TRADE FORECAST REPORT

CHINA

2H 2015

HSBC

CHINA: IN BRIEF

- The 2015H2 Trade Confidence Score for China declined to 129, 8 points lower than H1. Even if the overall sentiment for the six months to come is still largely positive, the volume of business outlook has declined.
- China will to continue to record high productivity growth as the industrial sector is being upgraded. While more labour intensive sectors should continue to migrate to lower cost countries such as Vietnam and Bangladesh, China is expected to further move up the value chain as Chinese companies continue to develop competitive processes.
- As a result, machinery and transport equipment will play the biggest role in driving export value growth in 2015-20, with around half of the contribution stemming from gains in ICT equipment exports.

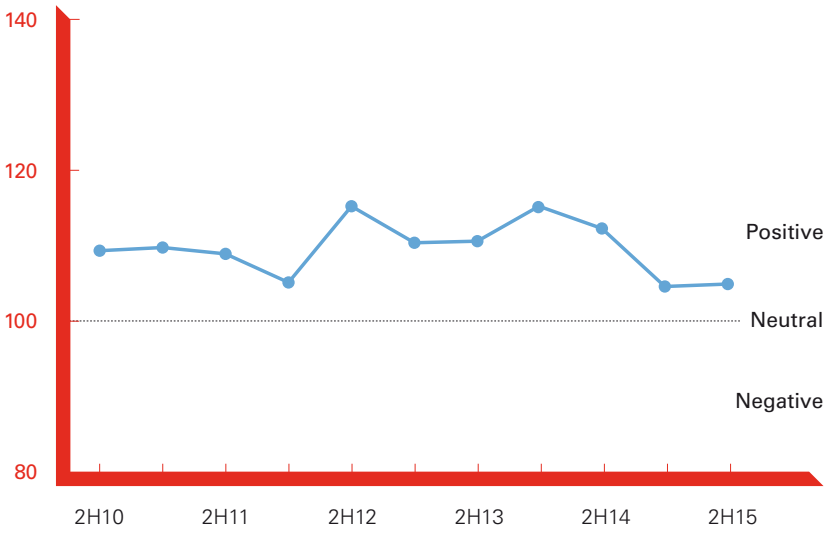
With the Chinese economy currently undergoing significant structural adjustments, domestic demand remains subdued while a strong RMB is dampening export growth. However, with the industrial sector being upgraded productivity gains are expected to remain strong. This will allow China to record fast export growth over the medium term, fortifying its position in global trade.

SHORT TERM SNAPSHOT

HSBC TRADE CONFIDENCE

The 2H 2015 Trade Confidence Score for China declined by nine points to 129 compared to the survey results in H1. Even if the overall sentiment for the six months to come is still largely positive, the volume of business outlook has declined: the share of companies expecting trade volumes to improve over the next six months declined to 69% from 79% in the last survey. Furthermore, the confidence on the local economy also declined, albeit more modestly. 70% of companies surveyed expect the outlook on the domestic economy to improve, down from around 76% in H1.

TRADE CONFIDENCE SCORE



Source: HSBC TCS data

While around 52% of companies surveyed still expect the global economy to improve over the coming six months, only 63% expect this to have a positive impact on business (down from 81% in the previous survey). This may be due to the fact that perceived spillover risks from the current economic adjustments in China will dampen the growth prospects for other Asian countries. However, the ongoing recovery in Europe is perceived as providing good opportunities for new business with 20% of companies surveyed expecting stronger demand growth (up from 17% in the last survey). Furthermore, the strengthening of the US economy is also perceived as providing support to business for Chinese companies.

With a stronger RMB eating into companies' profit margins, Chinese businesses aim to improve margins by cutting expenses linked to material and essential services. The main source of concern regarding financial risks is related to price fluctuations of commodities and the currency as well as the growing risk of buyers defaulting on payment. Companies plan to overcome these risks by negotiating better payment terms with suppliers and cutting costs internally.

52%

OF COMPANIES SURVEYED STILL EXPECT THE GLOBAL ECONOMY TO IMPROVE

LONG TERM OUTLOOK

ECONOMIC OUTLOOK

The Chinese economy is currently undergoing significant structural adjustments as the old drivers of growth are slowing while new engines are emerging. New housing constructions is plummeting as developers have accumulated significant inventories in recent years. And excess capacity in heavy industry is dampening output growth and prices. However, consumer spending continues to be supported by rapid wage growth, which, in turn, is supporting a strong expansion of the services sector. Further macro policy easing should continue to support economic growth as well.

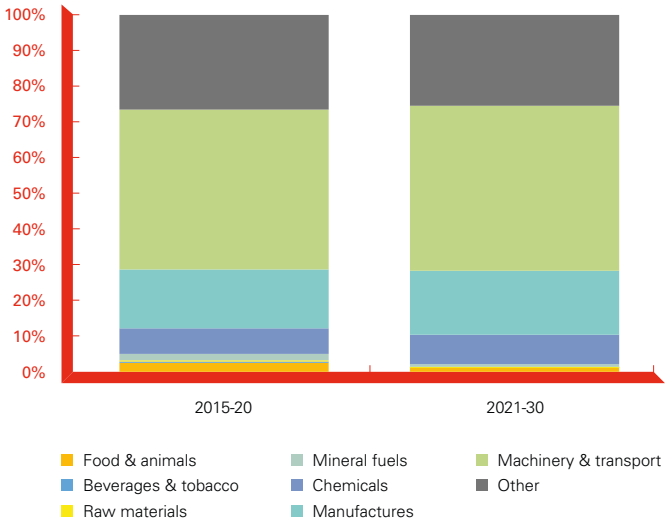
But several factors that have been driving rapid growth over the past few years should wane over the coming decades. China's demographic structure has become unfavourable with the working age population having started to fall. The share of investment in GDP has risen to an all-time high and will need to decline over the coming years. And companies have accumulated significant levels of debt.

However, China should continue to experience fast productivity growth as the industrial sector is being upgraded. While more labour intensive sectors should continue to migrate to lower cost countries such as Vietnam and Bangladesh, China is expected to move up the value chain. This will support export value growth and open new destination markets. Continued reform implementation should also bolster the export competitiveness of Chinese businesses as will the launch of new trade zones.

EXPORT CORRIDORS TO WATCH

At the sector level, machinery and transport equipment will play the biggest role in driving exports over the next fifteen years, contributing around 45% to overall projected merchandise export growth. Around half of this contribution will stem from gains in ICT equipment as China continues to move into higher value added sectors. Chemicals are projected to be the fastest expanding sector, followed closely by transport equipment. But despite the projected double-digit average annual pace of expansion, chemicals will continue to account only for a minor share of overall exports (6% by 2020). Clothing and apparel will remain a key export sector as well, despite lower cost countries such as Vietnam or Bangladesh increasingly competing for market share at the more cost-competitive end of the value chain.

SECTOR CONTRIBUTION TO INCREASE IN EXPORTS



Source: Oxford Economics

Over the coming decades a growing Asian middle-class will demand more higher-end and technological goods, in addition to basic consumer goods. As a regional production hub China is projected to benefit significantly from the projected rapid expansion of demand for goods and services. Exports to Asia excluding Japan are forecast to see the fastest pace of growth and Vietnam should remain the most rapidly growing export destination (amongst the 24 trade partners in the HSBC Trade Forecast). As a result, Vietnam will have replaced Japan as China's third largest export destination in 2030, ahead of Korea. Exports to other Asian countries such as India and Malaysia are also projected to expand at a solid pace.

TOP 5 HOTLIST EXPORT DESTINATIONS

Rank	2014	2030
1	USA	Hong Kong
2	Hong Kong	USA
3	Japan	Vietnam
4	Korea	Korea
5	Germany	Japan

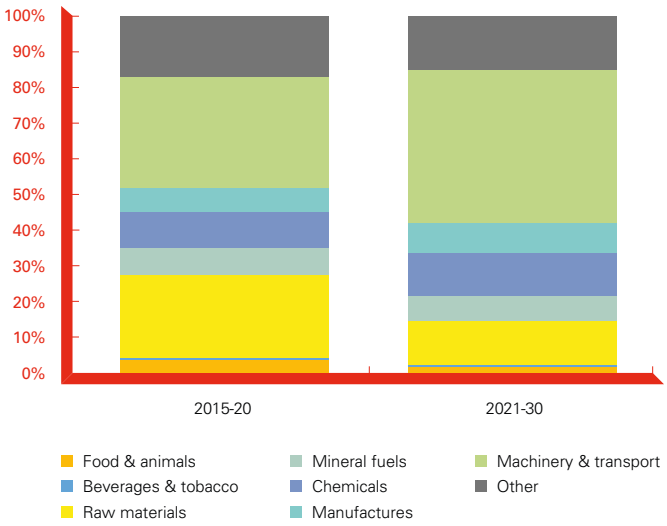
*Ranking among the 24 trade partners covered in the HSBC Trade Forecast

However, given its unparalleled size and spending power, the US will remain China's largest final export destination over the projected horizon. Hong Kong, on the other hand, is expected to remain China's main export hub, owing toits competitive regional advantage in terms of financial and physical infrastructure and the close ties to the Mainland.

IMPORT CORRIDORS TO WATCH

With China shifting its economic structure away from investment towards a consumption-led growth model and moving up the value chain, its import structure will change as well. Imports of transport equipment will accelerate in the decade from 2020, as internal mobility continues to be enhanced and more cities are being upgraded with the latest technology. Indeed, a continued expansion of the domestic railway system is one of the key policy objectives. As a result, transport equipment will become the second largest import sector in 2030, behind industrial machinery.

SECTOR CONTRIBUTION TO INCREASE IN IMPORTS



Source: Oxford Economics

Metalliferous ores, on the other hand, will slow in the medium term as China's demand for steel and other metals stabilises. However, metalliferous ores will remain the fifth biggest import sector in 2030, down from fourth place in 2014. More generally, raw materials will contribute only around half as much to overall export growth in 2021-30 compared to the expected average annual contribution in 2015-20.

TOP 5 HOTLIST IMPORT ORIGINS

Rank	2014	2030
1	Hong Kong	Hong Kong
2	Korea	Korea
3	Japan	USA
4	USA	Japan
5	Germany	Australia

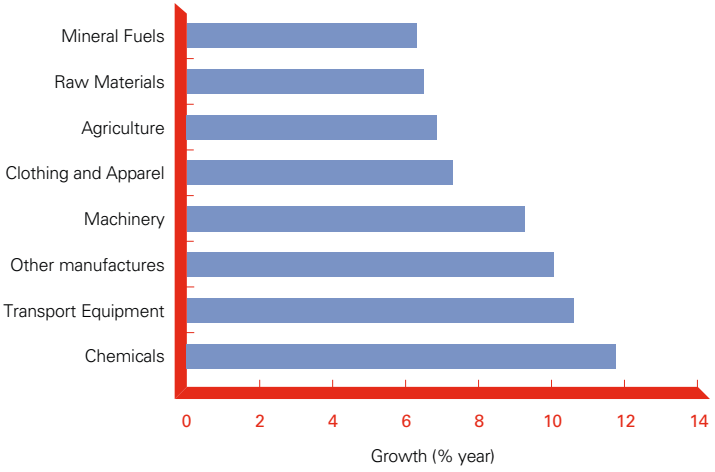
*Ranking among the 24 trade partners covered in the HSBC Trade Forecast

Indeed, Australia, a key exporter of iron ore and other raw commodities, will not feature in the top ten fastest growing import origins for China over the next decade, having seen rapidly growing demand from China for its goods exports in the past few years. Instead, imports from Vietnam and India are expected to continue recording the fastest pace of growth (amongst the 24 trade partners in the HSBC Trade Forecast), followed closely by Malaysia. Hong Kong will remain China's largest import origin, as it remains the key hub to channel products to the Mainland. Korea, the US and Japan will remain key goods origins as well.

DRIVERS OF RECOVERY

- The structural adjustments currently unfolding in China will continue to exert downward pressure on growth in the near term. New housing constructions are plummeting as developers have accumulated significant inventories in recent years. And excess capacity in heavy industry is dampening output growth and prices. However, the Chinese authorities continue to incrementally ease macro policy to stabilise growth. And consumer spending continues to expand at a solid pace propped up by rapid wage growth supporting a strong expansion of the services sector. These factors will limit the risks of a "hard landing".
- Merchandise export growth disappointed to the downside in H1 2015, nearly stalling compared to last year, as the global economic upturn remains weak and the RMB rose significantly against China's main trading partners, owing to US$ strength. This will limit China's gains from an acceleration of growth in the US and the Eurozone in the near term.
- However, looking ahead, China's exports should rebound, boosted by a reacceleration of Asian intraregional trade. The largest contribution to export growth will stem from the US as its robust domestic momentum will boost demand for foreign goods. As a result, the US should remain the largest single export market for China in 2020 (accounting for close to 18% of overall merchandise exports of the countries covered), closely followed by Europe (excluding Russia).
- With Chinese companies continuing to innovate and to develop competitive processes and production costs still lower than those in most advanced economies, China's higher value added products will further gain global market share. Transport equipment and manufacturing and machine tools will continue to benefit from China's key role in continued government efforts to further upgrade the country's manufacturing sector.

EXPORTS BY SECTOR



Source: Oxford Economics

THE US SHOULD REMAIN THE LARGEST SINGLE EXPORT MARKET FOR CHINA IN 2020

ABOUT THE HSBC TRADE FORECAST

The Trade Confidence Survey (TCS) is a quantitative indicator of the short-term outlook for global trade. The survey is the largest of its kind, and conducted on behalf of HSBC by TNS. Over 6,300 businesses globally – from small and mid-market to large corporations – are interviewed about their expectations towards global trade and business growth over the next six months.

In 2H15, the survey data collection method changed to online in 11 markets: Australia, Brazil, China, France, Germany, Hong Kong, Mexico, Poland, Singapore, UK, and USA. The past data has been calibrated to account for this change and to preserve the trends.

Oxford Economics has tailored a unique service for HSBC which forecasts bilateral trade in goods, 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 final demand in the destination market and the exporter's competitiveness (as measured by relative unit labour costs). Exports, imports and trade balances are identified, with both historical estimates and forecasts for the periods 2015-20 and 2021-30.

These headline bilateral trade forecasts are also disaggregated by sector, using Oxford Economics' Industry forecasts to inform future production trends. 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.

Oxford Economics produces a global report for HSBC, as well as country specific reports on the following 23 countries: Hong Kong, China, Australia, Indonesia, Malaysia, India, Singapore, Vietnam, Bangladesh, Canada, USA, Brazil, Mexico, Argentina, UK, France, Turkey, Germany, Poland, Ireland, UAE, Saudi Arabia, and Egypt. The analysis also includes trade with Japan and Korea for a total sample of 25 key trading nations.

All trade flows data are reported in nominal US-dollar value terms (using market exchange rates) unless otherwise specified. This means that fluctuations in a country's terms-of-trade due to relative price and exchange rate effects are reflected in the data.