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Economic Regime Change Part III – Deglobalization

"In a world of global trade and integrated capital markets, it is natural for economic and financial shocks and policy actions to be transmitted across borders."

- Jerome Powell, U.S. Federal Reserve Board member, former Fed Chair

The Through Line: Global trade has become an increasingly hot button issue in recent years after significant supply chain vulnerabilities were exposed by a combination of unusual economic events and shifting geopolitical priorities. The confidence in free trade that dominated most of the period after WWII is being eroded by a growing desire to stabilize weak links in supply chains and ensure capabilities in mission-critical industries. In short, the pendulum has swung from economic expediency toward sovereign security. This shift has implications for citizens, businesses and investors. We explore the issues at play and theorize about the shape of (trade) things to come.

A new world order

Much of the international commerce system we know today is rooted in a set of agreements established shortly after the end of WWII. The intent was to create a framework that would facilitate global trade cooperation in the belief that strong economic ties would discourage conflict (and perhaps – fingers crossed – encourage the spread of capitalism and democracy). For example, the international Bretton Woods agreement established the International Monetary Fund (IMF) and the World Bank while tying world currencies to the USD, which became the globe's reserve currency. Subsequent trade agreements (e.g., NAFTA), the creation of regional trading blocs (e.g., the European Union) and formation of bodies such as the World Trade Organization also encouraged cross-border activity. **This facilitated a tripling of world trade as a share of global GDP between 1950 and its peak in 2008[i] and lifted more than a billion global citizens out of abject poverty and into the middle class.[ii]**

Technology and advanced logistics systems also helped globalize activity by enabling manufacturing to occur in places where there was an ample supply of inexpensive labor, specialized manufacturing expertise (semiconductors in SE Asia, biotechnology in China, advanced manufacturing in Japan), and/or more lenient regulatory/environmental policies. Decades of intricate planning, development and investment created a spiderweb of global interdependencies.

"Just in Time" becomes "Just in Case"

Recent economic events have exposed the extreme fragility of far-flung supply chains, however:

- **Vulnerabilities in key routes** were highlighted by a number of acute choke points and catastrophic events, including COVID, multiple wars, extreme weather (fires, repeated hurricanes, grid-disabling freezes), drought (Danube), port strikes, blocked transit ways (Baltimore bridge, the Ever Given in the Suez Canal) and contested waterways (Panama Canal).
- **Vulnerabilities in locating and/or concentrating key assets** such as data centers and energy production in exposed or hard to defend areas have emerged.
- **Monopoly-like control of key materials / manufacturing expertise** such as chip production in Taiwan and South Korea or rare earths processing and biologic compound manufacturing in China. Trade can be weaponized for geopolitical purposes.
- **Knock on impacts create additional vulnerabilities.** Case in point: Taiwan's power supply is largely fueled with imported oil. Strategists note that an electricity shortage of just three weeks would disable the manufacturing sector entirely – including a majority of the world's semiconductors.

Taken together (and in rapid succession) these lessons are prompting reevaluation of the delicate balance between the need to protect **sovereign security** (end-to-end control over key inputs and mission critical products/services) and the desire for **economic efficiency** (lowest cost manufacturing no matter where it's located). In short: "Just in Case" versus "Just in Time" is the new order of the day.

Growing dissatisfaction with globalization

The globalization trend accelerated in recent decades based on the belief that entwined economics would discourage widespread conflict since countries would not want to risk harm to their own economic interests. This was logical in theory but became distorted in practice by a number of factors: protectionist policies; government subsidies of select industries (interventionist industrial policy); the hunt for more favorable regulatory infrastructures or looser environmental rules (hence China's dominance in rare earths processing, an extremely dirty activity); intellectual property theft; and fiscal leverage (currency manipulation, sanctions).

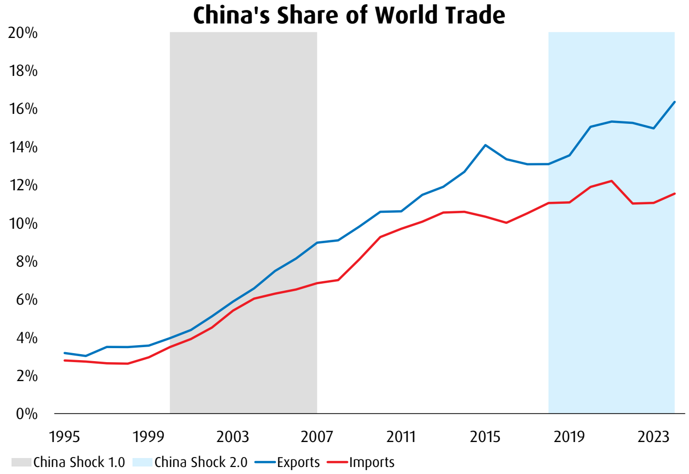
There is also mounting pushback from individuals and industries negatively impacted by globalization. While worldwide aggregate numbers paint a narrative of growth and increased wealth, individual sectors, industries, towns and citizens were caught in the gears of shifting manufacturing priorities. Job gains that relocated rural Chinese out of remote farming villages and into lifestyle-changing jobs in manufacturing hubs hollowed out entire industries and economic regions elsewhere. Fast-moving change meant that plans were inadequate to help transition those displaced by the shifts.

Businesses, too, are realizing the vulnerability of having such long lead times between finished goods and on-site availability. Consumer-facing entities in particular are feeling the pinch against a background of influencer-induced, rapidly changing consumer tastes (here's looking at you Labubus, Needohs and Dumpling Squishies). Now that plants are increasingly automated and wages in developing countries are rising substantially, the comparative advantage of offshoring has narrowed.

China: aspiring, economically dominant hegemon

After 14 years of negotiations, in 2001 China was admitted into the World Trade Organization with emerging market status. Based on its seemingly bottomless pool of low-cost labor, Beijing put an intense focus on developing manufacturing and distribution expertise in a host of industries. In 2015, the Middle Kingdom released its "Made in China 2025" industrial policy plan, outlining key industries it aimed to dominate, including solar panels, EVs, robotics and batteries. The impact of this intentionality is evident in the charts below.

China's Share of World Trade

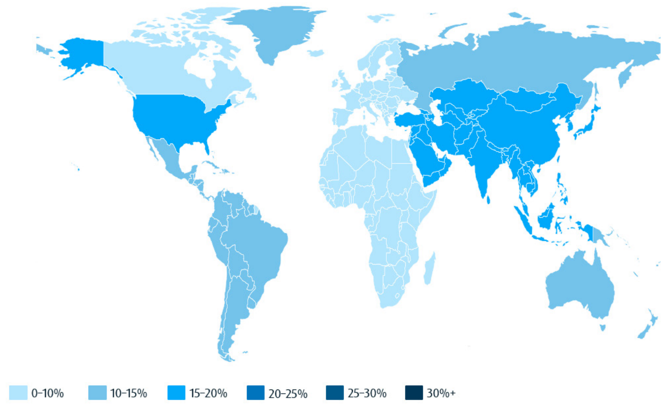


Source: Board of Governors of the Federal Reserve System (2026), as of 2024.

China has placed an intense focus on becoming a manufacturing powerhouse, arguably at the expense of balancing domestic consumption activities (particularly in the wake of the intractable problems still lingering in its real estate sector). Each year **China churns out over three million engineering graduates, its Politburo working body is predominantly populated by engineers, and it tops the innovation and patent leaderboard in 66 of 74 critical technologies** as tracked by the Australian Policy Institute.[iii] Countries around the world are increasingly pushing back against the cheap goods it exports. Shortly after last year's Liberation Day tariff announcement, for example, EU leaders began discussions about placing tariffs of their own on China – or demanding concessions like the sharing of intellectual property – to prevent below-market-rate goods from flooding across their borders.

Chinese Import Penetration by Region, 2007

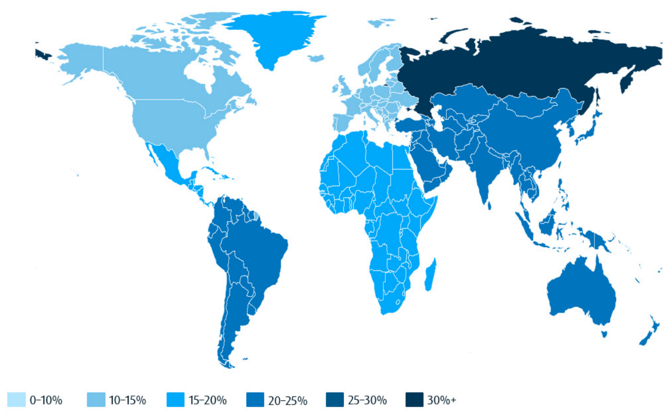
Percent share of imports from China in total goods imports by regional aggregates



Source: Board of Governors of the Federal Reserve System (2026)

Chinese Import Penetration by Region, 2024

Percent share of imports from China in total goods imports by regional aggregates

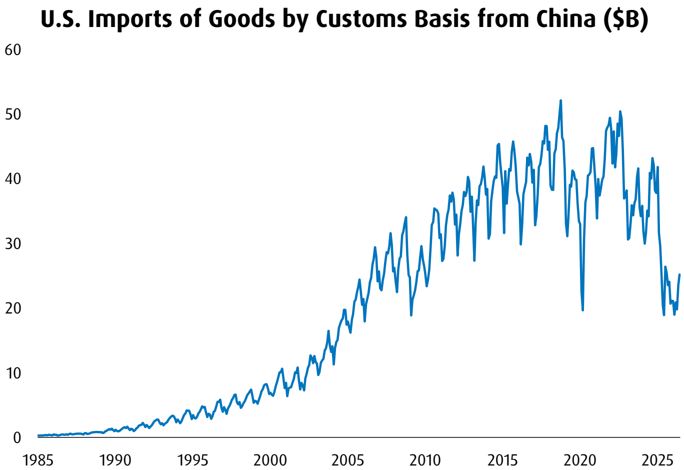


Source: Board of Governors of the Federal Reserve System (2026)

Now the country is moving quickly to dominate the "information manufacturing" of the 21st century, including AI models, chips and chip-making equipment. China is also working to set up alternate payments systems using renminbi (rather than dollars) and digital currencies. It is working to ensure its financial markets are broad and deep enough to keep the initial public offering needs of its most innovative companies at home – evidenced by a recent $10 billion IPO for ChangXin Memory Technologies.

Still tariff-ied

President Donald Trump began his first term in 2017 by delivering a clear message that he was a "tariff man, standing on a tariff platform," just like (25th) U.S. President William McKinley over 125 years before him. The first levies in the trade wars came in 2018 and were primarily aimed at China. They remained in place under the Biden administration (and were bolstered by a variety of other moves). Trade flows had already begun to change noticeably before President Trump embarked on his second term; **China's share of U.S. imports peaked in 2018 and has fallen by one-third since.** Despite everything, China generated record exports last year (and a record trade surplus) by shifting production to other end markets.



Source: Federal Reserve Economic Data, Federal Reserve Bank of St. Louis (2026), as of June 2026.

Source: Bloomberg L.P. (2026) and World Bank Group (2026), as of 12/31/2025.

Although the U.S. Supreme Court overturned President Trump's Liberation Day tariffs, he has deployed a variety of other mechanisms to enact multiple levies, including those that apply to a wide variety of specific goods: steel, aluminum, lumber and chips among many. He has made clear his "love" for the levies since the 1980s, meaning their use is unlikely to lessen despite any legal hurdles. His ultimate goal: reshoring manufacturing activity and reviving strategic industries, a.k.a. prioritizing security over economic efficiency.

Implications for investors – and global citizens

Fragile supply chains represent potential problems for investors, given the possible earnings hit that a black swan economic or political event could have. To date, companies and industries have proven quite adaptive, but there is a limited marginal capacity (or patience for shifting policy) to do so. **Many are taking steps to diversify and relocate suppliers, customers and trade routes; these actions will improve durability in the long haul. Like AI adoption, the process will be neither neat nor quick, but we see ample signs it is already under way.** In addition, the timing is fortuitous, taking into account the current earnings, margin and demand strength.

The move to strengthen or regionalize supply chains sends production back to potentially less economically efficient areas. However, the all-in cost calculation may well be worth the trade-off if it can provide strategic security for critical activities – and shorter lag times between manufacture and sale. It also could deliver jobs, sorely needed capital investment and support for dynamic economies.

The machinations of two global giants prosecuting different paths leaves much of the rest of the world caught in the middle. New trading blocs are already being explored, new partnerships forged, supply contracts signed and manufacturing plans drawn up. Countries are reconsidering choke points and actively crafting work-arounds so they can move goods and secure access to energy and critical inputs. These are all constructive potential outcomes in an ever-changing landscape.

Next week in North America

A light week coming up by recent standards; earnings week rolls on. Expect the U.S. inflation reports (CPI on Wednesday and PPI on Thursday) to be closely parsed in the new economic regime of no forward guidance from the Fed. Congress is on recess; however, Fed speakers are on the talk circuit. Canada's unemployment rate lands on Wednesday. Friday will bring several key reads on manufacturing activity.

Monday 8/10:	**U.S.** none scheduled | **Canada** none scheduled
Tuesday 8/11:	**U.S.** NFIB optimism index, existing home sales | **Canada** none scheduled
Wednesday 8/12:	**U.S.** CPI | **Canada** unemployment rate
Thursday 8/13:	**U.S.** Initial jobless claims, PPI | **Canada** Building permits
Friday 8/14:	**U.S.** Retail sales, Business inventories, Consumer sentiment | **Canada** Capacity utilization, Manufacturing sales, New vehicle sales

BMO Private Wealth

[i] Rethinking Free Trade
[ii] The arc of human history is toward cooperation, not division - Big Think
[iii] ASPI's Critical Technology Tracker: 2025 updates and 10 new technologies | The Strategist