prosperity. We all benefit from a stable, open, rules-based global order. We need to build it, protect it, adapt it and ensure the benefits are shared.

Effective and legitimate multilateral institutions don't just happen. They need good governance, adequate resources, talent and inspired management. Canada has long invested in the Bretton Woods institutions. We have a strong voice at the IMF and Financial Stability Board (FSB). We know the value of an effective WTO that can serve as a forum for negotiations, act as an arbiter of disputes and monitor the implementation of trade agreements. As Canada assumes the G7 presidency in 2025, we have a responsibility to lead difficult discussions. That includes trade, global financial stability and mitigating climate change.

As central bankers, our particular focus is the IMF, the FSB and the international monetary order. We need to be sure that the international monetary and financial system is up to the task and is integrated with the other parts. The fundamentals of economics have not changed, but the need for resilience and agility has increased with changing economic circumstances.

Managing disruption

Finally, Canada needs to be ready for the trade disruptions that seem inevitable amid a changing trade landscape. The Bank of Canada doesn't set trade policy. But we need to understand shifts in global trade because they affect lives and livelihoods, and they drive costs and inflation.

Conclusion

So let me conclude with the implications for monetary policy.

The rapid globalization through the 1990s to around the global financial crisis significantly reduced the prices for many globally traded goods. This contributed to a lower cost of living for many households. Going forward, with globalization slowing, the cost of global goods may not decline to the same degree. All things equal, this could put more upward pressure on inflation.

Trade disruptions may also increase the variability of inflation. The pandemic taught us a lot about supply shocks and how they can affect the volatility of prices. Supply chains are complicated, and shocks affect inputs and outputs in different ways. And while supply shocks are historically transitory, they can persist—and accumulate. We also learned that when the economy is already overheated, disruptions to supply can have an outsized effect on inflation.

So what is the Bank of Canada doing to ensure we're prepared for the supply shocks that come with trade disruptions? We're investing in data and analysis to better understand supply chains, especially at the global level. We're updating our models to use scenarios when periods of uncertainty make central forecasts less reliable. And we're using more microdata to track and understand the consequences of trade and industrial policy.

But even with a better understanding and better information, trade disruptions may mean larger deviations of inflation from the 2% target. Supply shocks present central banks with a difficult trade-off—monetary policy can't stabilize growth and inflation at the same time. That means we have to focus on risk management, balancing the upside risks to inflation with the downside risks to economic growth.

Most importantly, we must avoid adding uncertainty to an already uncertain environment. That means ensuring inflation is low, stable and predictable even as global trade is being rewired, recast and redirected.

Thank you.