GLOBAL TRADE

November 2018

Photo by Benjamin Child on Unsplash

THE SHOW MUST GO ON

Allianz

EULER HERMES

EXECUTIVE SUMMARY

Mahamoud Islam, Senior Economist for Asia
+852 3665 8989
Mahamoud.ISLAM@eulerhermes.com

Ana Boata,, Senior Economist for Europe
+33 184 11 4873
Ana.BOATA@eulerhermes.com

Ludovic Subran, Global Head of Macroeconomic Research
at Allianz and Chief economist at Euler Hermes
+33 184 11 5399
Ludovic.SUBRAN@eulerhermes.com

Francois de Panisse Passis
+33 184 11 4873
Francois.dePanissePassis@eulerhermes.com

- Global trade of goods and services remained quite resilient this year despite the US' protectionist rhetoric. In 2019, trade momentum is set to soften to +3.6% (down from +3.8% in 2018) in line with global growth. Protectionism will stay under control but further escalation to a trade feud (average US tariffs above 6%) could cost half a point of GDP growth. The price tag of an all-out trade war (average US tariffs above 12%) could reach two points of GDP and precipitate a global recession.
- There are three reasons to believe a trade war can be avoided. First, pragmatism in America. Second, the Chinese trade safety net plays a role. Third, protectionism fatigue might kick in. We expect a more constructive approach to trade on the US's side. Moreover, China's retaliation has not wreaked havoc on global trade so far. At the same time, trade facilitation reforms and new agreements are somewhat compensating for the US-China quarrel.
- In 2019, the top five destinations for exporters will be the US (+USD193bn of additional demand for imports), China (+USD161bn), Germany (+USD67bn), India (+USD58bn), and Japan (+USD48bn). The best performing sectors will be services (+USD365bn of export gains) and electronic and electric (E&E) products (+USD337bn). Services will benefit from the rise of the middle class in emerging markets and the ongoing *servitization* of the manufacturing sector which is accelerated by digitalization.
- In spite of trade tensions, Chinese exporters could gain as much as +USD146bn in new exports in 2019. American (+USD134bn), Indian (+USD71bn), German (+USD64bn), and Dutch (+USD52bn) companies might also make significant export gains. Asian and African newcomers could rise to the Export Wall of Fame.
- Apart from the impact of protectionism, businesses should prepare for a higher cost of trade, trade diversion, and rising political risk. First, the trade financing gap (USD1.5tn) will rise as monetary and financial conditions tighten (in USD terms), while currency, political and non-payment risks will increase. Second, trade diversion could create winners and losers. Asian trade pivots should benefit the most. Last, we expect 400 new protectionist measures globally (compared to 560 in 2017). Yet sophistication, as well as confiscation and expropriation risks, could increase as the economy experiences a soft landing.

Global trade
in 2019

USD 1.3 trillion

GLOBAL TRADE
IT'S THE CYCLE, STUPID!

Global trade of goods and services remained relatively resilient this year despite the US' protectionist rhetoric

In 2017, global trade recovered by USD1.9tn after losing c.USD3tn over 2015-2016., helped by a synchronized improvement of demand from major economies.

In 2018, trade is expected to grow by +3.8% as the volume of merchandise trade continued to rise above the 2012-16 average performance in a range of 2 to 4% supported by a solid growth in global demand[1].

Trade prices continued to expand supported by more elevated commodity prices. Protectionism has had a very limited impact so far; yet sentiment, as reflected by the decline of major economies' manufacturing PMIs, has been affected by trade threats.

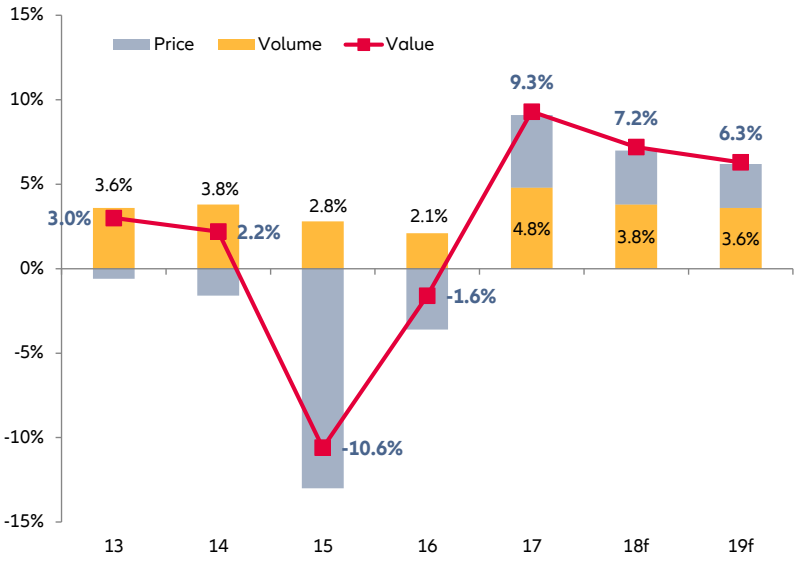
In 2019, trade momentum is set to soften in line with the softening of GDP growth. Not more, not less.

The growth in the volume of global trade of goods and services is estimated to decelerate to +3.6% in 2019 (from +3.8%) and value growth is set to slow to +6.3% (from +7.2%). In USD terms, trade is expected to increase by 1.3tn in 2019 (from 1.7 in 2018).

The economic assumptions behind this forecast are: First, global economic growth decelerates slightly in 2019 (+3.1% from +3.2% in 2018). Such deceleration can be attributed to the US (+2.5%; -0.4pp), the Eurozone (+1.7%; -0.2pp), and China (+6.3%; -0.3pp). Second, tighter monetary policy in the US is expected to lead to slower investment growth and less momentum – especially in Emerging Markets.

We expect two additional rate hikes next year in the US and a first rate hike in Q4 2019 in the Eurozone; and third, with regard to trade prices, though we expect Brent oil prices to decrease to USD69/bbl in 2019 on average, resilient currencies and stronger inflation should support trade growth in value terms. As for our policy assumptions, all eyes on *America First*.

Figure 1 Global Trade Growth



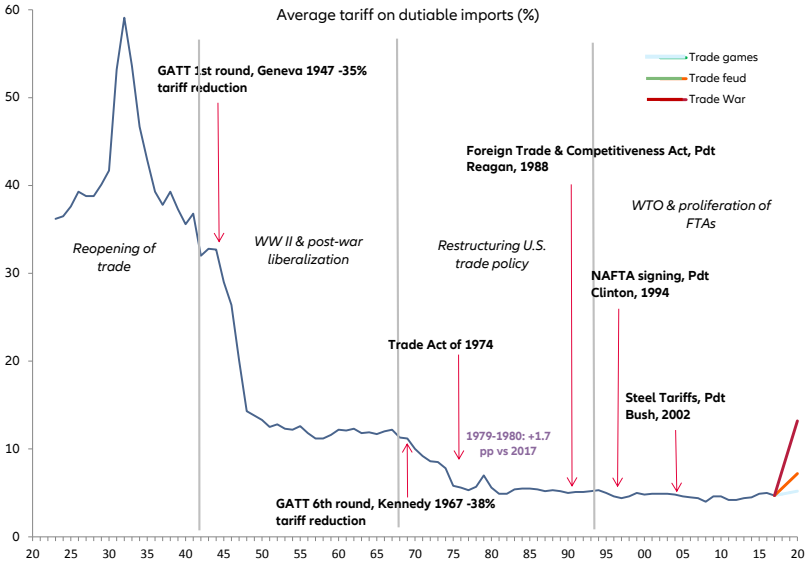
Source: Euler Hermes

[1] Global economic growth rose by +3.2% in 2018 helped by stronger economic growth in the US (+2.9% in 2018 from +2.2% in 2017), a solid growth in China (+6.6%) and the Eurozone (+1.9%).

Protectionism will stay under control. Earlier this year, we introduced a proprietary analytical framework around growing trade threats – Protectionism: Trade Games, Trade Feud or Trade War?. We defined three scenarios based on a sensitivity analysis of the average US tariffs ([3.5-6%]; [6-10%]; and close to 12%); the number of protectionist measures; and the resulting global trade dynamics ([2-4%]; [0-2%], or contracting). We called them respectively trade games, trade feud, and trade war. While the first half of 2018 pointed to prolonged trade games with negligible impact (on growth, trade, inflation, and financial markets) apart from defiance and volatility, President Trump's September 23rd announcements bumped the average US average tariffs by +1.7pp to an estimated 5.2% (which corresponds to the level of tariffs of the 1980's). Another way to look at it is to consider the amount of trade that is covered by tariffs currently. The WTO estimates that new import-restrictive measures imposed by G20 countries from mid-May 2018 to mid-October 2018 cover USD481bn of trade (more than six times the amount reported from mid-October 2017 to mid-May 2018). We are now getting closer to a trade feud situation but our main assumption is that protectionism continues to be under control.

An escalation to a trade feud scenario could cost half a point of GDP in growth; a trade war would cost two points of GDP growth. For our baseline scenario to move to a trade feud situation, milestones include a US implementation of 25% tariffs (currently at 10%) on USD200bn worth of imports from China; and a US slap of 25% tariffs on USD50bn imports from China and USD200bn imports of vehicles. With such measures, the average US tariffs would go above 6% and the volume of global trade growth would be cut by -2pp over two years. Growth would be hit by one third to half a point in the three major economies. For a trade war scenario to manifest, the average tariffs to 12% due to 25% tariffs on all imports from China and 25% tariffs on USD200bn of total US automotive imports. Global trade growth would be cut by -6pp over two years and a global recession becomes very likely.

Figure 2 US average tariffs



Sources: National Statistics, Euler Hermes

THREE REASONS TO BELIEVE A TRADE WAR CAN BE AVOIDED

Pragmatism in America, the Chinese trade safety net, and protectionism fatigue

The determinants behind our central assumption come from the practice of trade agreement in the US, the decisive role that China plays as a trade safety net, and protectionism fatigue, whereby companies and countries have been adapting to sophisticated protectionism in the past years.

We do expect a more constructive approach to trade from the United States. The rebalancing of the political landscape after the midterms calls for a less aggressive stance on trade. Moreover, the example of the revamped NAFTA (with Mexico, Canada) and KORUS (with South Korea) deals and the easing of tensions with the EU tend to confirm our view that: the US uses threats as a tool for negotiations; obtaining a trade deal is the end-game. As the US is by far the largest outlet for Canada's and Mexico's exporters, a major trade partner and political ally for South Korea, the Trump Administration had the upper hand in the negotiation.

Regarding China and the EU, the resolution of tensions may last a bit longer as both markets are much larger and less dependent on the US than the previous ones.

In that context, our scenario envisions lengthy negotiations that could lead to an agreement by the end of 2019, with: (i) China's extending the opening of its domestic market to US corporates; (ii) moves to reduce trade barriers between the EU and the US and encourage the EU to buy more US goods. November political developments tend to confirm our view of a potential positive outcome of this conflict: talks between China and the US have resumed; President Trump hinted at a potential trade deal by the end of this year with China. Yet, successive negative remarks from US officials (Pence, Lighthizer) suggest that the process will be lengthy.

China's retaliation to US rivalry is not breaking global trade. Domestically, a first step would be to maintain a downward bias for the RMB. We estimate that -10% depreciation of the RMB per USD would help absorb a tariff cost of USD50bn (c. 25% tariffs on USD200bn imports from the US).

A second step would be to set a soft economic patriotism policy to force the US to negotiate. This could include: (i) non-regulatory measures such as an anti-US campaign, a boycott of some US products; (ii) regulatory measures that affect American companies operations in China.

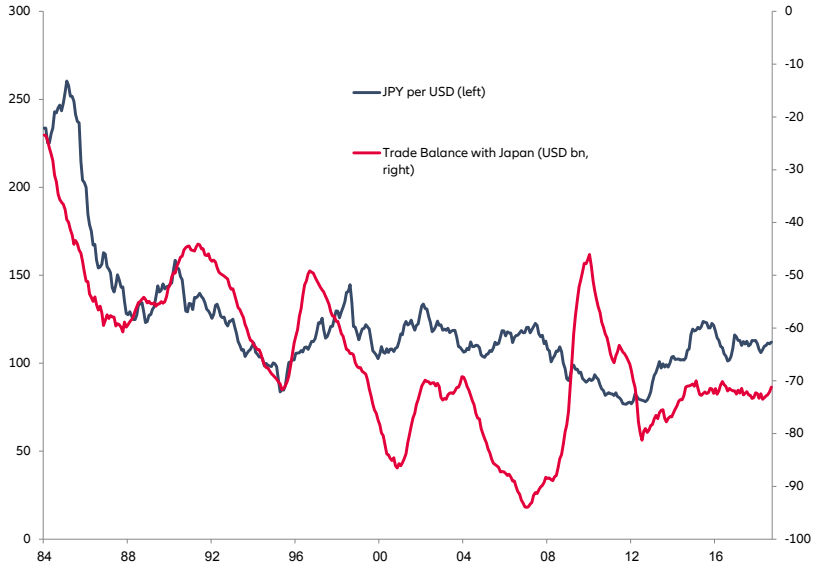
The latter could consist in tighter regulation at the customs, more difficult rules for basic and routine procedures (set up of a company, revenues repatriation to the US, e.g.).

China has already employed this strategy in the past when South Korea decided to install a US made Terminal High Altitude Area Defense anti-missile system (THAAD). A third step would be to encourage innovation and productivity in order to keep trade balance in surplus.

So far, US protectionist measures have been counter-productive. Past trade spat with Japan can explain why. The China-US trade deficit for the first 9 months of 2018 accounts for -USD318bn, +10% higher than last year in the same period.

Moreover, one lesson learned from the past is that it takes more than a price shock to revert a trade deficit. The Plaza accord shows a cautionary tale about the effect of price adjustment on the trade balance. In September 1985, G5 countries delegates met and announced that the USD was undervalued and that they would correct the situation. The JPY appreciated by +46% between September 1985 and December 1986. Contrary to what could be expected from such a deterioration of price competitiveness, the trade balance against the US remained in surplus (Figure 3). Non-price competitiveness elements such as productivity and efforts to innovate mattered. Indeed, the growth of GDP-to-Employed Labor Force in Japan oscillated between +1.5% and +5.1% between 1985 and 1991, while it ranged in the US from 0.8 to 2%. In our view, this example suggests that it would take more than a tariff (price) shock to derail the Chinese export machine. Productivity growth is strong and the country is continuously investing in innovation. China's total expenditures on research and development have increased to c.USD279 billion in 2017 (+14% y/y). These account for 2.1% of GDP against 2.8% in the United States.

Figure 3 JPY per USD and US-Japan trade balance



Sources: IHS, Euler Hermes

China acts as a global trade safety net and wants to open up faster. With full policy mix support, we forecast import growth in China to remain strong at USD 161bn in 2019. In addition, since December last year, China cut import tariffs (except for the US) for a certain number of consumer goods including food products, pharmaceuticals, garments, cosmetics and home appliances, and passenger cars. In November 2018 in particular, 1585 industrial products, including machinery, electronic devices, textile and construction material, have seen a tariff cut. Moreover, China stepped up initiatives to open its market to neighboring countries, namely India, South Korea, Bangladesh, Laos, and Sri Lanka with significant tariffs cut for imports of soybeans, beef, liquefied petroleum gas, textiles, and medical X-ray devices. While it is too early to assess the impact of such moves, these measures are expected to: reduce input cost for corporates, support consumption growth as households get access to cheaper products domestically; boost imports growth and global trade ultimately. We estimate that: a tariff cut of 1pp could boost global trade by +0.3pp.

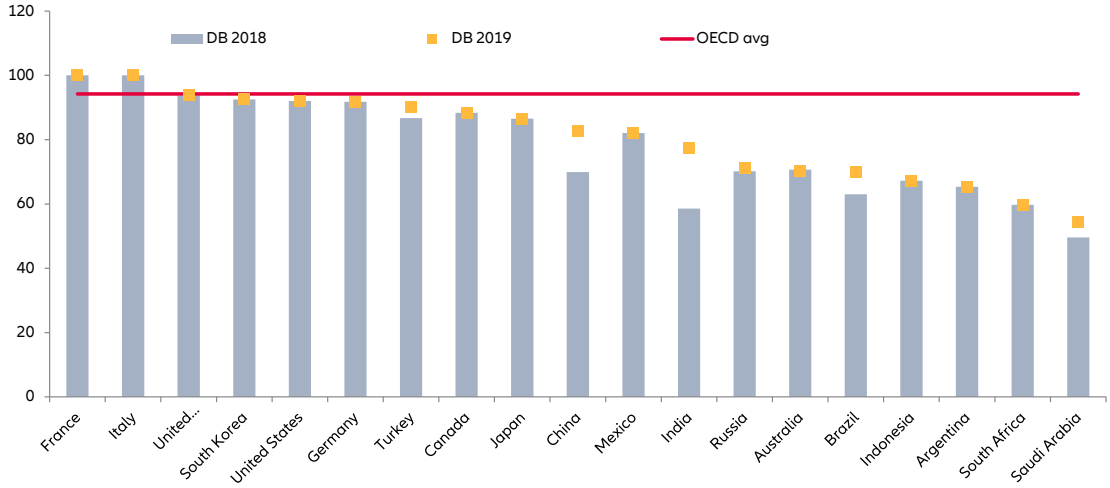
Trade facilitation reforms and new free trade agreements are partially compensating for the US-China quarrel. Out of the US, countries tend to favor free trade initiatives. The last edition of the World Bank Doing Business (Doing Business 2019) points to a positive trend: trading across borders sub-score have increased in almost all major economies (see Figure 4), and especially in emerging markets that used to have poor scores such as India, Indonesia or even China. One-third of G-20 countries improved their score.

Moreover, there is a certain number of game-changing Free Trade Agreements that could be effective soon. The Comprehensive and Progressive Agreement for Trans-Pacific Partnership (TPP without the US) has already been ratified by six nations and is set to come into force on 30th December 2018. This new integrated market will account for 13% of global GDP, 7% of the global population and 16% of global trade. The Regional Comprehensive Economic Partnership, which gathers almost all Asia-Pacific big players (China, Japan, India, South Korea, Australia, New Zealand, and ASEAN) is currently in negotiation and a deal could be reached next year. The grouping will represent nearly half of the global population, 32% of global GDP and 30% of global trade. Last, there are also free trade initiatives that are ongoing and are expected to bear fruits gradually. The Belt and Road, for instance, is getting traction, with more countries getting involved, and enlarged financial capabilities. The initiative gathers now 80+ countries (60+ in its beginning) which represent nearly 36% of global GDP, 68% of the world's population, 41% of the global trade and 46% of global savings.

Ludovic Subran, Global Head of Macroeconomic Research at Allianz and Chief economist at Euler Hermes

"Protectionism should stay under control. Yet an escalation to a trade feud scenario could cost half a point of GDP in growth; a trade war would cost two points of GDP growth."

Figure 4 G-20 Trading across borders (100 = best score)



Source: World Bank Doing Business

Could plurilateral agreements be the (trade) new normal? The World Trade Organization (WTO) is at full speed: its dispute settlement process has functioned reasonably well. Efforts to modernize the WTO and maintain the current international trading system are intensifying. Major disagreements between WTO members relate to the way to address intellectual property rights, industrial and agricultural subsidies and new realities such as digitalization and e-commerce.

In September, the EU released a concept paper to improve the institution with tighter rules on industrial subsidies, new rules to reduce barriers to services and investment, and a more fine-tuned dispute settlement mechanism. One example of the multilateral system pulling itself by its bootstraps is the current platform under negotiation around e-commerce – which started in 1998 and has stalled because of categorization issues and resuscitated in Bali (2013) in line with the Trade in Services Agreement (TiSA). In spite of failing rounds, the WTO is now open about plurilateral agreements – which involve only some members – or trade compacts which could replace consensus agreements. It certainly is not enough to counterbalance the many trade-related risks but certainly shows that a new model is possible.

G20s are calling upon countries to come back to their senses and let go of tweet storms. At the same time—beware of protectionism fatigue.

President Trump does not like to leave international summits without flamboyance. On July 9th, 2017 (one day after the G20 in Hamburg), he confirmed by tweet his will to "fix bad trade deals" despite an adopted declaration on further trade integration the previous day.

In the same way, he instigated the trade feud with China three days before the Davos summit in January by imposing the first tariffs on washing machines and solar panels.

While much of these imports do not come from China, the statement made clear that Chinese dominance of the global supply chain was a concern.

At the G7 summit on June 8-9, President Trump had initially agreed to sign on the communique traditionally cobbled together by the countries at the end of the summit saying that America was still on board with the liberal democratic project it helped build in the ashes of WW2.

However, somewhere in the Pacific on his way to meet KJU, the US President declared: "Based on Justin's false statements at his news conference, and the fact that Canada is charging massive tariffs to our U.S. farmers, workers and companies, I have instructed our U.S. Reps not to endorse the Communique as we look at Tariffs on automobiles flooding the U.S. Market!".

At the 29th NATO summit, on July 11-12 in Brussels, Donald Trump once again hit the retweet record by opening the summit with blistering criticism of Germany, calling it a 'captive of Russia'.

These invectives detracted from the summit's goal of projecting unity in the face of Russian aggression.

In Buenos Aires on November 30th and December, 1st 2018, leaders of the world will meet again.

On the official agenda, trade; on the officious agenda the so-called Thucydides' trap: The US, worried about the growing influence of China, decided to attack first economically.

Throughout history such situations of paranoia versus hubris have often resulted in a military conflict - 12 times out of 16 to be exact[2].

The final declaration will certainly advocate for trade liberalization and against isolationism at a time when a soft landing is visible in the three major economies.

But it is hard to predict what would be the following morning's tweet.

[2] Out of the 4 which did not end into a conflict, 3 happened in the 20th Century: UK-US in the early 1900s, the Cold War or more recently Germany versus the UK and France in the 1990s.

2019: IN SPITE OF RISKS
WHERE TO GO?
WHO WILL GROW?

The US, China, and the Eurozone continue to be the best destinations for exporters. Despite rising trade tensions, imports from major economies – namely the US, the Eurozone, and China – are expected to remain essential.

We pencil a rise of +USD193bn in 2019 for the US, of +USD260bn for the Eurozone.

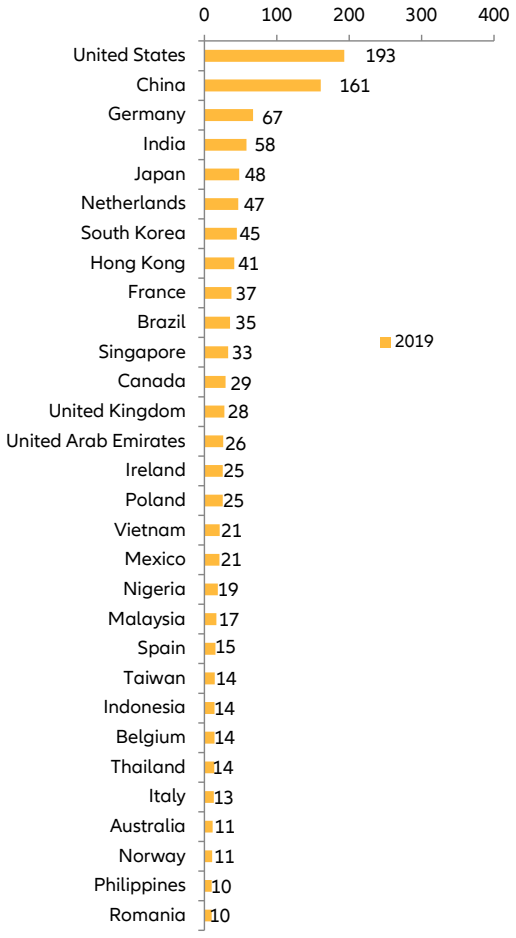
In the US, the fiscal stimulus of the Trump administration and a rise in wages associated with the strength of the dollar will keep both domestic demand and imports in-check. In China, solid growth of private consumption and an opening of the domestic markets are expected to support import growth (+USD161bn in 2019). In the Eurozone, improving job markets and resilience in both investment and consumption will support the rise of imports.

We expect wage growth to rise to +2.4% in 2019 (from +2.2% in 2018), unemployment rate to decrease to 7.9% (from 8.2%). In other large advanced economies namely Japan, South Korea, Switzerland, and Sweden, imports are expected to grow as firm currencies boost purchasing powers.

In emerging markets, Emerging Asia will continue to record a solid import growth, reflecting a burgeoning domestic demand and a rise of capital and equipment goods imports as the region becomes more integrated into global supply chains.

We particularly expect a rise of imports of +USD108bn for the ASEAN-6 grouping and USD58bn for India in 2019. In the eastern part of the EU, demand will remain relatively firm as the positive economic outlook in the EU boosts income growth. Poland will continue to lead the trend with an import growth of +USD25bn.

Figure 5 Top 30 Additional Import Needs by Market (Goods & Services, in USD bn for 2019)



Source: Euler Hermes

Mahamoud Islam
Senior Economist for Asia

"China acts as a global trade safety net, and wants to open up faster. We estimate that: a tariff cut of 1pp could boost global trade by +0.3pp."

Photo by Negative Space, Pexels

Thanks to servitization, services exports are expected to post a growth of +USD365bn (a pace relatively similar to 2018).

First, this will be driven by a continued growth of the services sector in emerging markets. China's services are expected to account for 53% GDP (from 52% in 2017) for instance. In these markets, the manufacturing sector is becoming more service-oriented with higher spending on research & development, marketing and sales, customer support and financial services.

Moreover, services are developing at a fast pace as the rise of the middle class leads to new consumer needs.

This trend is fostered by continued digitalization, which enlarges opportunities for corporates through new trading platforms and a better offering of online services (online courses, online consulting, e.g.)

The Electronics and Electrical equipment sector will benefit from the economic resilience in the largest electronics importers (China, US, Germany, and Japan). The mass adoption of IoT devices and the arrival of 5G technology, which has already started to be commercially deployed, will foster the trend in 2019. Machinery and Equipment exports are expected to post resilient growth supported by a rise in infrastructure spending mainly led by China as part of its fiscal stimulus and its Belt and Road Strategy. The energy sector will be driven by two dynamics: a strong catch up in 2018 as oil price increases rapidly on year on year terms (around +31%), and a correction in 2019.

Ferrous and Non Ferrous metals and Vehicles are faced with significant protectionist threats. The former is already heavily targeted by protectionist policies and we expect a moderation in trade performance next year.

The latter is under stress and could be hit severely over the next months if the US were to impose a 25% tariff on USD200bn of automotive imports.

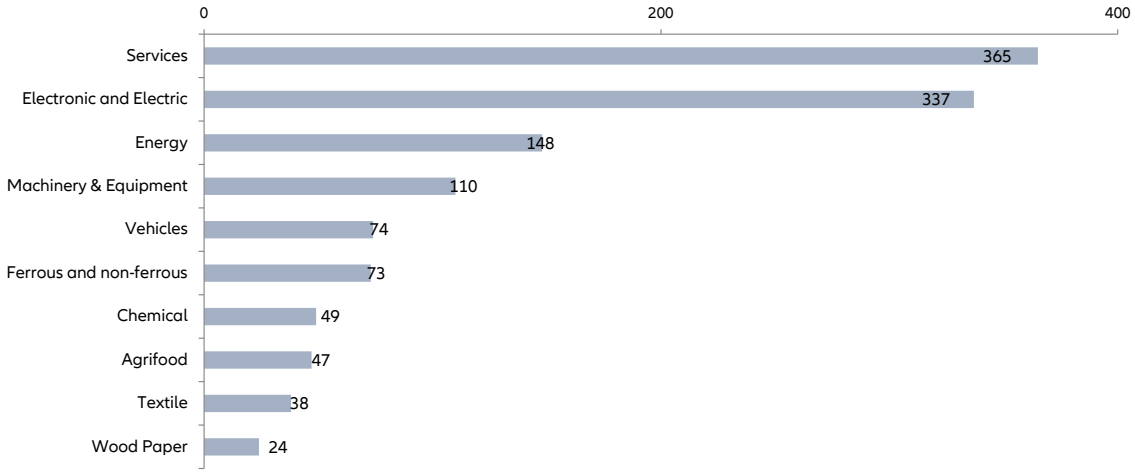
For now, we expect demand to remain resilient, sustained by solid demand in advanced economies and continued expansion in emerging markets such as China and India.

Agrifood and textile industries hindered by strong price pressures. Strong competition may act as a drag on nominal growth.

Paper will continue to feel the heat of the march towards digitalization.

Last, lower demand in the agrochemical industry (around 6% of total output), lower prices in petrochemical (around 50% of total output) due to strong competition from the US will act as a drag on the sector overall.

Figure 6 Sector gains for merchandise goods (USD bn)



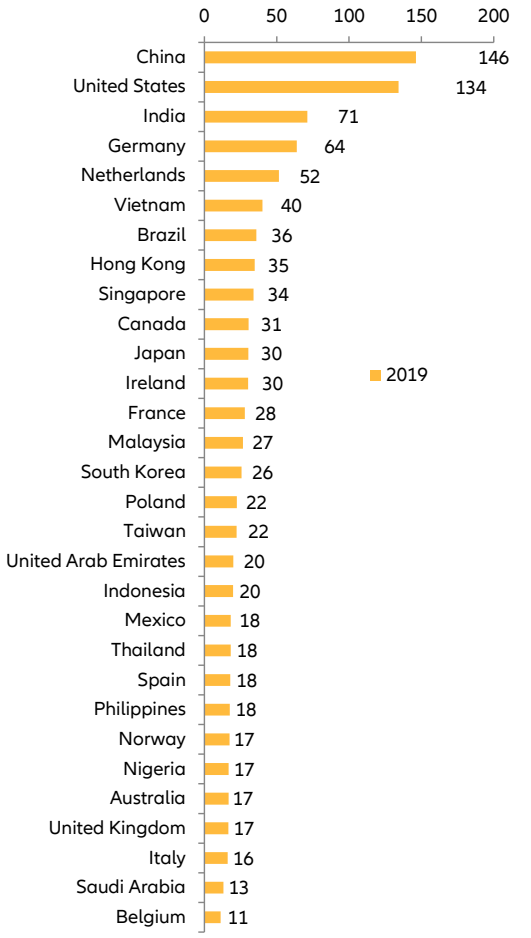
Source: Euler Hermes

Heavyweight exporters – China, the US, and Germany – are best positioned to benefit from trade growth. China, the US, and Germany remain on top of our export gains. In China, currency depreciation and front-loading of exports to the US help explain the strong rise of exports in 2018. In the medium term, we expect Chinese trade initiatives, namely the Belt and Road and potentially the RCEP, to help diversify exports. Note that China's exports to Belt and Road markets account for a third of total China's merchandise exports while the US accounts for 19% of merchandise exports. In the US, the export acceleration of 2018 should be based on higher capacity to export energy, alongside higher oil prices, as well as a stable demand at a global level.

The same factors should explain the deceleration of exports in 2019, with lower energy prices and an expected deceleration of global demand. In the Eurozone, the performance will be mainly driven by demand from the EU (60% of trade is intra-regional) as emerging markets show signs of weakness and a weak euro encourages corporates to look for local suppliers. Germany, France, and Italy, in particular, are expected to post a rise of export of USD64bn, USD28bn, and USD16bn respectively in 2019.

Asian and African newcomers could make it to the Export Wall of Fame. We expect strong performance from manufacturing countries in Asia, Eastern Europe, and Africa. These markets will likely benefit from: the rise of protectionism in the US (as corporates will look for new suppliers out of China and the Eurozone), the advancement of the Belt and Road project (which should improve connectivity within these three regions), and the development of China's value chain (which should benefit low-end producers in both emerging Asia and Africa).

Figure 7 Top 30 – Potential Export Gains by Market (Goods and Services in USD bn for 2019)



Source: Euler Hermes

Ana Boata,
Senior Economist
for the Eurozone

"The US, China, and the Eurozone will continue to be the best destinations for exporters in 2019. We expect a rise of imports of goods and services of +USD193bn from the US, +USD161bn from China and +USD260bn for the Eurozone."

WHAT SHOULD BUSINESSES WATCH FOR IN 2019?

Opportunities should continue to attract companies ready to internationalize but there are three main risks they should prepare for: a higher cost of trade, trade diversion, and political risk beyond protectionism.

First, the cost of trade will mechanically increase in 2019. On top of increased tariffs, and time to clear customs because of uncertainty, trade financing is expected to become more costly, in line with tightening monetary and financial conditions in dollar terms, as well as a specific increase of currency, political and non-payment risks.

For every 100 basis points of increase in US 10 year interest rates, trade finance costs increase by 80 basis points. Currency depreciation risks come on top, as most emerging markets' currencies are expected to depreciate (to the dollar) by another 5 to 10% in 2019.

Policy mistakes (miscommunication on macro-policies and pro-cyclical macro-policies) have become very costly for demand; the cases of Argentina and Turkey where recession prevails are important to note. Vulnerable countries include Brazil, Russia, South Africa, and to a lesser extent India, Philippines, Indonesia, Romania, and Hungary.

In addition, insolvencies have been up for the third consecutive year globally by more than +5% with Asia and Latin America contributing the most to the number of companies going bust. Last, trade to/from emerging markets is already affected by the scarcity of trade finance. The trade finance gap is estimated at USD1.5tn.

Second, trade diversion has already started and could disrupt supply chains. Corporates could focus on local markets and secured trade routes, to keep revenues in check as the risk of supply chain disruptions has increased with US-China trade tensions.

While the value of global trade continues to grow in both 2018 and 2019, foreign direct investment worldwide could decrease by -14% in 2018 before a modest uptick in 2019 (+5%)[3]. In the US, companies are experiencing a boom – and a lesser incentive to go after trade outlets abroad. Out of the US, past the wait-and-see mode, corporates try to secure their supply chain.

Blue wire trade – red wire trade: Duplicating supply chains or banking on competitive and neutral trade hubs to avoid tariffs?

In the face of growing trade threats, and political risks including Brexit and bilateral tensions as in the Gulf countries, company boards and the risk managers' community have started to discuss secured trade routes either banking on neutral and competitive trade hubs that are not subject to protectionist measures from major economies, or by regionalizing their value chains along trade areas. For instance, a company could decide to operate: in the USMCA FTA (US Mexico Canada Free Trade Agreement) world; along mega trade agreements such as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership and the Regional Comprehensive Economic Partnership. This offers new opportunities in terms of organization for corporates. In the case of the RCEP for example, we expect Chinese corporates to invest and build factories in Cambodia, Laos, and Myanmar in order to manufacture low-end products (textile and electronic).

This would make the Chinese supply chain more competitive but will also open new markets for Chinese companies. Both external strategies would lead to a diversion of supply chains. Intermediate consumption hubs will be scrutinized.

Asian pivots will benefit the most from global trade re-wiring.

Figure 8 and 9 help identify the locations that could benefit the most from the trade's new normal.

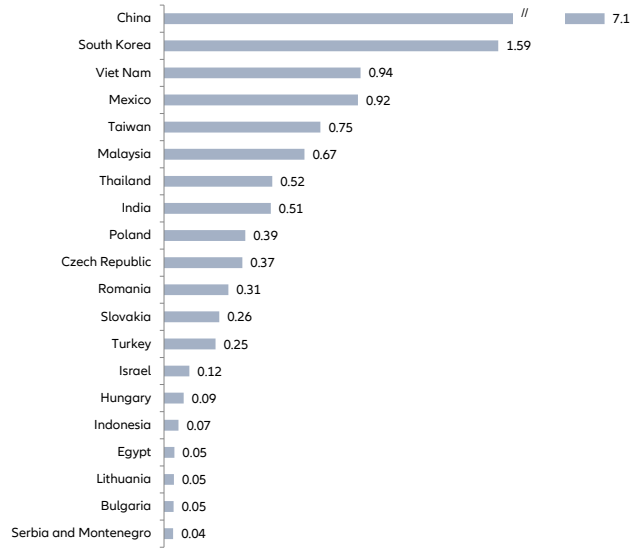
Figure 8 shows the countries that have recorded the largest gains in global market share for intermediate goods exports (electronic components, engines, e.g.) over 2006-2016. This is a crucial indicator of countries integration in the global supply chain.

China tops the ranking by far. The markets that follow (South Korea, Vietnam) are solid contenders but catching up to China will take time.

Figure 9 shows the average growth of stock of Inward FDIs and average growth of trade for selected countries over 2014-17 (post Taper Tantrum and after the start of the Belt and Road Initiative).

[3] Global foreign direct investment inflows fell by 41% y/y in H1 2018 because of the repatriation of foreign earnings by US companies from their foreign affiliate after the tax reform. Short-term indicators provide a more nuanced picture with M&A sales decreasing by -1% y/y in H1 2018 and announced Greenfield investment growing by +42% y/y.

Figure 8 Intermediate goods exports: Change in global market share, % – Top performers



Sources: IHS, Euler Hermes

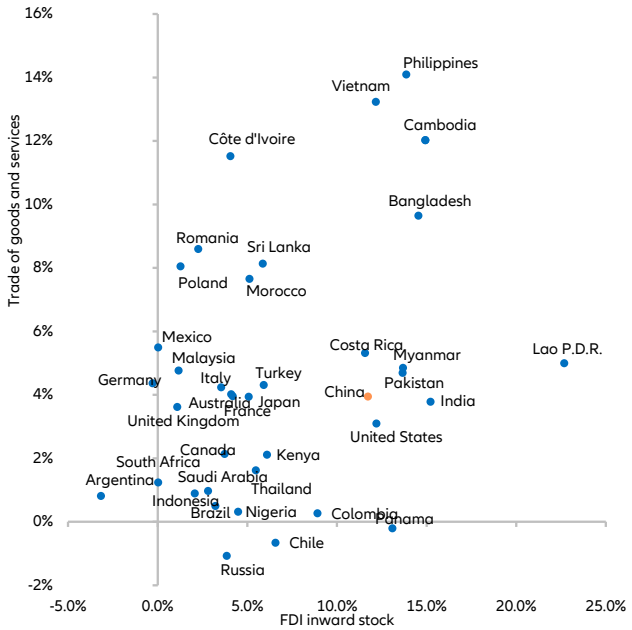
One feature of new manufacturing hubs is a strong growth of foreign direct investment associated with a strong growth of trade. Corporates invest in factories in the new markets, import capital goods and start selling from these markets. We use China as a benchmark. In the North East part of the graph, we see the new manufacturing hubs which are mainly Asian markets (Bangladesh, Vietnam, Cambodia, Laos, e.g.).

It is unlikely that China will be replaced soon as the key supplier. The market is still extremely competitive (taking market share aggressively), foreign investment is strong, and its position in the global supply chain is crucial. In the longer term, we see new players emerging and diversion effects due to new trade policies and corporates strategies will likely exacerbate this trend.

In Asia, these markets are found in ASEAN. Malaysia, Thailand, and Indonesia are already integrated into the global supply chain and are competitive; Vietnam, Philippines, Cambodia, and Laos are becoming more integrated.

In Europe, Romania and Poland are the best positioned with modest growth of investment and strong growth of trade.

Figure 9 FDI Inward Stock and Trade of Goods and Services (growth average over 2014-2017)



Sources: UNCTAD, IMF, Euler Hermes

Last, tariffs are the tip of the iceberg. Other forms of protectionism, political risk, and Fait du Prince could increase further in 2019. On top of more costly trade routes, transaction risks as exemplified by growing sanctions or targeted regulatory risks on highly visible and strategic sectors – such as automotive –, as well as confiscation and expropriation risks on assets, especially critical infrastructure could be a second phase to mounting protectionism.

From the United States to Germany and France, to China, government interventions against foreign takeovers have increased, in both number and visibility[4].

In several countries in Latin America (Mexico, and Brazil), in Asia (Indonesia e.g.), in Europe (Italy), in Africa (South Africa), the protectionist rhetoric did not concern trade directly but the benefits from critical sectors such as energy, and agriculture. As the economy enters a soft landing, more interventionism and defensive strategies could be enacted.

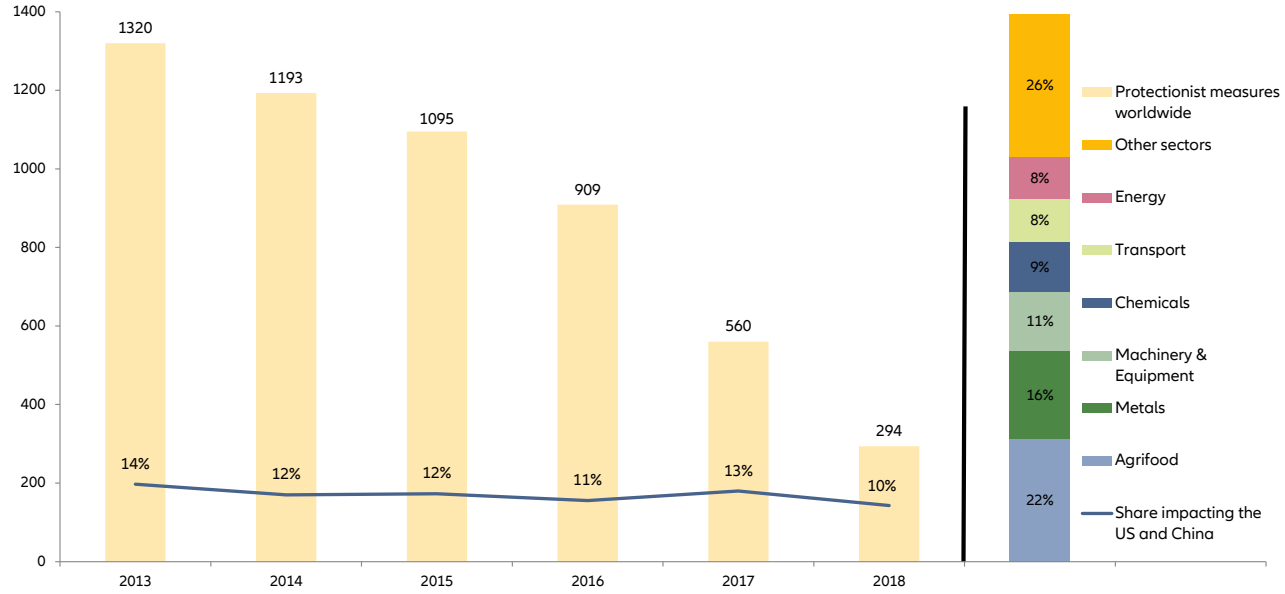
Cautious optimism prevails on protectionism-at-large. Figure 10 shows the number of protectionist measures that have been implemented by country since 2014 with a focus on top contributors.

The number of protectionist measures kept increasing since 2014, yet the pace is slowing. After 560 measures in 2017, the first nine months of 2018 saw an increase of 294. And based on current trends, we could end the year with 400 measures implemented. The WTO figures indicate an increase of trade restrictive measures among the G-20 countries recently (+40 from mid-May to mid-October). Globally, our calculations indicate that the US tops the ranking accounting for 20% of the implemented measures. Protectionist measures are very specific. They targeted specific countries such as China, followed by Canada and the US, as well specific sectors.

China was targeted by 369 measures during the period 2014–18.

On top of the US and China, several economies have also adopted non-tariff trade barriers especially in Metals, Chemicals, and Construction, or Agrifood, and Machinery & Equipment. Going forward, visible and strategic sectors could face significant headwinds.

Figure 10 Number of protectionist measures adopted by year and distribution by sector



Sources: GTA, Euler Hermes calculations

[4] Committee on Foreign Investment in the United States or CFIUS, Außenwirtschaftsverordnung, and Decret Montebourg are the names in the US, Germany in France respectively of the legal proceedings which help limit foreign acquisitions of critical companies and assets domestically.

[5] Our estimates are based on Global Trade Alert Database. We adopted a broad definition (similarly to GTA) of protectionism and include all initiatives that can hinder another country's commercial interest. We focus on measures that have been initiated and implemented by national bodies.

Photo by Charles Deluvio □□□□ on Unsplash

Director of Publications: Ludovic Subran, Chief Economist
Euler Hermes Allianz Economic Research
1, place des Saisons | 92048 Paris-La-Défense Cedex | France
Phone +33 1 84 11 35 64 |
A company of Allianz

http://www.eulerhermes.com/economic-research
research@eulerhermes.com
euler-hermes
eulerhermes

FORWARD-LOOKING STATEMENTS

The statements contained herein may include prospects, statements of future expectations and other forward-looking statements that are based on management's current views and assumptions and involve known and unknown risks and uncertainties. Actual results, performance or events may differ materially from those expressed or implied in such forward-looking statements.

Such deviations may arise due to, without limitation, (i) changes of the general economic conditions and competitive situation, particularly in the Allianz Group's core business and core markets, (ii) performance of financial markets (particularly market volatility, liquidity and credit events), (iii) frequency and severity of insured loss events, including from natural catastrophes, and the development of loss expenses, (iv) mortality and morbidity levels and trends, (v) persistency levels, (vi) particularly in the banking business, the extent of credit defaults, (vii) interest rate levels, (viii) currency exchange rates including the EUR/USD exchange rate, (ix) changes in laws and regulations, including tax regulations, (x) the impact of acquisitions, including related integration issues, and reorganization measures, and (xi) general competitive factors, in each case on a local, regional, national and/or global basis. Many of these factors may be more likely to occur, or more pronounced, as a result of terrorist activities and their consequences.

NO DUTY TO UPDATE

The company assumes no obligation to update any information or forward-looking statement contained herein, save for any information required to be disclosed by law.