Tourism vs technology

A two-speed recovery in services trade

Economics
Economics – Europe

- Services trade has collapsed amid the COVID-19 pandemic
- Recovery prospects for tourism and business travel are bleak as international travel restrictions remain broadly in place…
- …while the acceleration of digitisation could provide new trade opportunities for digital services

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Services versus goods trade

The COVID-19 pandemic has resulted in unprecedented falls in services trade for most economies. Services exports from advanced economies contracted by 28% y-o-y in Q2 2020, steeper than the 25% decline in goods exports from these markets. Emerging markets have also experienced steep contractions in their services exports with few signs of revival amid ongoing travel restrictions. Thailand's services exports tumbled by over 70% and Malaysian services exports were down 55% y-o-y in the second quarter.

Cause of the collapse

Unlike during the Global Financial Crisis when services trade demonstrated remarkable resilience compared to goods trade, services flows are bearing the brunt of the trade shock this time around. Tourism and business travel, which together comprise nearly one-quarter of global services trade, have largely ground to a halt thanks to global travel restrictions. And with the number of COVID-19 infections once again gathering pace, particularly in the northern hemisphere which will soon be heading into winter, it is unlikely that international travel will rebound anytime soon.

Acceleration of digitisation

On the other hand, the current situation has increased the relative importance of other types of services such as telecoms, computer, financial and entertainment services, which tend to be delivered electronically and are more amenable to digitisation. In fact, over 60% of global services exports are traded digitally. Prolonged lockdown and travel restrictions are likely to accelerate digitisation trends, providing opportunities for economies to further boost digital services trade.

Recovery path

We expect the COVID-19 pandemic will lead to a two-speed recovery in services trade, whereby international travel is likely to remain largely suppressed due to travel restrictions, while digital services may recover more quickly. However, growth in digital services is unlikely to fully offset the collapse in travel in the near term. This suggests that services trade is likely to remain well down on pre-pandemic levels for some time to come, for most economies. On the other hand, digitally-enabled and R&D services could see a post-COVID boost, as businesses look to build resilience into supply chains and reshore some production from overseas. Tackling barriers to digital trade and improving digital infrastructure will help support greater digital flows across borders, and could help speed up the recovery in global services trade.

This is a redacted version of the report published on 21-Oct-20. Please contact your HSBC representative or email AskResearch@hsbc.com for information.

Services trade collapse

- Tourism exports have plummeted amid ongoing international travel restrictions …
- …while there are clear signs that digital services are holding up better in the wake of the COVID-19 pandemic
- Tackling barriers to digital trade and improving tech infrastructure could help accelerate the recovery in services trade

Services trade snapshot

Importance of services trade

Services are an increasingly important part of global trade

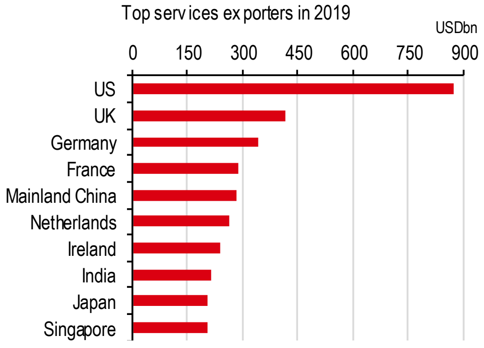
Services are an increasingly important and fast-growing part of global trade. Services trade comprises cross-border flows in a number of sectors including tourism, international education, transport, banking, entertainment, professional services and more.

Global services exports have expanded rapidly over the past decade, growing from USD3.6trn in 2009 to USD6.1trn in 2019.[1] On a gross basis, services comprise around one quarter of global export flows today, although this share can reach nearly 50% if the contribution of services inputs to manufacturing is considered (e.g. financial, research and development, design and customer care services).

In terms of top services trading economies, the US, UK, mainland China, France, Germany, Netherlands, India and Japan have remained important services exporters over the past decade, together comprising nearly half of global services export flows in 2019 (Chart 1). Indian services exports grew by 131% over 2009 to 2019, with the economy moving from being the tenth largest services exporter in the world in 2009, to the eighth largest in 2020. Singapore's services exports also increased by over 100% over the past decade, thanks to growth in its finance, insurance, information and communication industries. The US tops the list of services importers, followed by mainland China and Germany (Chart 2).

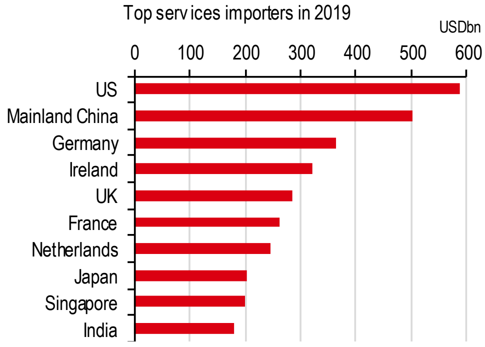
[1] For comparison, global services imports increased from USD3.5trn in 2009 to USD5.8trn in 2019.

Chart 1. The US is the world's largest services exporter…



Source: UNCTAD

Chart 2. …and importer



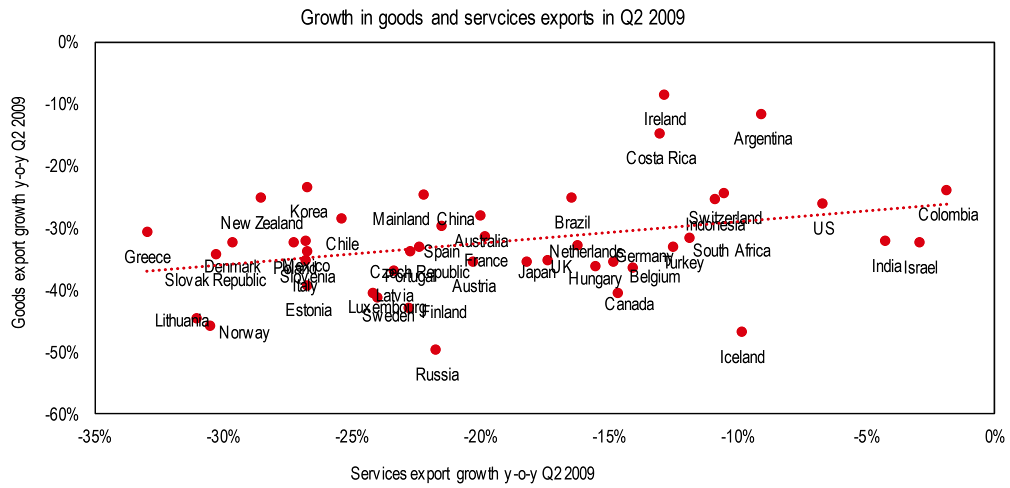
Source: UNCTAD

Resilience of services trade

Services trade was relatively resilient during the global financial crisis

Moreover, services trade is typically much more resilient to economic shocks than goods trade, as evidenced in 2009 during the Global Financial Crisis. During this time, most economies experienced a sharper contraction in their goods trade than services trade (Chart 3). In fact, world goods exports contracted by 22% y-o-y in 2009, while global services exports fell by just 10% over the same period.

Chart 3. Services trade was more resilient to the 2009 economic shock than goods trade



Source: OECD, HSBC

The relative resilience of services trade in 2009 can be put down to two key factors.[2] First, services trade is less dependent on external finance than goods trade, suggesting that the service sector was not significantly affected by tighter credit conditions during this time.

Second, trade in services tends to be less sensitive to demand shocks than goods trade. This is because services are not storable, meaning that consumers and businesses cannot use previously purchased services in the same way as one might continue driving an older car for example, rather than buying a new one, during a downturn. Moreover, services are not affected by inventory adjustments and are generally less susceptible to economic downturns than trade in investment-related goods such as machinery. In addition, most professional services (e.g. telecommunications, computer services and financial services) are still required even during a crisis.

[2] Ingo Borchert and Aaditya Mattoo, "The Crisis Resilience of Services Trade", World Bank, April 2009.

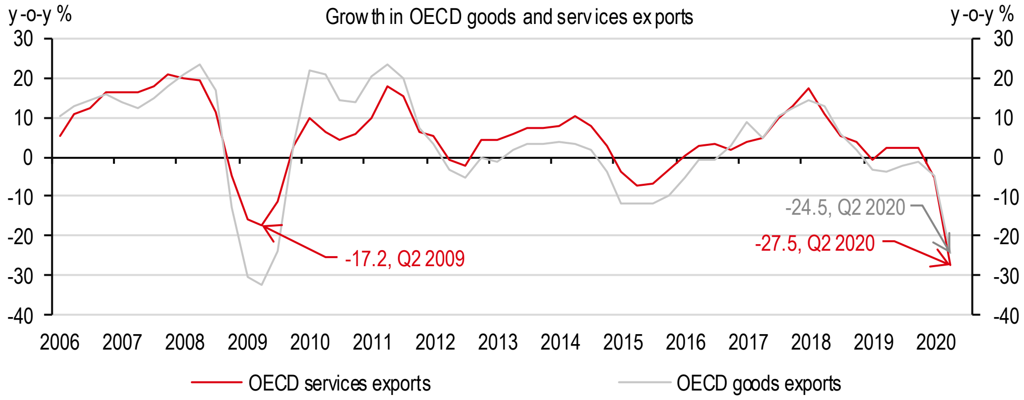
COVID-19 impact

The COVID-19 pandemic has significantly disrupted services flows

Unprecedented falls

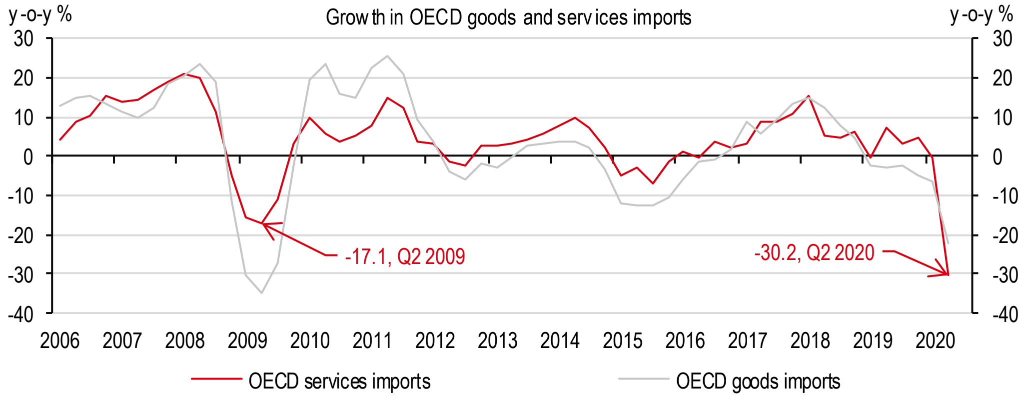
However, the COVID-19 pandemic has significantly disrupted global services trade. And unlike the trade shock in 2009, this time around services trade has fallen by more than goods trade, for most economies. For example, services exports from OECD economies collectively contracted by 28% y-o-y in Q2 2020, while their goods exports fell by 25% (Chart 4). This compares to y-o-y declines of 17% and 33% respectively in Q2 2009. Services imports by OECD economies also declined steeply in Q2 2020, falling by over 30% y-o-y (Chart 5).

Chart 4. The decline in services trade has been steeper than the fall in goods trade



Notes: Data not seasonally adjusted, in USD.
Source: OECD, HSBC

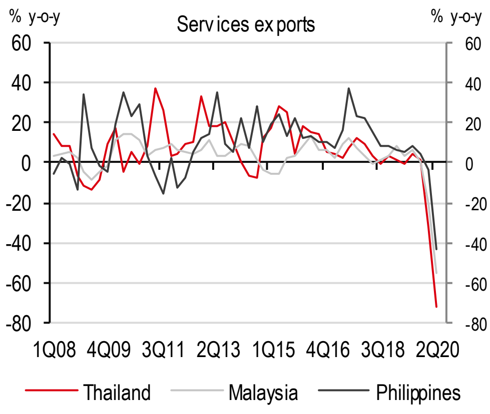
Chart 5. The drop in OECD services imports is steeper than the contraction in exports



Notes: Data not seasonally adjusted, in USD.
Source: OECD, HSBC

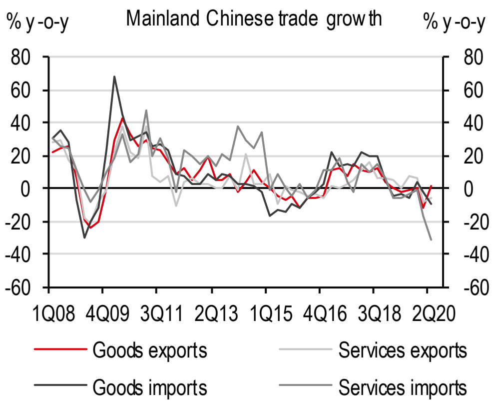
Similarly, most emerging markets also experienced steep contractions in their services exports, likely due to the importance of tourism for these economies. For example, Thailand's services exports contracted by 72% y-o-y in Q2 2020, while its goods exports fell by 16.8%. Similarly, Malaysian services exports fell by 55%, while its goods exports declined by 18.7% over the same period. Exports of services from the Philippines contracted by over 43% y-o-y in Q2 2020, compared to the 35% decline in the economy's goods exports (Chart 6).

Chart 6. Most EMs have seen a sharp contraction in services exports…



Source: Bank of Thailand, Refinitiv Datastream

Chart 7. …including mainland China



Source: State Administration of Foreign Exchange

On the other hand, Chinese services exports declined by 5.7% y-o-y in Q2 2020, while its goods exports increased by 1.7% (Chart 7). Chinese travel services exports fell by nearly 60% y-o-y in Q2 2020, while Chinese exports of transport services bucked the trend, growing by 27% over the same period. Chinese services imports fell 32% while its goods imports were down 9.5% over the same period.

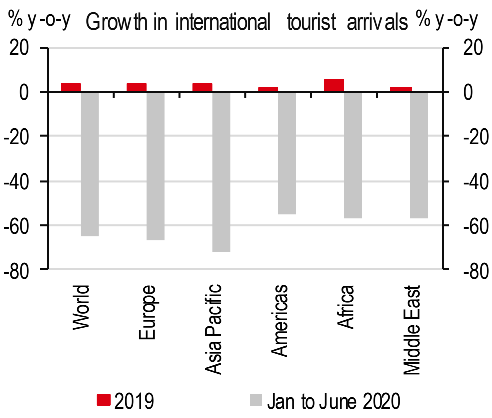
Cause of the COVID-19 collapse

So why isn't services trade holding up as well as it did previously? Largely due to travel restrictions. Travel, whether for tourism or business purposes, comprised 23% of total world services exports in 2019. But these flows have largely ground to a halt amid the COVID-19 pandemic.

Global international travel arrivals declined by over 65% y-o-y in H1 2020

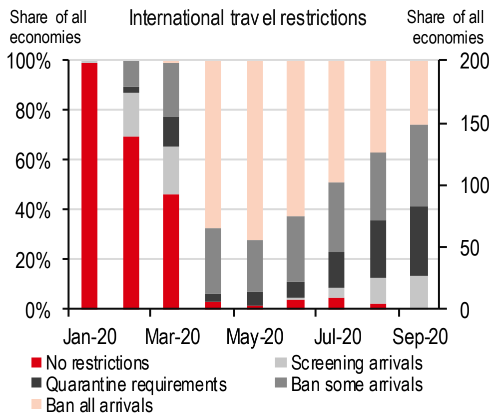
Global international travel arrivals declined by over 65% y-o-y over January to June 2020, translating into a loss of around USD460bn in total world export revenues from international tourism (Chart 8). The Asia Pacific region was hardest hit with tourist arrivals falling by 72% in the first half of this year. Based on current trends, the UN World Tourism Organization (UNWTO) expects global international tourist arrivals to decline by around 70% y-o-y in 2020.[3]

Chart 8. International tourism numbers have plummeted…



Source: UN World Tourism Organization, HSBC

Chart 9. …as most economies maintain some form of travel restriction



Notes: Data as at the 1st of each month. Total number of reporting economies varies slightly each month.
Source: University of Oxford, HSBC

[3] UNWTO, World Tourism Barometer, Volume 18, Issue 5, August-September 2020.

Nearly all countries are imposing some restriction on international travel

As at 1 September 2020, 182 economies were implementing some form of international travel restriction, including screening arrivals and quarantine requirements (Chart 9). Over 100 of these economies have banned arrivals from some or all other regions. Economies such as Thailand, Australia and New Zealand that are highly reliant on tourism revenue and continue to maintain relatively stringent travel restrictions are likely to experience a prolonged downturn in their services exports (Table 1).

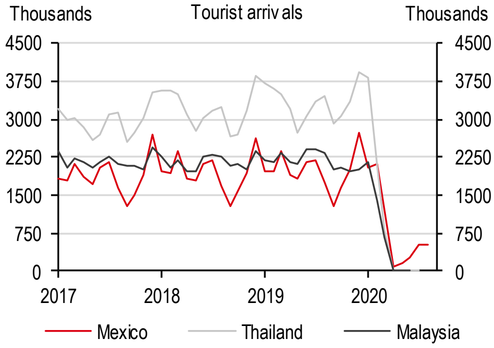
Table 1. Economies highly reliant on tourism exports are being hit by travel restrictions

	% y-o-y growth in services trade Q2 2020		Share of services exports in 2019			Stringency of international travel restrictions (latest available)
	Exports	Imports	Transport	Travel	Other services	
Mexico	-79.1	-44.0	7.2	78.9	13.9	1
Thailand	-72.2	-36.9	9.5	73.5	17.1	3
Australia	-31.1	-56.0	8.3	64.6	27.0	4
New Zealand	-40.8	-32.8	13.1	63.7	23.2	4
Spain	-62.1	-42.9	11.4	51.6	35.8	3
Portugal	-57.0	-38.6	21.4	51.2	27.4	1
Malaysia	-55.4	-31.0	12.5	48.9	38.6	2
Greece	-53.2	-21.8	43.6	44.0	12.4	3
Turkey	-67.5	-15.0	40.7	43.6	15.7	1
Italy	-43.9	-31.4	12.7	40.1	47.2	3
Hong Kong	-47.5	-44.6	29.4	31.1	39.5	4
Canada	-25.4	-34.7	14.1	26.7	59.2	3
US	-29.3	-31.5	10.5	22.7	66.7	3
France	-25.1	-21.5	16.6	22.2	61.2	3
Japan	-29.8	-16.2	15.3	20.7	64.0	1
South Korea	-27.8	-27.4	27.1	15.9	57.0	2
Mainland China	-5.7	-31.8	16.0	14.6	69.4	3
Germany	-20.8	-29.0	20.1	12.4	67.5	2
UK	-17.8	-31.7	9.7	12.2	78.1	2
Singapore	-20.3	-24.1	28.8	10.5	60.7	3
Netherlands	-13.5	-14.1	16.9	7.6	75.5	3

Notes: International travel restrictions data as at 12 October 2020. Key for scores: 0=No travel restrictions; 1=Screening arrivals; 2=Quarantine requirements; 3=Ban some arrivals; 4=Ban all arrivals. Trade growth data for Q2 2020 is based on figures in national currencies, except for Mexico, Turkey, Hong Kong, South Korea, Singapore, and mainland China, and Japan which are in USD. US, South Korea and UK data are seasonally adjusted.
Source: National statistics agencies, OECD, UNCTAD, University of Oxford, HSBC

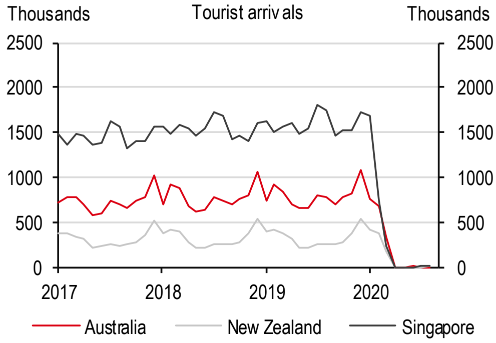
For example, Thailand welcomed nearly 40m tourists last year but closed off its border to foreign tourists amid the current pandemic. As a result, international visitor arrivals to Thailand plummeted earlier this year and remained at zero from April through to August 2020 (Chart 10). Similarly, Malaysian tourism arrivals declined from 6.7m in Q2 2019 to under 20,000 in Q2 2020. International arrivals into New Zealand, Australia and Singapore have also largely ground to a halt due to border closures (Chart 11).

Chart 10. Border closures have halted tourist flows…



Source: Refinitiv Datastream, Tourism Malaysia

Chart 11. …into both EM and DM economies



Source: Australian Bureau of Statistics, Statistics New Zealand, Singapore Tourism Board

Modes of supply

Broadly speaking, services can be traded via four means known as "modes of supply" (Box 1). However, traditional trade in services statistics only capture services traded via modes 1, 2 and 4. Mode 3 trade falls outside the scope of services transactions measured under the Balance of Payments framework.[4]

Box 1: Four modes of supply

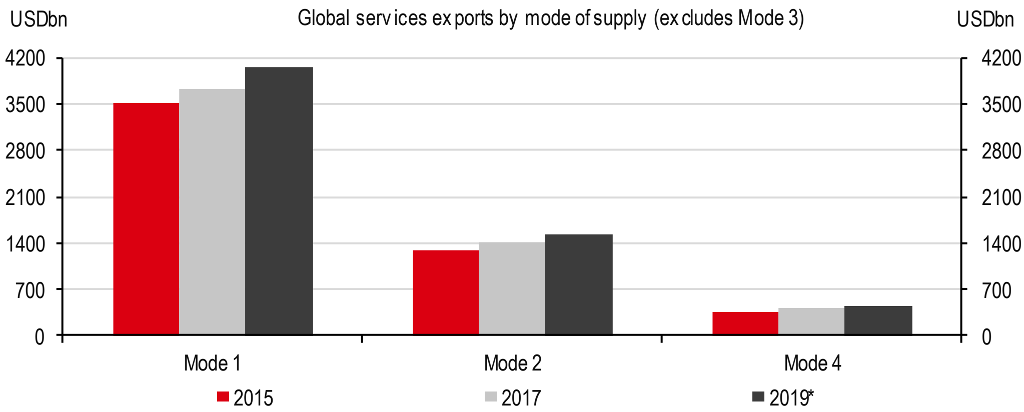
- **Mode 1 – Cross-border:** The service is traded electronically without the need for people to cross borders, e.g. architectural drawings or a consultancy report sent via email
- **Mode 2 – Consumption abroad:** The consumer travels abroad to consume the service, e.g. tourism
- **Mode 3 – Commercial presence:** The service is provided by a locally-established affiliate or subsidiary, e.g. a foreign-owned construction company
- **Mode 4 – Presence of natural persons:** The service provider travels overseas to supply the service, e.g. a health worker or a consultant

Some services trade flows rely exclusively on the movement of people across borders

According to experimental modes of supply data from the World Trade Organization (WTO), around one-third of global services exports (excluding mode 3) are traded via modes 2 and 4 and therefore rely on the movement of people across borders (Chart 12). This share varies by service type ranging from 100% of travel, maintenance and repair services, and construction services to under 20% of telecommunications, computer and information services. Therefore, services exclusively traded via modes 2 and 4 are most at risk of being disrupted by travel and lockdown restrictions.

Moreover, disruption to travel also has implications for other services categories such as mode 1 transport services which captures passenger airfares and freight.Air freight and sea freight have also been impacted by lockdown restrictions and the downturn in goods demand, resulting in cancelled container sailings and limited airfreight capacity. However, more recent data suggests that global container trade growth turned positive in August (1.5% y-o-y) and maintained momentum in September 2020.[5]

Chart 12. One-third of global services exports rely on the movement of people



Notes: *2019 data estimated using 2017 proportions from the WTO's TISMOS dataset. Mode 1=Cross border trade, whereby the service is traded electronically without the need for people to cross borders. Mode 2=Consumption abroad, whereby the consumer travels abroad to consumer the service. Mode 4=

[4] EU Commission, "Trade in services by GATS modes of supply: statistical concepts and first EU estimates", November 2016. To note: In order to overcome these measurement challenges, the WTO compiled an experimental database on all four modes of supply. This data shows that most services are traded via mode 3 with the exception of travel, transport and trade-related services (e.g. commission on goods and services).
[5] See HSBC Global Research note by Parash Jain on Global Container Shipping, 13 October 2020.

Services trade recovery

The level of travel services exports is unlikely to recover for some time

Travel services

Although economies most reliant on tourism revenue are likely to see the sharpest rebound in services trade growth once travel restrictions are lifted, the actual level of travel services exports is unlikely to return what it was pre-COVID for a long time. Moreover, the intangible nature of services means that catch-up demand is harder than it is for goods. For example, even once travel restrictions do lift, people are unlikely to go on significantly more overseas holidays to make up for lost trips this year. There is also a risk that people may be hesitant to travel abroad once restrictions are lifted, affecting those economies most reliant on tourism flows.

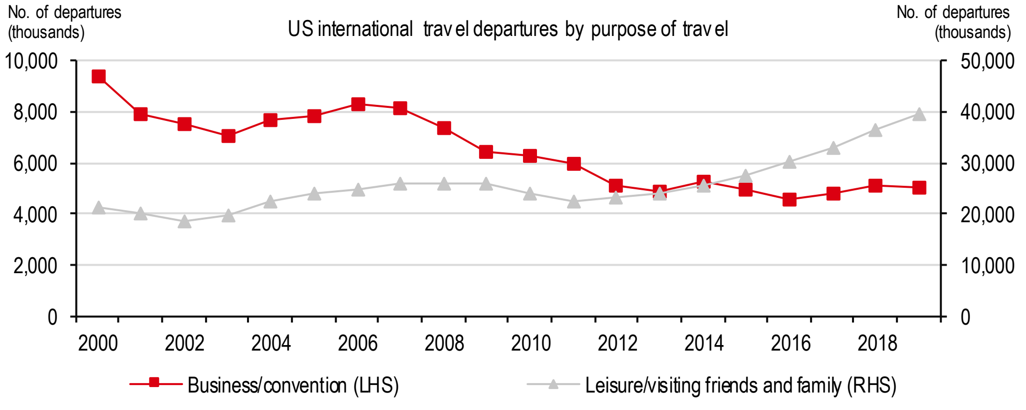
The UNWTO estimates that it could take between two and a half to four years for international tourism to recover to 2019 levels. By comparison, it took 11 months for international arrivals to recover after the SARS epidemic of 2003, 14 months after the September 11 attacks of 2001, and 19 months after the global economic crisis of 2009.[6]

2.5 to 4

Estimated number of years for international tourism to recover to 2019 levels, UN World Tourism Organization

Moreover, according to McKinsey, business travel has historically been more volatile and slower to recover than tourism after economic shocks.[7] For instance, outbound US business travel declined by 13% y-o-y in 2009, while tourism departures remained flat in 2009 but registered an annual decline of 7.7% the following year (Chart 13). And while US outbound tourism recovered to pre-crisis levels in around five years, the number of US residents travelling abroad for business has continued to decline steadily.

Chart 13. Fewer US residents travel abroad for business compared to pre-2009



Source: US Department of Commerce, International Trade Administration

[6] UNWTO, World Tourism Barometer, Volume 18, Issue 5, August-September 2020.
[7] McKinsey & Company, "For corporate travel, a long recovery ahead", 13 August 2020.

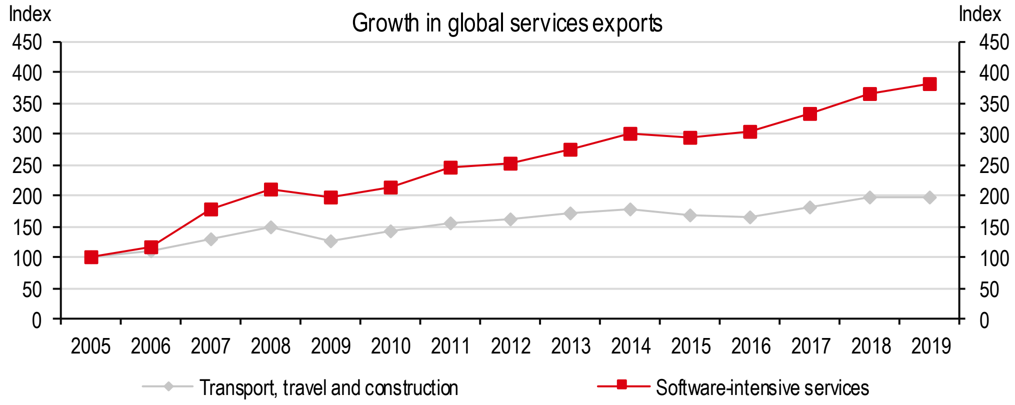
Growth prospects for digital services

The COVID-19 pandemic is likely to accelerate digitisation trends

On the other hand, the depth and duration of the current economic shock is likely to accelerate digitisation trends and bring about permanent changes to all aspects of our lives including how we work (e.g. greater remote working, more virtual meetings), eat (e.g. digital menus), exercise (e.g. virtual gym or yoga sessions) and more. This shift towards greater digitisation provides an opportunity for economies to boost digital services flows.

In general, demand for digital services or services that are typically traded via mode 1 tend to be more resilient to economic shocks because they involve activities that need to be carried out even during a crisis (e.g. IT or banking).[8] Economic shocks and the subsequent adjustment process can also accelerate the development and adoption of new technologies. For example, global exports of software-intensive services grew twice as fast as traditional services exports (e.g. transport, travel and construction) over 2010-2019, although this delinking started before the Global Financial Crisis (Chart 14).[9]

Chart 14. Software-intensive services exports has been delinking from traditional services flows



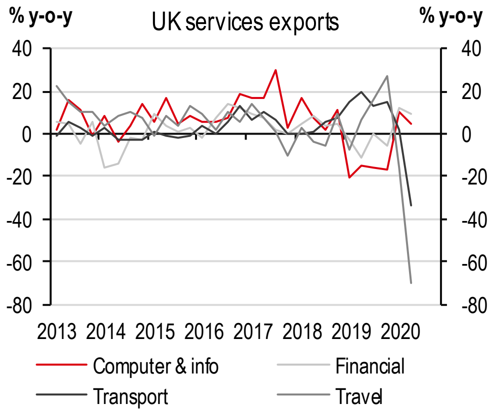
Notes: Software-intensive services include: finance, insurance, charges for the use of intellectual property, telecommunications, computer, information, R&D, professional and audio-visual services. Index, 2005=100.
Source: UNCTAD, ECIPE, HSBC

Digitally-enabled services are holding up better than more traditional services flows

There are already clear signs that digitally-enabled services are holding up better than more traditional services flows. For example, although growth in UK exports of computer and information services and financial services slowed in the second quarter of this year, both services categories remained in positive territory. UK exports of computer and information services expanded by 5% y-o-y in Q2 2020, while financial services exports grew by 10% (Chart 15). Similarly, US computer services exports have fared better than exports of other services, declining by just 0.1% over the same period, although it remains to be seen whether these flows decline further (Chart 16).

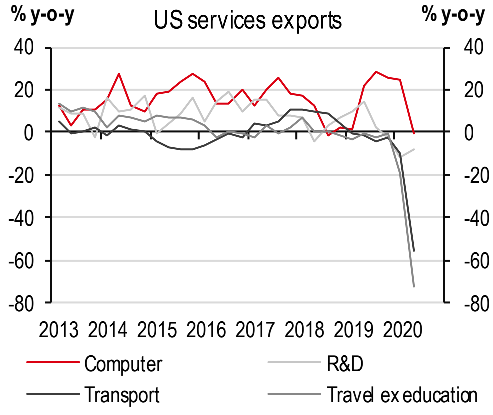
[8] Aaditya Mattoo and Ingo Borchert, "Services trade – the collapse that wasn't", 27 November 2009.
[9] ECIPE, "Shifting into Digital Services: Does a Crisis Matter and for Who?", August 2020.

Chart 15. UK digital services exports have remained relatively resilient...



Source: Refinitiv Datastream

Chart 16. …as have US computer services exports

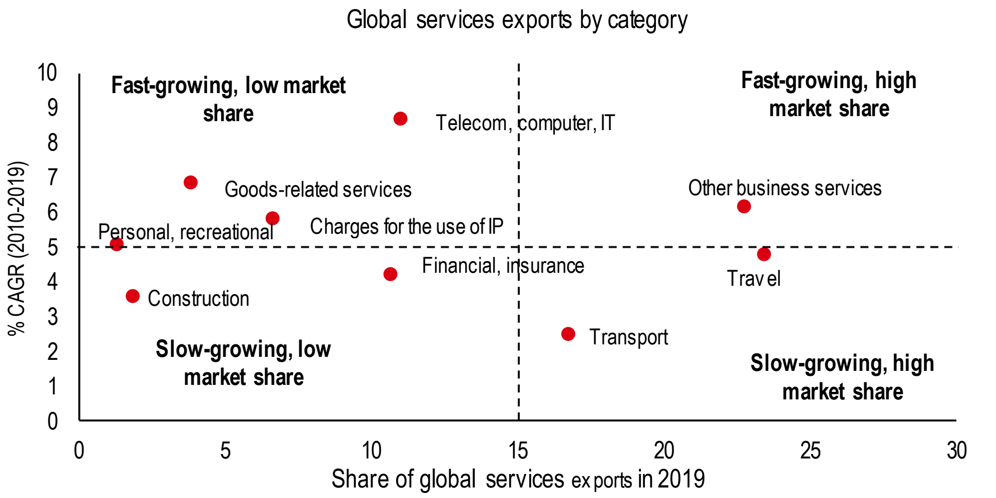


Source: Refinitiv Datastream

Looking ahead, there remains considerable growth potential for digitally-enabled services such as telecommunications, computer, IT, other business services (e.g. R&D, consulting, accounting, advertising), and personal and recreational services (e.g. audio-visual). These service categories are fast-growing, albeit off a relatively low base, but still comprise a small share of world services trade compared to more mature service sectors (Chart 17). There may also be opportunities to expand R&D services as businesses look for new ways to build resilience into supply chains post-COVID, and as certain economies look to reshore critical production chains and build out domestic manufacturing capacity.

Moreover, the shift towards digitisation could lead to even more goods being digitised in the future. For example, it may be possible that trade in traditional intermediate inputs are replaced by trade in digital design files (i.e. computer-aided design or CAD files) that are required for 3D printing.

Chart 17. Digital services are fast-growing but comprise a small share of world services trade



Source: UNCTAD, HSBC

Barriers to digital trade

International trade rules have not kept pace with digitisation

Tackling barriers to digital trade and improving digital infrastructure will be key to capturing trade gains from greater digitisation and could help accelerate the recovery in global services trade. We have written extensively about barriers to digital trade such as taxation, tariffs, data localisation requirements, and issues around the interoperability of regulations across different economies, as well as on global efforts to tackle these. In general, international trade rules have not kept pace with digitisation and barriers to digital trade remain significant.

Table 2 presents three key metrics to assess the readiness of certain economies to benefit from an expansion in digital trade. The technology infrastructure score is based on the number of broadband subscriptions and secure internet services, and household internet access. Technology adoption covers mobile device penetration, internet usage, and spend on cloud services. The digital services trade restrictiveness index provides an indication of how restrictive a certain economy's policy settings are to digital flows.

Based on these indicators, developed economies such as the US and Luxembourg are best prepared to engage in digital trade, while economies such as India, Indonesia, and Colombia still maintain relatively high barriers to digital trade and would benefit from digital infrastructure investment. It is also important to note that other factors such as the availability of skilled workers will also affect the level of digital readiness of an economy.

Table 2. EMs could benefit from investment in tech infrastructure and tackling barriers to digital trade

	Tech infrastructure score 2019 Score 0 to 4 (best) Cisco Digital Readiness Index	Tech adoption score 2019 Score 0 to 3 (best) Cisco Digital Readiness Index	Digital Services Trade Restrictiveness Index 2019 0 (open to trade) to 1 (closed) OECD
US	2.69	2.22	0.08
Canada	2.30	2.05	0.12
Luxembourg	2.48	2.03	0.08
Austria	2.03	1.82	0.20
Switzerland	2.85	1.77	0.08
Norway	2.51	1.77	0.08
Iceland	2.85	1.75	0.27
Sweden	2.41	1.75	0.14
Denmark	3.44	1.70	0.10
Japan	2.49	1.69	0.10
South Korea	2.39	1.69	0.14
New Zealand	2.17	1.69	0.18
Netherlands	3.12	1.67	0.10
Finland	2.55	1.63	0.12
Germany	2.53	1.63	0.14
UK	2.39	1.63	0.12
Australia	2.34	1.62	0.08
Ireland	2.51	1.59	0.14
Belgium	2.13	1.51	0.16
Estonia	2.50	1.50	0.08
Costa Rica	1.35	1.46	0.04
Spain	1.97	1.44	0.12
France	2.19	1.42	0.12
Lithuania	1.86	1.40	0.10
Russia	1.55	1.39	0.32
Chile	1.64	1.37	0.26
Slovakia	1.78	1.36	0.10
Latvia	1.97	1.34	0.22
Argentina	1.51	1.34	0.30
Israel	1.93	1.32	0.18
Poland	2.03	1.31	0.26
Saudi Arabia	1.83	1.31	0.39
Italy	1.75	1.31	0.13
Czech Republic	2.12	1.30	0.14
Slovenia	2.00	1.29	0.12
Portugal	1.80	1.29	0.14
Greece	1.67	1.24	0.14
Hungary	1.89	1.23	0.17
South Africa	1.06	1.18	0.34
Brazil	1.26	1.13	0.29
Colombia	0.94	1.13	0.30
Turkey	1.40	1.01	0.26
Mexico	1.01	0.99	0.14
Mainland China	1.28	0.97	0.49
Indonesia	1.01	0.97	0.41
India	0.37	0.66	0.34

Source: Cisco, OECD, HSBC

Two-speed recovery

Looking ahead, the recovery in overall services trade will largely depend on how long it takes for travel restrictions to be lifted and other contributing factors such as medical developments. For instance, the quicker an effective vaccine is rolled out, the faster travel restrictions are likely to be lifted. The easing of restrictions may also differ by region. But prospects for the removal of such restrictions are not bright, at least in the near term. As the northern hemisphere heads into winter and with second waves of the pandemic gathering pace, it is unlikely that countries will rush to remove their travel restrictions anytime soon.

On the other hand, the longer such restrictions remain in place, the more important digital services become. Prolonged lockdown and travel restrictions may also bring about permanent changes in behaviour post-COVID that could provide growth opportunities for trade in digital services. For example, we may see longer-term shifts between modes of service delivery or even between services categories (e.g. business travel replaced by virtual meetings) as we adjust to the new, post-pandemic world.

There could be a two-speed recovery in services trade given travel restrictions and digital trends

Although growth in digital services is unlikely to fully offset the collapse in tourism and business travel in the near term, we expect the delinking in growth of digital and more traditional services to continue, and even accelerate, as consumers and businesses further embrace digital technologies. This could result in a two-speed services trade recovery, whereby international travel remains largely suppressed while digital services recover more quickly.

But given the significance of travel to global services trade and especially for some economies, overall services trade is likely to remain well down on pre-pandemic levels for some time to come. Much of the services trade recovery will depend on how quickly travel restrictions are eased, the willingness of people to travel once restrictions are lifted, behavioural shifts brought about by the pandemic, and broader economic conditions. Meanwhile, as we discussed above, tackling barriers to digital trade and improving tech infrastructure could help accelerate the recovery in services trade.

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