Navigator

Now, next and how for business

Global report

HSBC

Global Report

Will trade's resurgence prove short-lived?

Global trade growth rebounded last year, thanks to a stronger world economy, higher commodity prices, and a weaker US dollar. Leading indicators hint that trade growth will remain robust in the coming months, but risks remain tilted to the downside. Governments should take advantage of the global economy's current "sweet spot" to combat protectionist rhetoric and restore faith in globalisation, pushing ahead with free trade initiatives.
If governments refrain from introducing new impediments to trade, our projections indicate the value of global traded goods should expand by around 6% a year on average in the decade to 2030, while growth in services is forecast to average close to 7% a year.

Short-Term Snapshot

Stronger global investment is boosting merchandise trade ...

Dispelling rumours that globalisation has peaked, the long-awaited recovery in merchandise trade finally arrived last year, as GDP growth picked up in the world's major economies. Europe and Asia were the star performers, although North America and some large emerging markets, notably Brazil and Russia, contributed as well.

World: GDP and merchandise trade volumes (% growth)

Source: Oxford Economics, IMF, Haver Analytics

Global goods trade grew faster than GDP last year for the first time since 2013. Historically, merchandise trade volumes increase at about 1.5 times the pace of global output. In 2017 the ratio of merchandise trade growth to GDP growth, which fell to around 1:1 after the global financial crisis and dipped below 1 in 2015–16, rebounded to an estimated 1.4. But is the recovery sustainable?

Action points for business

- Firms should consider taking advantage of a weaker dollar now, as the Federal Reserve is likely to raise interest rates faster than other central banks, putting upward pressure on the dollar.
- Is your business ready to tap into stronger US consumer and corporate demand, as wages rise and tax reform boosts household spending power?
- Ensure your business has adequate security measures to protect e-commerce transactions against the growing threat from cyber criminals.

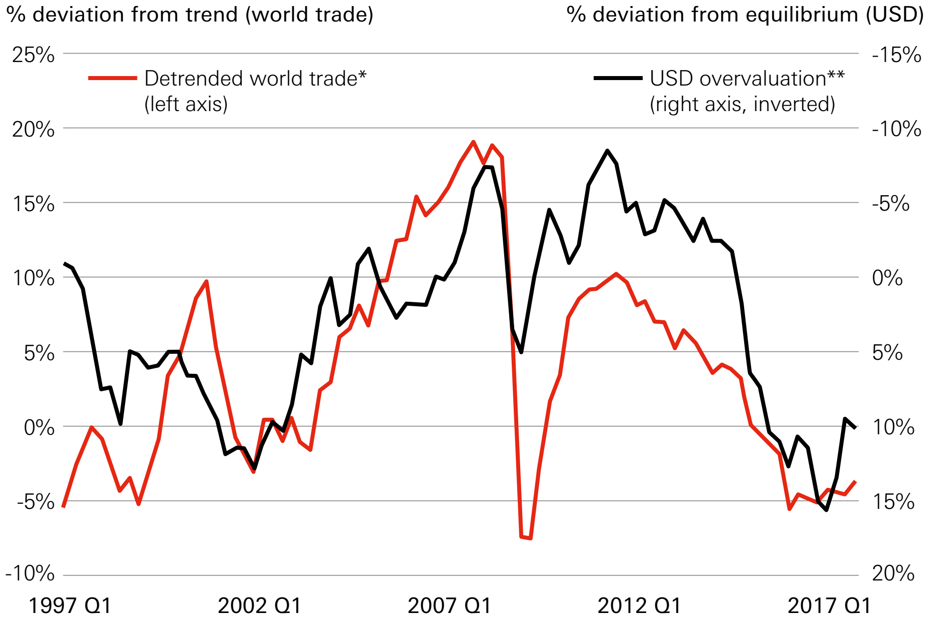
We estimate that global trade in goods grew around 1.4 times faster than global GDP in 2017.

Trade's improved responsiveness to GDP last year in part reflected the upturn in global investment. Crucially, as commodity prices recovered, so did investment in commodity-producing countries. And recently, commodity importers in Europe and Asia have also boosted capital spending.

... with an assist from the weak dollar

The US dollar, which has fallen by 8% in trade-weighted terms since first-quarter 2017, should give global trade volumes momentum going forward. Data show a clear relationship between the US dollar and world trade volumes (i.e. trade flows measured in constant prices and exchange rates); the chart below illustrates how, since the late 1990s, periods of weakness in global trade have mirrored periods of US dollar strength.

World trade and US dollar strength



* World trade relative to (exponential) time trend
** US real effective exchange rate relative to BEER (behavioural equilibrium exchange rate)

Source: Oxford Economics, BIS, Haver Analytics

Academic research also points persuasively to the dollar-trade relationship. For example, recent research from the Bank for International Settlements (BIS) and International Monetary Fund (IMF)[1] focuses on the dollar's role as the world's dominant invoicing currency. It concludes that the slow adjustment in prices of traded goods means that a weakening of the greenback is associated with cheaper global imports in non-dollar terms, which provides a boost to trade flows. The study finds that a 1% drop in the US dollar boosts global trade volumes by 0.6-0.8% within a year. Further BIS research[2] suggests that by easing credit conditions and stimulating global supply-chain activity, a weak dollar has an amplified impact on world trade.

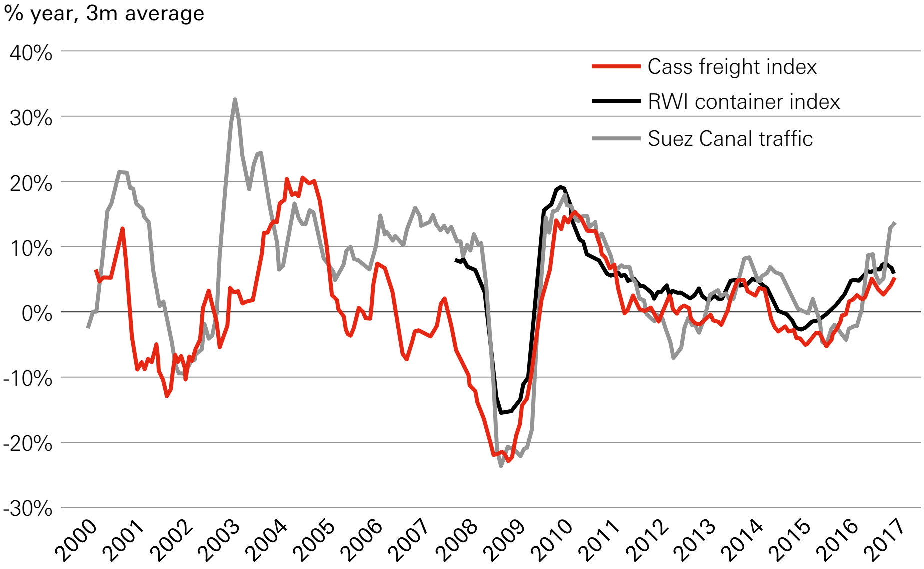
Historically, a weak dollar supports world trade growth.

1 Boz, Gopinath and Plagborg-Møller (2017), "Global Trade and the Dollar", IMF Working Paper No. 17/239
2 Bruno, Kim and Shin (2018), "Exchange rates and the Working Capital Channel of Trade Fluctuations", BIS Working Paper No 694

2018 gets off to a strong start

Merchandise trade growth remained buoyant at the turn of the year. For example, the Cass Freight index, which measures North American freight volumes, clocked in 5.4% higher on the year in the final quarter of 2017. The RWI/ISL container trade index, which is based on data from 75 ports and covers around 60% of worldwide container traffic, showed a 6.1% increase in the year to Q4 2017—while traffic through the Suez Canal surged by 13.8% over the same period.

World: alternative trade indicators



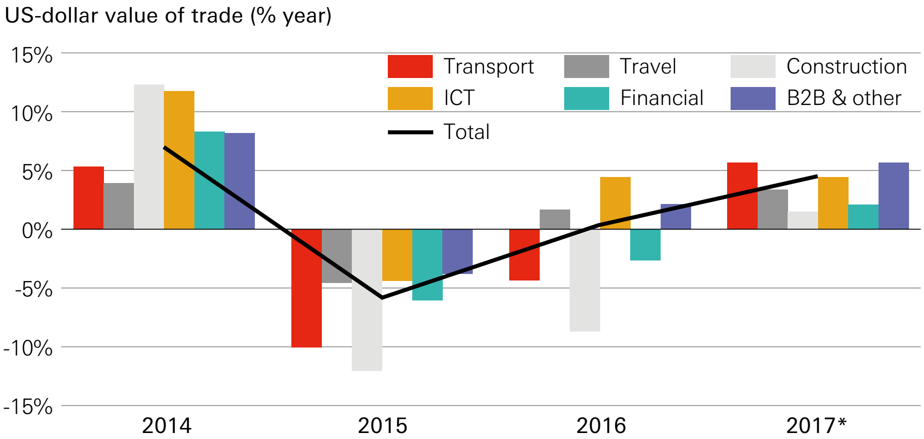
Source: Oxford Economics

Global semiconductor sales, an important driver of Asian exports, posted a heady 28% increase in 2017. But some freight indicators for Asia ended the year on a sour note. Cargo handled by the ports of Shanghai and Hong Kong slowed sharply in late 2017, potentially signalling headwinds for trade on the horizon.

Financial service exports still struggle to gain traction

Service exports have generally grown at a healthier pace than goods trade in recent years, although both slowed noticeably in 2015/16. Specifically, weaker transport exports dragged down total service exports—not a shock, since there were fewer goods to deliver. Tourism revenues also suffered following a number of terrorist attacks, while falling prices for raw materials cut into revenues of commodity exporters, which in turn imported fewer services; construction and financial services were particularly hard hit.

World: value of trade in services

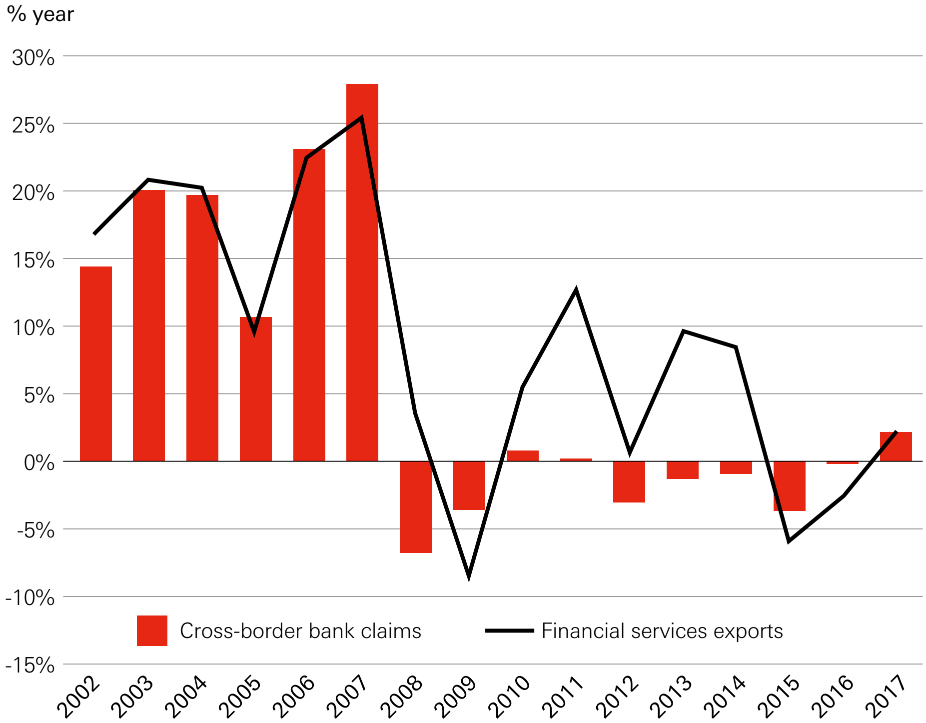


* Estimate based on country-level BOP data for Q1–Q3

Source: Oxford Economics, WTO, Haver Analytics

Trade in services appears to have strengthened in 2017, at least in value terms. In particular, tourism and transport have recovered strongly, but weak spots remain in the generally positive picture. Financial services underperformed, which could perhaps be explained by the ongoing impact of regulatory changes that have encouraged banks to pull back from international exposures.[3] From 2000 to 2007, BIS member country banks aggressively expanded cross-border exposures, and world financial services exports boomed in tandem. But since 2007, cross-border bank claims have stagnated.

Financial services exports and bank claims



Source: Oxford Economics, WTO, BIS

Positive momentum in world trade carries over into 2018 …

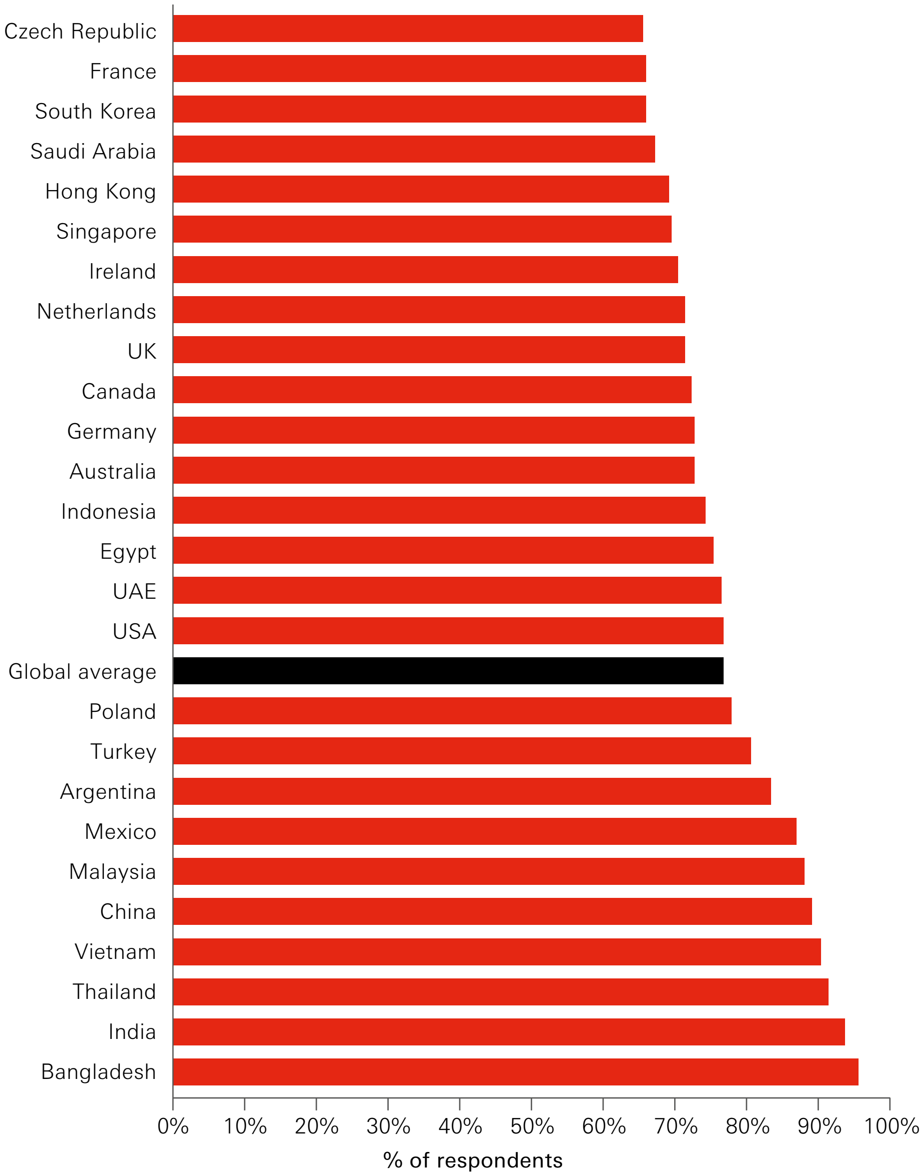
We expect the value of world trade in goods & services to grow by a robust 7% in 2018, albeit somewhat slower than last year's estimated 8% pace of expansion. The emerging markets, which made a large contribution in 2017, will again play a major role, along with renewed demand in the Eurozone and expected fiscal stimulus in the US. And global trade should benefit from the weak dollar—at least until later in the year, when the Federal Reserve is likely to raise interest rates faster than other central banks.

More than three- quarters of businesses in our survey expect their trade volumes to increase in the next 12 months.

Our survey respondents are appropriately optimistic: 77% of firms expect their trade volumes to increase in the next 12 months. Businesses in the Asia-Pacific region show the most confidence, with 82% of respondents there saying they expect trade volumes to rise; Bangladesh and India are especially upbeat. European firms are slightly less optimistic than the global average, although a healthy 71% anticipate trade growth.

3 Cross-border bank claims measure the extent of banks' exposure to potential losses due to their lending activities in foreign jurisdictions. These lending flows are a major component of total cross-border trade in financial services.

Firms expecting an increase in trade volumes

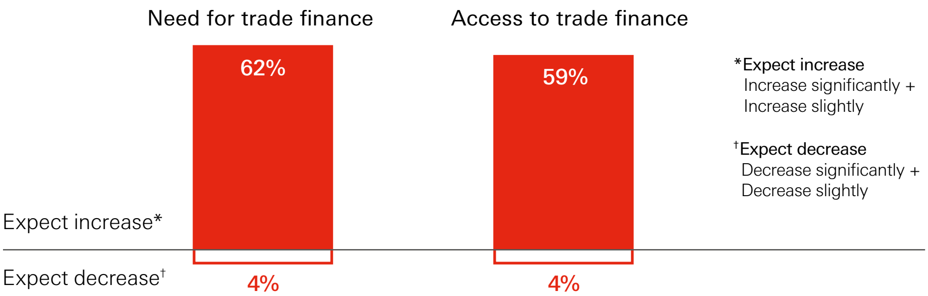


Source: HSBC Trade Confidence Survey Q1 2018

… and North America still offers the most opportunities

Despite Washington's current protectionist leanings, North America is the region businesses cite most often as their principal export growth market. Clearly, the strong near-term growth prospects in the huge US consumer market continue to attract exporters all over the world.

Outlook for trade finance need and access in the next 12 months



Source: TNS Kantar

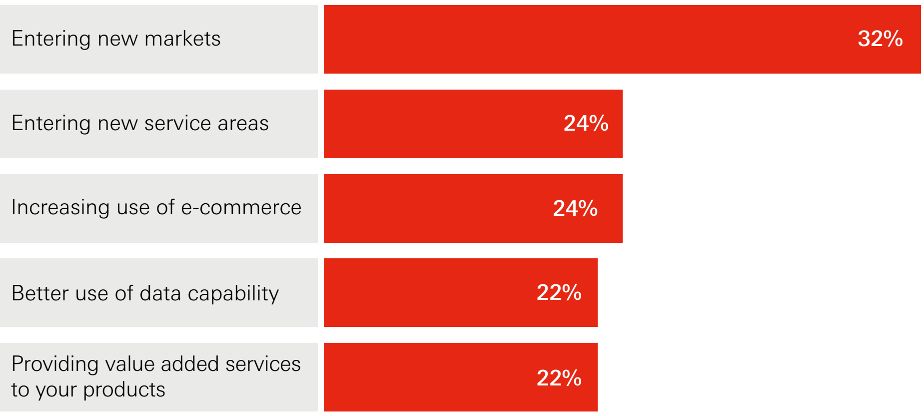
Reflecting the upbeat outlook for trade, over 60% of respondents globally expect to need more trade finance over the next 12 months. A similar proportion think their access to trade finance will improve, as credit conditions remain generally accommodative. For firms in Asia-Pacific and the Middle East, high transaction costs are the top obstacles to meeting trade finance needs, while respondents in Europe and North America are more likely to cite regulatory barriers.

Spotlight on services: Trade recovers strongly in Asia-Pacific

Just under two-thirds of service businesses expect their trade volumes to grow over the next 12 months—slightly fewer than for total global trade. Again, firms in Asia-Pacific are most sanguine about prospects; 69% of respondents from this region think service trade volumes will rise, followed by their counterparts in the Middle East (61%), North America (59%), and Europe (51%).

These regional results concur with available data for 2017, when services trade picked up more rapidly amongst emerging markets than in developed economies. One potential reason: The transport and tourism sectors, which performed well last year, tend to represent a higher share of services trade in less developed economies.

How do you plan to grow your services business?



Source: TNS Kantar

How are service providers boosting their trade? Our survey suggests entering new markets and service areas is the most popular approach. But services firms are also more likely than manufacturers to say they're using e-commerce and data capabilities to power growth.

That said, businesses across the world consider cyber security a grave risk, with almost 80% agreeing that cyber crime is a growing threat. And although 77% of firms think easier access to data levels the playing field in international business, two-thirds say data-related regulation could create barriers to cross-border service delivery. About six in 10 companies, across all markets, feel that some firms' Big Data capabilities may give them an unfair advantage.

> Emerging markets tend to be more optimistic about service trade in the near term than developed countries.

Trade Policy Developments

Global firms see protectionism on the rise …

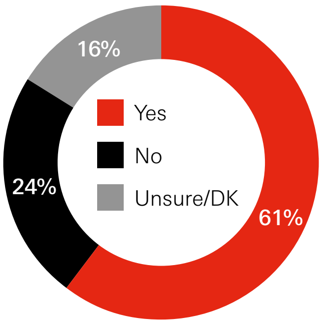
Unwarranted shifts in monetary policy, developments in financial markets, and geopolitical tensions could all jeopardize global economic growth—and by extension trade—in the near term. Another risk is that anti-globalisation sentiment leads to more restrictive trade policies, which would threaten trade prospects in the long term as well. The Brexit vote in the UK and the US withdrawal from the Trans-Pacific Partnership provided stark examples of how populism can trigger significant economic and political change.

More than 60% of our survey respondents think governments are growing increasingly protective of their domestic businesses. The feeling is most prevalent in emerging markets (68%), perhaps because the backlash against trade liberalisation has occurred in their most critical developed-country export markets. Not surprisingly, respondents say protectionism's main impact is to increase the cost of doing international business.

Action points for business

- Firms need to understand the implications of a more complex global trade policy landscape—on the one hand, how to capitalise on the potential opportunities from trade liberalisation, and on the other, how to manage potentially higher supply-chain costs as a result of possible risks such as a hard Brexit or US withdrawal from NAFTA.
- Businesses should join the political debate around trade policy, to help ensure that liberalisation efforts move forward.

Are governments becoming more protective of their domestic business?



Note: may not total 100% due to rounding

Source: TNS Kantar

Top 3 impacts of protective policies on my business

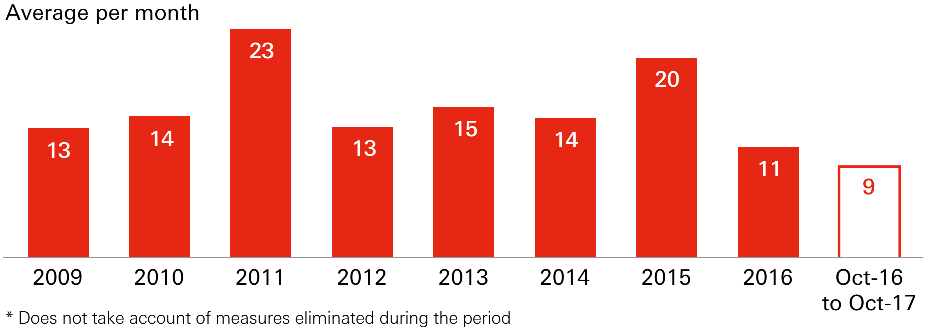
Source: TNS Kantar

… but in reality the picture is mixed

The World Trade Organisation (WTO) reports that its members are putting fewer new trade-restrictive measures[4] in place than in previous years. In fact, trade-facilitating measures have lately outnumbered trade-restrictive measures among WTO members—and covered more than twice as much trade in value terms as restrictive policies did. Furthermore, additions to the recently expanded Information Technology Agreement[5] liberalize tariffs on an estimated $1,300 billion worth of IT trade— 2.4% of the total value of world merchandise imports. And the WTO Trade Facilitation Agreement, ratified in February 2017, is helping to reduce red tape at the border in many countries. However, the incidence of trade disputes and litigation is substantial and often results in trade remedies being put into place to protect domestic industries.

> Over 60% of businesses feel that governments are becoming more protectionist.

New trade restrictive measures by WTO members*



* Does not take account of measures eliminated during the period

Source: WTO Secretariat

4 New or increased tariffs, customs regulations, and rules-of-origin restrictions.

5 The ITA was originally agreed in 1996, with participants agreeing to remove tariffs on a range of IT products. Over 50 members recently expanded the agreement to cover an additional 201 products.

The coming year could be pivotal for trade policy

In one piece of good trade-policy news, the 11 members of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) recently finalised a trade pact. The deal should come into force at the turn of the year if the pace of ratification proceeds as expected. The agreement greatly enhances market access for goods and services trade among members.[6] It also addresses non-tariff barriers to merchandise trade, for example through enhanced regulatory coherence and shorter waits for exports and imports to clear customs. CPTPP members hail the deal's success as an antidote to growing US protectionism.

Several other trade policy initiatives are in advanced negotiations. Many are comprehensive in scope—besides lowering tariffs on goods, they also address non-tariff barriers to trade in both goods and services:

- **EU-Japan Economic Partnership Agreement:** This ambitious deal would remove duties on most industrial goods, liberalise some agricultural trade, increase market openness for services, and address issues such as regulatory cooperation. Negotiations are concluded; the treaty is being drafted and is likely to be signed in the next few months.
- **EU-Mercosur Association Agreement:** Negotiations are at an advanced stage between the EU and four Mercosur countries (Argentina, Brazil Paraguay, and Uruguay) to improve market access for goods and services. Negotiators hope to conclude talks within weeks. (In a separate parallel initiative, the EU and Mexico are making good progress in negotiations for an expansion of their existing bilateral accord and expect to conclude that deal in the coming months.)
- **Regional Comprehensive Economic Partnership (RCEP):** The pan-Asian[7] deal would liberalise goods and services trade, and facilitate trade-related investment. Members hope to conclude the agreement during 2018.
- **Belt and Road Initiative:** China and other participants have pledged to boost resources for infrastructure development and to cooperate in various areas of economic policy. With a number of projects already planned for 2018, the initiative could significantly improve infrastructure across Eurasian trade routes over the coming years.

Despite these promising initiatives, uncertainty regarding trade policy has rarely been more acute—and significant risks remain that anti-globalisation sentiment could bring a resurgence of protectionist measures. The malaise is particularly apparent in the ongoing renegotiation of NAFTA. An updated and modernised accord could address pressing issues including e-commerce, data security, agricultural market access, and logistics (such as regional truck access). But talks could break down if US negotiators focus on bilateral trade deficits or controversial proposals such as a sunset clause that would terminate the agreement in five years unless the partners agree otherwise. If the talks fail, the US might even withdraw from the agreement.

> Several big new trade accords are being negotiated or finalised. But anti-globalisation sentiment poses an ongoing threat.

Other questions swirl around future US trade policy. The US has recently moved to implement tariffs on imports of steel, aluminium, washing machines and solar cells. The ongoing Section 301 investigation of China could also lead Washington to implement additional trade measures.

Across the Atlantic, the **Brexit** outcome still hangs in the balance. We expect the EU and UK to agree to a transition deal that would keep existing EU trade arrangements in place for up to two years post-Brexit. In that case, the immediate impact on UK trade will be limited. We assume a free trade agreement will follow that two-year transition period. On the other hand, if talks break down, the UK could leave the EU in March 2019 with no trade deal at all or with just a transition period.

6 CPTPP members are Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, and Vietnam.

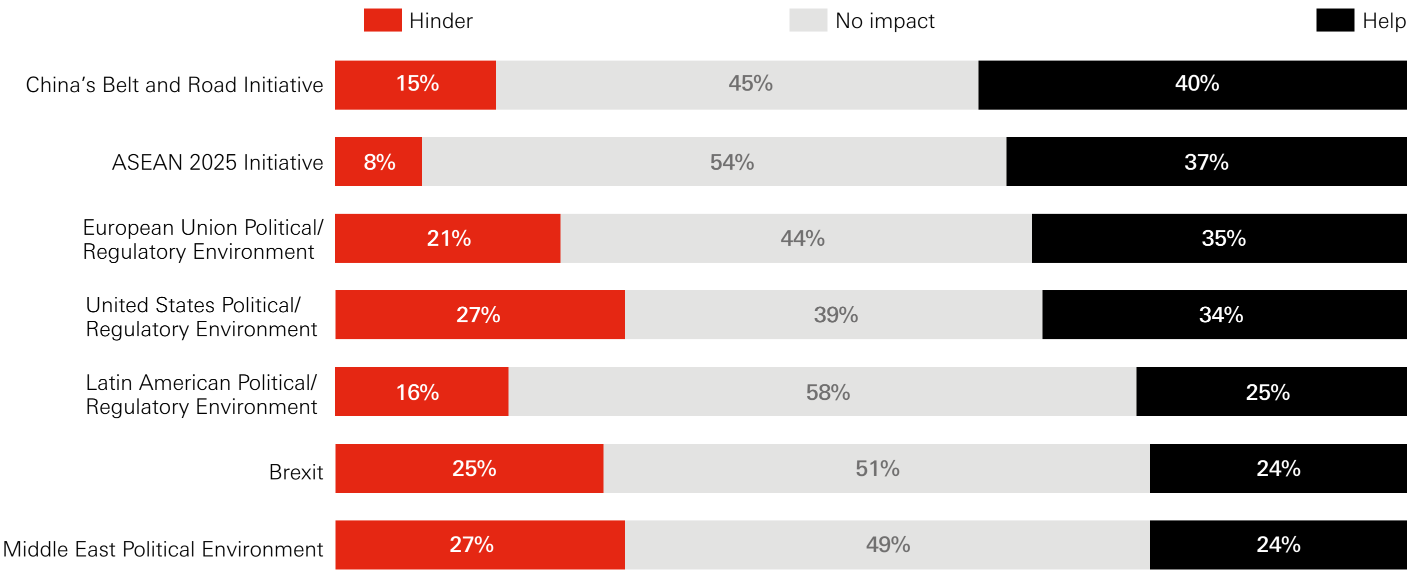
7 RCEP members are Australia, Brunei, Cambodia, China, India, Indonesia, Japan, Korea, Laos, Malaysia, Myanmar, New Zealand, Philippines, Singapore, Thailand, and Vietnam.

Firms are neutral about trade policies outside their region
Business awareness of the shifting policy landscape and its consequences remains rather patchy. Despite their ambitions to expand into new markets, our survey respondents appear focused on developments in their own region. For example, whereas nearly 60% of respondents in Asia think ASEAN 2025 and China's Belt and Road initiative will help their business over the next two years, most respondents in Europe and North America say these initiatives will have no impact on their firm. Similarly, over 60% of respondents in Europe consider the CPTPP pact as irrelevant.

More surprisingly, European respondents outside the UK seem unalarmed about Brexit-related risks: 62% of respondents expect either no impact or a positive impact on their firms. Globally, 75% of respondents have a similarly benign view of the outcome of Brexit. As for US policy and regulation, the numbers of optimistic, pessimistic, and neutral responses are fairly even—and almost 40% of firms expect no impact from Washington's moves in the next two years.

These findings suggest businesses may need to become better informed about policy developments that could disrupt their supply chains or hamper their ability to reach new markets. At a time when creeping protectionism poses an ongoing threat, firms should join the public debate to defend open markets and advocate policies for sustainable and inclusive trade.

Impact of government/economic policies on my business in the next 2 years*



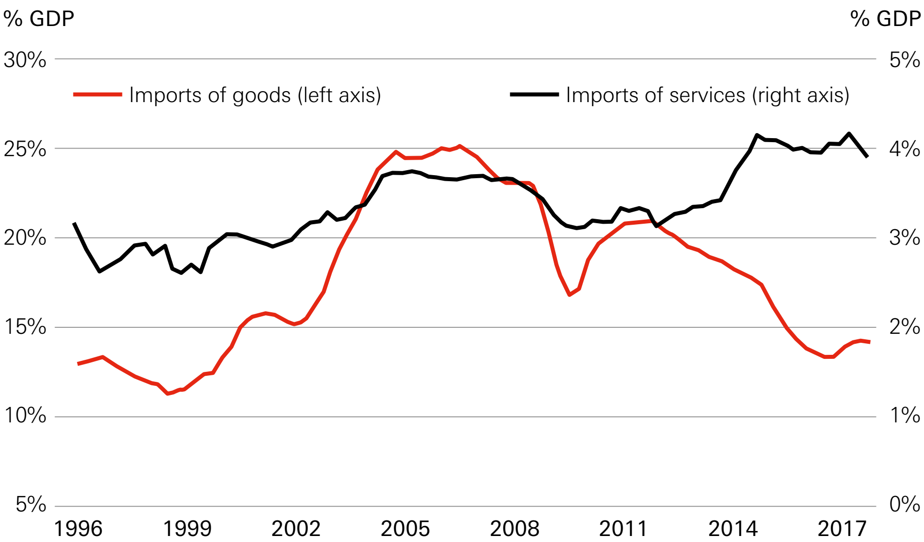
Source: TNS Kantar

*May not total 100% due to rounding

Long-Term Outlook for Trade

The emerging markets will have much to do with prospects for global trade in the long term. Strong fundamentals in these countries, including favourable demographics and steadily rising incomes, point to economic growth for many years to come. On the other hand, China's economy is expected to grow more moderately over the coming decade, and the ongoing shift from manufacturing toward services will likely weigh on goods imports growth. But the shift will also help create a more stable Chinese market, and demand for foreign services will grow as consumers play a bigger role and the economy becomes more sophisticated.

China: import intensity of output



Source: Oxford Economics, Haver Analytics

We expect world trade to grow faster than global GDP fairly consistently over the coming decade as globalization makes a comeback. But trade's responsiveness to GDP growth is unlikely to match its performance in the 10 years before the financial crisis, when global supply chains were spreading rapidly. Indeed, supply chains seem to be shortening, as more multinationals establish regional production centres to reduce risk and improve flexibility in meeting customer demand.

Our projections show the value of global goods exports expanding by around 6% a year in the decade to 2030, while growth in services will be close to 7% pa. It is worth highlighting that our forecasts are based on current or confirmed trade policies. Meaningful progress toward further liberalisation would, of course, accelerate cross-border commerce—while a relapse into protectionism presents perhaps the single biggest risk to the long-term outlook for both trade flows and the global economy. Much empirical evidence links trade openness to higher productivity and better living standards.

Action points for business

- Firms in advanced economies should learn how they can participate more fully in the rapidly growing trade between emerging markets—so-called 'South-South' trade. What are the hurdles and risks in these markets? What are the best approaches to market entry?
- Could your supply-chain strategy benefit from new technologies? Is it agile enough to adapt to changing production and distribution trends over the next decade? Have you considered the potential of your wider 'value chain,' to generate revenue from pre- and post-production activities?

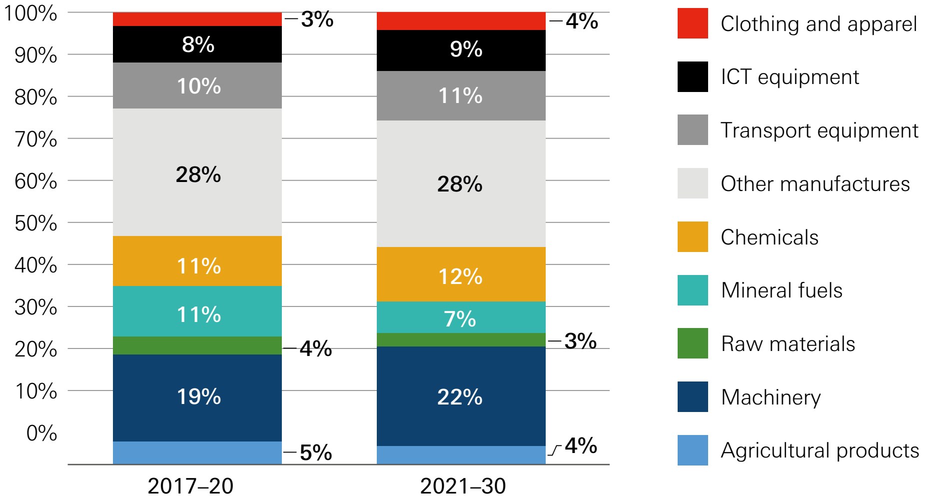
We expect a renewed 'globalisation' trend to emerge over the coming decade.

Goods trade will get more regional

In the decade to 2030, machinery and transport equipment will contribute most to the growth in goods trade, reflecting cross-border supply chains and strong demand for consumer and capital goods from emerging markets. Trade in raw materials and mineral fuels, meanwhile, should get a boost from higher commodity prices.

Manufacturers should grasp opportunities to bundle services with big-ticket products.

Sectoral contribution to increase in exports*



* Chart shows the contribution from each sector to the projected increase in total merchandise exports over the relevant period

Source: Oxford Economics

'South-South' trade is expected to grow briskly, especially if regional trade agreements and initiatives like China's Belt and Road proceed. In addition, as oil-exporting countries in the Middle East diversify their economies, we expect to see more trade investment in the region, albeit with modest results between now and 2030.

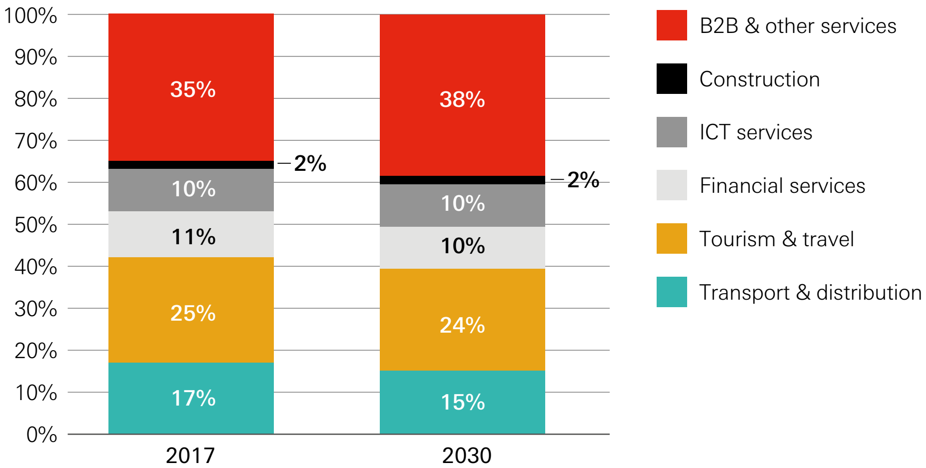
Given the rapid pace of change in technology and mounting international competition, manufacturers in developed countries will need to focus on R&D, stay innovative, and position themselves to take advantage of fast-growth markets. Manufacturers in particular should grasp opportunities to bundle services like maintenance, consultancy, and financing with their big-ticket goods sales—add-ons that can bring significant value.

Industry 4.0 initiatives could see developed-country manufacturers also generate revenue by selling technological knowledge to "smart" factories abroad. These factories would be characterised by fully connected and flexible cyber-physical systems that can self-optimise performance across a broader network. Such sales would not completely replace trade in goods, but are likely to accelerate the trend toward regional production hubs.

The boundary blurs between goods and services

Services' share of global trade will continue to rise over the medium to long term, outstripping growth in goods trade. Structural shifts in the global economy, including a growing middle class, are rapidly boosting demand for consumer-related services. But trade in services is also getting a boost from technological advances and regulatory measures that make services more tradable.

Sectoral shares in total services exports



Source: Oxford Economics

Much service trade growth over the next decade will result from firms outsourcing intermediate business services to specialised suppliers. And while more manufacturers are already bundling services with products, the distinction between goods and services may blur further as smart, connected products become more commonplace.

With their skilled labour, infrastructure, and wealth, developed countries currently dominate international service exports. But developing nations are likely to move into this space, following the example of India, which is already a highly successful exporter of business process outsourcing and support services for finance, medicine, and engineering. In particular, China's booming demand for services presents a significant opportunity for providers in the region.

Conclusion

In summary, our research indicates that trade flows are benefitting from the global economy's current "sweet spot", resulting in a renewed upswing in the process of globalisation. Prospects for continued expansion appear generally positive, but there are risks on the horizon - in particular, the outlook for developments in global trade policy has rarely appeared so uncertain. Over the longer term, we expect an ongoing structural shift in the pattern of globalisation, with trade increasingly shifting towards Asia and leading emerging markets in other regions, and flows of services outpacing growth in traded goods.

About the HSBC Navigator

The HSBC Navigator presents a blend of survey evidence, policy analysis, and economic modelling to generate unique and timely insights into the changing landscape for global trade.

The business survey is a quantitative indicator of the short-term outlook for global trade. The survey, which is the largest of its kind, is conducted on behalf of HSBC by Kantar TNS. It is compiled from responses by decision-makers at over 6,000 businesses – from small and mid-market to large corporations – across a broad range of industry sectors in 26 markets. Interviewees were polled on a range of questions including expectations around future growth in trade, trade finance needs, attitudes toward trade policy developments and strategic business plans.

The survey represents a timely source of information on the fast-evolving trade environment. And it can provide a useful contextual setting for interpreting developments in official data. In this way, economists at Oxford Economics are able to blend insights from the survey with their own analysis and modelling of developments in trade.

Oxford Economics has tailored a unique service for HSBC which forecasts bilateral trade in goods and services, in part based on HSBC's own analysis and forecasts of the world economy. A top-down approach is employed, with Oxford Economics' suite of models used to ensure consistency between HSBC's forecasts for economic growth and exchange rates in key countries and the more granular projections for bilateral trade flows presented here.

Oxford Economics employs a global modelling framework, with headline bilateral trade forecasts constructed as a function of demand in the destination market and the exporter's competitiveness (as measured by unit labour costs in nominal USD terms). Exports, imports and trade balances are identified, with both historical estimates and forecasts for the periods 2017-20 and 2021-30.

These headline bilateral trade forecasts for goods and services are also disaggregated by sector, using Oxford Economics' Industry forecasts to inform future production trends and taking into account the historic relationship between output and exports in each sector, by market:

- For trade in goods, sectors are classified according to the UN's Standard International Trade Classifications (SITC) system at the two-digit level and grouped into 30 sector headings.
- For trade in services, we identify five broad sectors: B2B and other services, tourism & travel, transport & distribution, financial services, ICT services and construction.

Drawing on the Kantar TNS survey results and Oxford Economics' long-term forecasts, Oxford Economics produces in consultation with HSBC a global report and specific reports on the following 23 markets: Argentina, Australia, Bangladesh, Canada, China, Egypt, France, Germany, Hong Kong, India, Indonesia, Ireland, Japan, Malaysia, Mexico, Poland, Saudi Arabia, Singapore, Turkey, UAE, UK, USA and Vietnam. The analysis of trade in goods also includes trade with Brazil and Korea for a total sample of 25 key trading markets; for trade in services the analysis also includes Korea for a total sample of 24 key trading markets.

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