9 February 2023

Trade in 2023 and beyond

Will weakness persist?

Free to View
Economics - Global

- While global trade looks set to be subdued in 2023…
- …longer-term questions are being asked about globalisation
- This could mean a worse growth-inflation trade-off

James Pomeroy
Economist
HSBC Bank plc

Harriet Smith
Economist
HSBC Bank plc

The global trade outlook for 2023 isn't pretty. Weaker import demand from the US and softer global goods demand are likely to weigh on trade data. It's likely that global trade growth in 2023 is below 1%, despite the likely rebound in global tourism being supported by more travellers from mainland China.

But the worries may extend beyond this year, and to a world where global trade is no longer a structural tailwind for the global economy and instead becomes a headwind. Geopolitical tensions top the list of challenges, with a rise in protectionist measures from governments, but global supply chains are likely to be shuffled in the years to come, with reshoring, near-shoring and friend-shoring all likely to become much more widespread as firms react to the vulnerabilities in their supply chains that the pandemic has unearthed.

However, so far, the data suggest there's little evidence of trade's importance shrinking in practice. Global trade's share of GDP rose in 2021 and in 2022 it most likely rose again, to the highest share since 2014. While firms may be talking more openly about the need to 'nearshore' or 'reshore' in earnings calls and surveys, the data suggest this process is yet to begin in earnest beyond some small moves from some manufacturers and some industries (such as semiconductors) seeing a more focused push to improve supply chain resilience.

Going forward, these trends will need to be monitored. One of the big questions is whether the previous era of globalisation evolves into one with less global trade, or simply trade that involves different parties. Supply chains may end up being more resilient as a result, but this may come at a cost of higher input prices for firms and additional trade frictions. Much will depend on how new forms of production are created, and essentially whether more digitisation can offset these challenges.

This is what creates concerns – that an era of more open borders that, by-and-large, helped to improve efficiency, lift economic activity and keep a lid on prices could be coming to an end. This could well mean a deterioration in the growth-inflation trade-off if this plays out. However, it's worth adding that global trade data may be weighed down by other factors such as a rotation to services trade (that is hard to capture) or environmental concerns meaning changes to what is produced and shipped. Automation of many processes may limit the supply side shock, too.

This is a Free to View version of a report with the same title published on 09-Feb-23. Please contact your HSBC representative or email AskResearch@hsbc.com for more information.

Trade in 2023

- Weak consumer demand in the developed world will likely weigh on trade in 2023
- Easing supply chains and tourism may give some support…
- …and some economies will likely see exports hit more than others

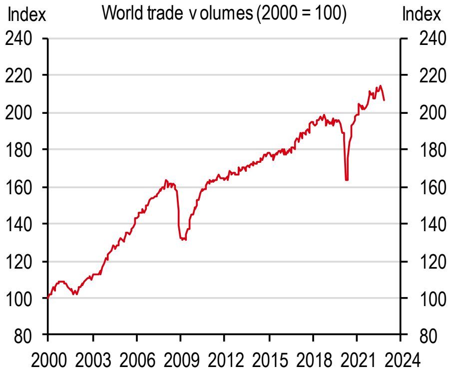
A tricky 2023

Global trade faces a challenging year. Weaker US demand and a consumer services-led rebound in mainland China are likely to mean more subdued import demand from the world's largest economies this year. This may prove to be even worse for global trade as consumer spending continues to rotate from goods back to services and more firms have now stockpiled the inventory they need, having been able to replenish supplies in 2022 with shipping and logistics disruptions from 2020 and 2021 now largely a thing of the past.

Up and then down?

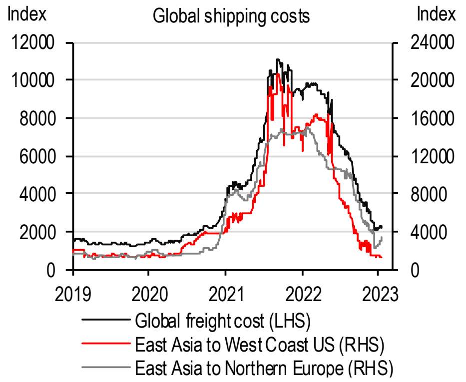
Global trade volumes hit new highs in 2022. The latest set of data to November show a slight softening, but a world of much higher interest rates and soaring inflation didn't weigh on end demand as much as may have been originally feared. The risk is that 2023 is more challenging, particularly on the goods side of the global trading system. We've already seen this in some key economies, such as Korea and mainland China showing a rapid slowdown in exports based on timely national data at the end of 2022.

1. Global trade volumes edged down at the end of 2022 after a strong year



Source: CPB

2. Reversals in shipping rates highlight the easing of global supply chain issues



Source: Refinitiv Datastream

Some better news on the supply front…

Over the past couple of years, global trade data have performed incredibly well. That has been despite huge supply challenges, with congestion at ports and lockdowns in various parts of the world limiting how many goods could possibly flow across the world at any given time. Closed borders greatly limited the flow of people, impacting services flows from business services to tourism, no matter how much of this was able to be done virtually.

But in 2022, these supply headwinds rapidly abated. Borders reopened through the year and in early 2023, while congestion in global shipping eased very quickly in the second half of 2022. This has proven to be a good thing for the flow of goods, but the challenge going forward is that this easing has been driven by a drop in demand. With inventories restocked and consumer spending on goods softening, production and shipment of many items may be weak.

…but challenges ahead

This recovery in stockpiles adds to the challenges for global trade in 2023. The headwinds are best summed up by the latest set of PMI data that show the collapse in new export orders in recent months. Demand for goods is weak and our global GDP forecasts suggest that it's unlikely to get materially better, particularly in the coming months. For many manufacturing firms, the outlook for international demand isn't pretty – and our forecast for global trade growth in 2023 (just 0.9%) chimes with pessimistic tones from the WTO (who look for 1% growth in 2023) and UNCTAD, who expect the slowdown in global trade to continue in 2023.

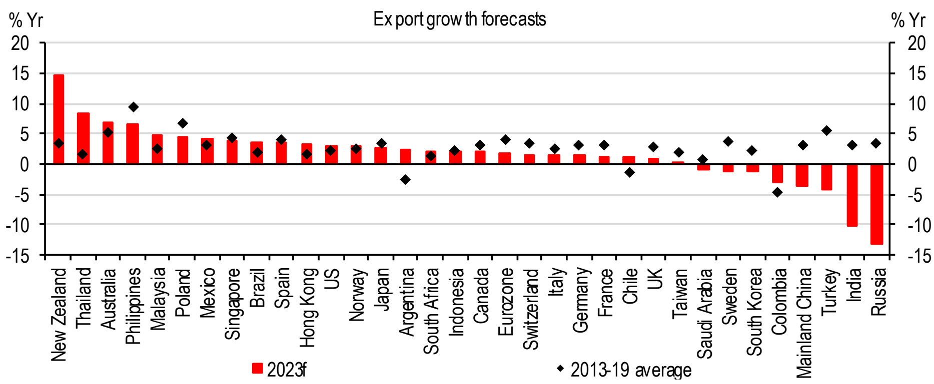
3. The outlook for global trade isn't pretty

Source: S&P Global

Despite this gloom, there are some reasons for optimism – which are generally on the supply side. The aforementioned improvements in logistics and lower shipping rates mean that more sectors, such as autos, may continue to see shipments rebound as supply challenges fully abate. UNCTAD also flag the positive impact of recently-signed trade agreements – such as the Regional Comprehensive Economic Partnership and the African Continental Free Trade Area, which may play a role in supporting global trade in these regions, too.

By economy, too, some may fare better. Chart 4 shows our forecasts for export growth for 2023 across the world, with a few notable standouts in Asia. Some of these are heavily exposed to tourism – Thailand, New Zealand and Spain, but for all the justified pessimism about global trade in 2023, it's worth noting that the gloom doesn't spread everywhere.

4. Trade growth isn't likely to be consistent across the world

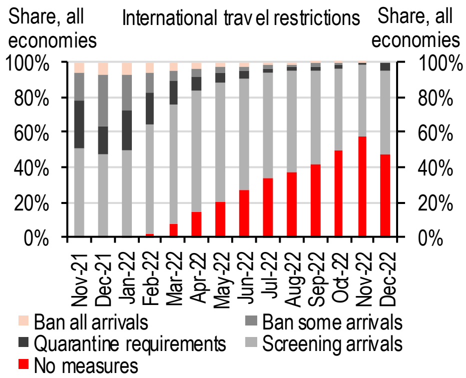


Source: HSBC estimates, Refinitiv Datastream, Bloomberg.

But there are, of course, many economies where export growth is likely to be weak. India is a standout here, but much of this is payback from a very strong 2021 and 2022, with exports expected to normalise as export levels normalise. The other economies expected to see weaker export growth are generally industrial economies – Sweden, Korea and mainland China, where the goods export mix being concentrated in durable or industrial goods is likely to fare worse.

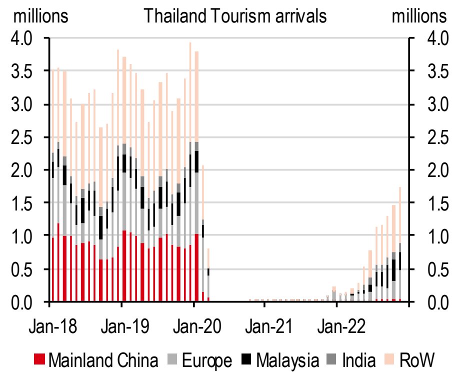
Services could end up faring better – notably because of the continued recovery in tourism. The re-opening of Chinese borders and more of the world getting back on planes could well lift global tourism flows back close to pre-pandemic levels. Doing so would lift annual global trade (of goods and services in aggregate) by 5% compared to 2021 levels: but some of this will have already happened in 2022.

5. As tourism restrictions are easing…



Source: Source: University of Oxford, HSBC

6. …travel flows may pick up sharply through 2023



Source: Refinitiv Datastream

Rotation or decline?

In 2023 it will be important not just to look at the total amount of global trade, but how flows are adjusting across the world. In recent years we've seen geopolitics and the pandemic reshape global supply chains and trade flows, something we discuss in more detail in the following pages, and watching the data in 2023 will give us some clear signals as to whether there's any momentum in these dynamics for now.

A new era for trade?

- Deglobalisation fears are likely to grow further in 2023
- But the hard data suggest global trade is still growing…
- …despite more worries about supply chains needing to be rejigged

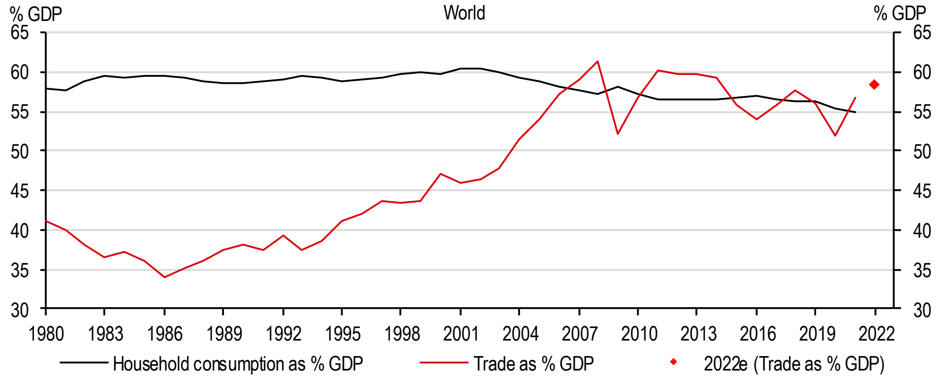
In 2023, as the near-term trade outlook starts to get weaker, we will likely hear more discussions about this weakness being more structural in nature, rather than a period of cyclical weakness, driven in part by weaker demand for goods from the US.

A new era for global trade?

You've probably seen the series in chart 7 before. Global trade as a share of GDP has stagnated, and this could go into reverse, creating a number of problems for the global economy. Whilst this is a valid concern, for reasons that we will come to shortly, it's worth pausing to highlight that this chart doesn't show any concern, yet.

While trade's share of nominal GDP has stagnated since the GFC, it's not falling, unlike the share of global GDP accounted for by consumption. Given the likely growth rates for global trade and GDP in 2022, it's also likely that the series below edged up again when that data is ready (although this will be partly a pricing story with higher commodity prices). That would make 2022 the most "open" year that the global economy has seen since 2014, hardly a clear sign of deglobalisation, at least for now. In 2023, depending on what happens with tourism, this figure may well edge up again, too, given a broadly weak global demand outlook.

7. Global trade has stagnated as a share of GDP



Source: World Bank, HSBC estimates for 2022 based on GDP and trade forecasts

That doesn't mean that trade levels will keep rising forever. There are numerous challenges for the future of trade – ranging from geopolitics to changing consumer spending habits and technological change that we will discuss in due course. But, it's important to put these global figures in context: if we take the US, the share of GDP that goods trade has accounted for has been remarkably steady since the mid-2000s (despite some volatility), and this is a similar story to a global basis. On the other hand, mainland China has seen that share drop in recent years as domestic consumption and investment has become a much bigger share of GDP. Essentially, instead of the economy producing goods for the rest of the world, much more of this is consumed internally, pulling down the Chinese economy's openness as a result.

8. The US economy hasn't become any more or less open in 20 years…

Source: IMF DOTS, Refinitiv Datastream. Note: Goods trade = imports + exports

9. …while the Chinese economy has been less reliant on overseas as it gets bigger

Source: IMF DOTS, Refinitiv Datastream. Note: Goods trade = imports + exports

As a result, we need to look at what's happening on a global basis – and we can see that for many smaller, but still important, economies this ratio has been increasing steadily in recent years. In Brazil, the ratio has surged since roughly 2017 thanks to more exports to mainland China, weaker GDP growth affecting the denominator and higher commodity prices around the pandemic, while Poland has become a more important component of global supply chains in recent years given its position as a relatively cheap production centre in Europe.

10. Other economies are getting more open…

Source: IMF DOTS, Refinitiv Datastream. Note: Goods trade = imports + exports

11. …as global trade rotates

Source: IMF DOTS, Refinitiv Datastream. Note: Goods trade = imports + exports

The same is true in Asia – with the likes of Vietnam showing that trade as a percentage of GDP has risen from ~100% at the start of this century to nearly double that in the latest figures. Korea, Japan, India, Australia and Thailand have all steadily become more open (time series are much shorter for Malaysia and Indonesia so excluded from comparison). Even in Europe, we've seen the openness of Germany and the UK grind higher, while Turkey and South Africa have become more open, too.

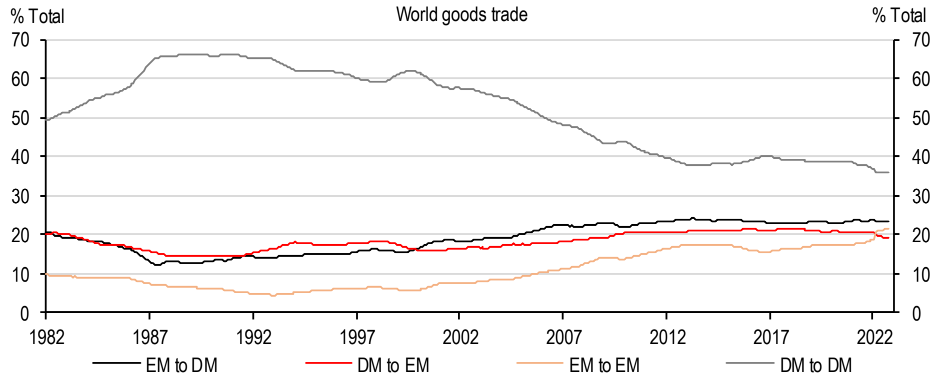
12. Many economies continue to get more open – the US and mainland China are the anomalies

	US	Asia							EMEA					LatAm	
Goods trade as % GDP	**US**	**Mainland China**	**Japan**	**India**	**Australia**	**Korea**	**Thailand**	**Vietnam**	**Germany**	**UK**	**Poland**	**Turkey**	**South Africa**	**Brazil**	**Mexico**
Q3 2001	17	40	17	22	34	51	108	106	52	36	47	36	41	23	11
Q3 2010	22	51	26	36	35	79	116	161	70	40	74	35	45	19	15
Q3 2022	21	37	40	38	41	89	120	188	80	44	108	66	61	36	22

Source: IMF DOTS, HSBC

This is partly due to the slow rebalancing of global trade in recent years, with intra-EM trade growing at a much faster pace than EM-DM trade and DM-DM trade. Back in the 1990s and even early 2000s, global trade was completely dominated by intra-DM trade, but that share has steadily been in decline – now roughly 35% of the total of global trade. At the same time, intra-EM trade has risen steadily from less than 10% of the total in the 1990s and early 2000s to being more than 20% in the latest set of data through 2022.

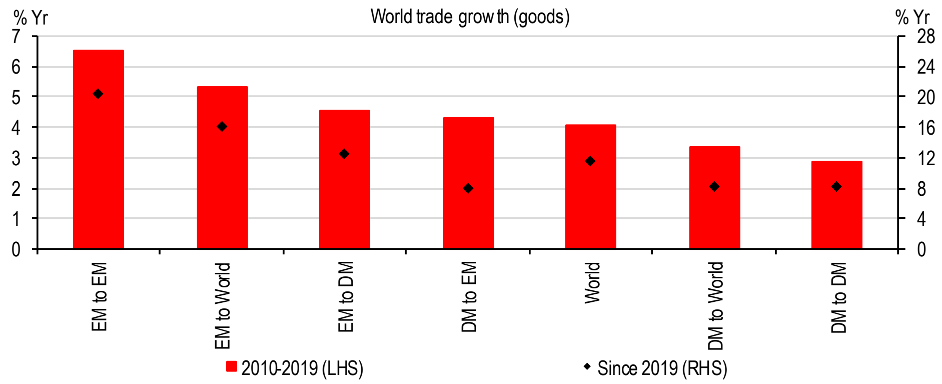
13. Global goods trade is slowly changing



Source: IMF DOTS

This is mostly because of the much faster pace of growth in trade between EM economies. DM to DM trade is still much larger, but we can see in chart 14 that even up to 2019 (and the pandemic and inflation distortions) – intra-EM trade has grown very quickly, at more than 6% pa, compared to just over 4% for global goods trade as a whole. The past decade of trade's share of GDP stagnating has been much more due to very weak intra-DM trade and demand.

14. World trade is slowly shifting away from the developed world



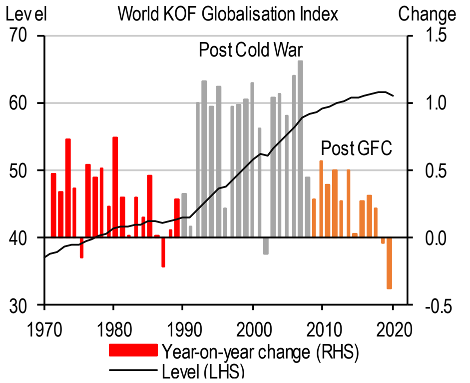
Source: IMF DOTS, HSBC. Note: Uses nominal figures.

Of course, mainland China has played a central role in this, but if we look at the same data for EM ex-mainland China, we can still see trade growth well in excess of the growth rates we've seen in the developed world. The same figure, between 2010 and 2019 for intra-EM trade (excluding mainland China) is for 5.3% growth per year. Since the pandemic began, trade is up sharply between EM regions.

But is that changing?

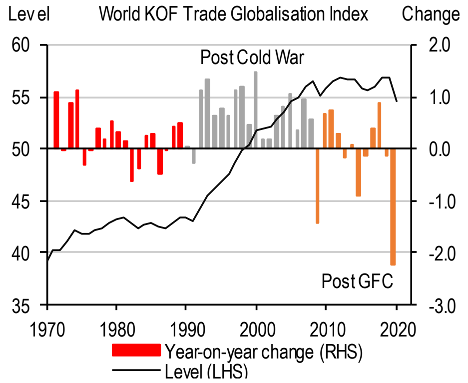
These data show that over time, most parts of the world have become increasingly connected – and this has spread beyond trade, to political and social ties, too. As observed by the KOF Swiss Economic Institute (chart 15), this trend picked up in the 1990s following the end of the Cold War as former communist states integrated with the global economy (the so-called peace dividend) and accelerated after mainland China joined the WTO in 2001. The Global Financial Crisis later acted as a trigger slowing progression, and then in more recent years, the COVID-19 pandemic, supply chain challenges and the Ukraine war have further changed the way in which economies interact. The data the institute releases show the slowdown in globalisation in the past decade across a number of different forms, including global trade, but the data only run to 2020 as a result of availability of underlying indices.

15. Globalisation has been slowing…



Source: KOF Swiss Economic Institute. Note: Calculated from sub-indices looking at trade, financial globalisation, interpersonal, informational, cultural and political globalisation. Only goes to 2020.

16. …partly due to trade

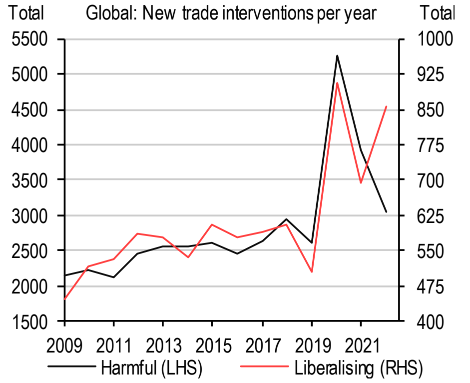


Source: KOF Swiss Economic Institute. Note: Calculated from a range of trade indicators including trade flows, tariffs and the number of agreements. Only goes to 2020.

Trade policy has played a key role. Chart 17 shows that the number of new trade interventions enforced each year has been on the rise and that, overwhelmingly, the number of restrictive measures enforced massively outweighs efforts for more open trade. Globally, increases each year prior to 2020 were relatively gradual, but the pandemic coincided with an acceleration in trade policy action. In 2020, 5,269 harmful new interventions were introduced worldwide, and although the number of new liberalising policies also jumped, to 908, efforts on this front remained in the shadows.

As of now, Brazil stands top as the nation with the highest number of liberalised trade policy measures in force, while not surprisingly, the US and mainland China are leading the way as the biggest contributors to restrictive trade policy. German trade flows suffer from the most exposure to harmful polices.

17. The pandemic saw a surge in trade restrictive policy measures



Source: Global Trade Alert

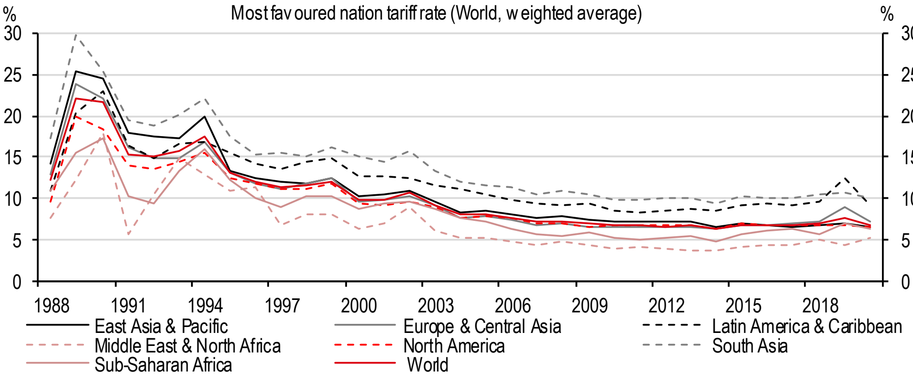
18. Some economies are much more exposed to, or involved in, trade interventions

	Contribution to interventions	
	Liberalising	**Harmful**
1	Brazil	US
2	India	Mainland China
3	Mainland China	Germany
4	Russia	Italy
5	Argentina	India
	Exposure to interventions	
	Liberalising	**Harmful**
1	Mainland China	Germany
2	US	Italy
3	Germany	France
4	UK	UK
5	Italy	Japan

Source: Global Trade Alert as of time of publication.

The good news is that for now, these increases in tensions haven't led to a surge in one of the most quantifiable metrics for trade restrictions: tariffs. Even with the pickup in tariffs that came about during the US-mainland China trade war from 2018, tariffs across the world still have rates below where we were back in the 1990s – and if anything, there is further scope for them to fall across LatAm and Asia.

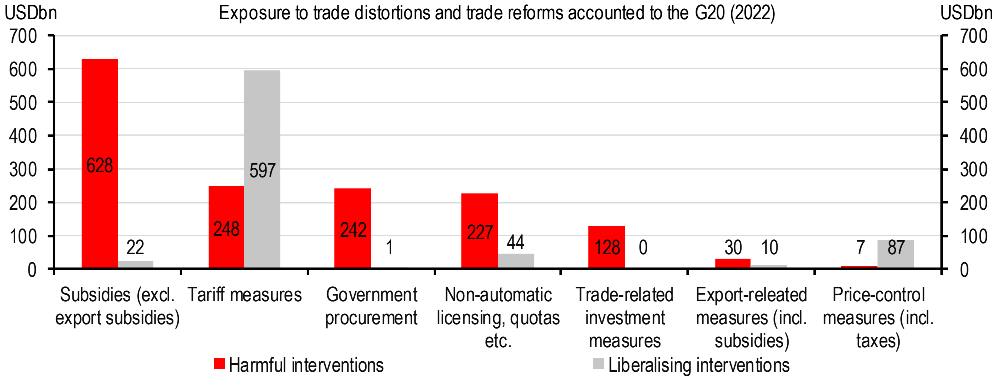
19. Tariff rates have been slashed since the mid-1990s



Source: WITS. Note: Weighted average

The bad news, however, is that non-tariff barriers are on the rise. Chart 20 indicates the breakdown of G20 commercial policy intervention implemented since the 2021 Rome summit. Overall in 2022, much more trade was at risk from harmful G20 interventions as opposed to liberalising steps. In terms of the measures in force, subsidies on imports had the largest disruptive impact, affecting USD628bn worth of trade flows.

20. Global trade faces more harmful G20 trade policies than liberalising steps



Source: Global Trade Alert

There have been plenty of high profile trade restrictive actions, be it in terms of tariffs or otherwise, too. President Trump's 'America First' campaign stimulated the start of a tit-for-tat trade war between the two nations that started in 2018. The number of restrictive trade measures enforced by each nation on the other increased sharply, but since 2021, there has been a moderation in the number of new policies enforced, particularly from mainland China. But flagship announcements such as the US' Inflation Reduction Act (IRA) may be seen as an example of a new wave of trade policy. The IRA aims to, amongst many things, ensure that many critical products are produced in the US. By including green subsidies, such as tax credits for American-made electric vehicles, EU members believe that this discriminates against European firms and on 1 February announced the Green Deal Industrial Plan, which includes tax relaxations to compete for green investment. We could continue to see more governments want to look after their own economies by insisting that key industries need to be protected locally, which could mean these trends are accelerated in the years to come.

Rejigged supply chains?

The past few years have clearly made firms think about their supply chain arrangements. The surge in shipping costs, production disruptions in many parts of the world due to pandemic restrictions and further concerns about geopolitical tensions have focused minds in boardrooms as to how their supply chains may need to evolve in the coming years. This has made many observers worry about the future of global trade – particularly if businesses accelerate moving production towards where end demand is or look to diversify their geography exposure.

In an April 2022 piece, we wrote that the hard evidence of a substantial change in global trade was limited in the trade data at that point in time. Whilst there may be plenty of rhetoric and news flow on the idea of firms adjusting their supply chains, the evidence of actions has remained relatively small. For example, Apple moving some of the manufacturing of its iPhone 14 to India from mainland China is a high profile example of 'friend-shoring', yet so far only roughly 5% of production is estimated to have been moved[1].

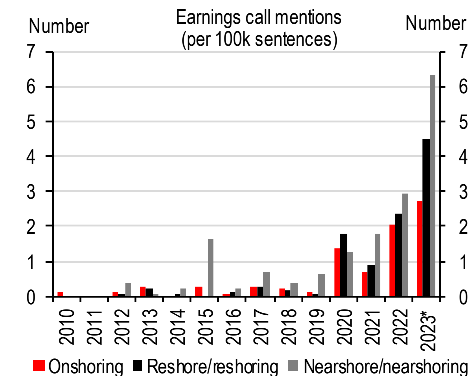
Noises are getting louder

But that doesn't mean that changes aren't afoot. The EU Chamber of Commerce in mainland China's annual Position Paper (from September 2022) showed that businesses aren't leaving mainland China entirely, they're simply diverting some investments to other markets to mitigate risks (such as those related to policy shifts or trade disputes). While the paper warned that potential new entrants to the Chinese market may not take the plunge due to market obstacles, the "China+1" strategy – businesses supplement their operations in mainland China with investments in other Asian economies such as Vietnam and Indonesia – is proving popular, while some firms may diversify further.

According to research from Gartner owned company Capterra, the trend towards nearshoring supply chains is happening faster than expected[2]. It found that many US-based corporate giants have already found new suppliers closer to home and have made substantial investments in US manufacturing, with General Motors and Boeing investing heavily in manufacturing plants in the US and Mexico. It found that 88% of small and midsize supply chain professionals in the US have plans to switch at least some of their suppliers to ones closer to the US as it makes it easier to manage critical situations as well as benefitting them financially given that Mexico, Canada, and the Central American region offer competitive labour costs and quicker delivery.

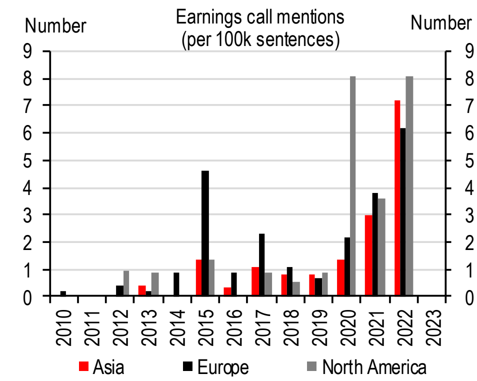
This is echoed by what firms are saying on their earnings calls. Data compiled by Mark McDonald, HSBC's Head of Data Science and Analytics, counts the number of times executives mention terms like 'near-shoring', 're-shoring', or 'on-shoring' in earnings calls globally. Over the past three years, there has been a notable jump, with 2022 hitting another record (Chart 21). And it's not just US-listed firms that are increasingly talking about supply chain restructuring: in Asia and Europe the trend has accelerated similarly (Chart 22).

21. More firms are discussing moving production



Source: HSBC, Bloomberg. Note: *2023 is based off a much smaller set of firms

22. The rise is relatively consistent across geographies



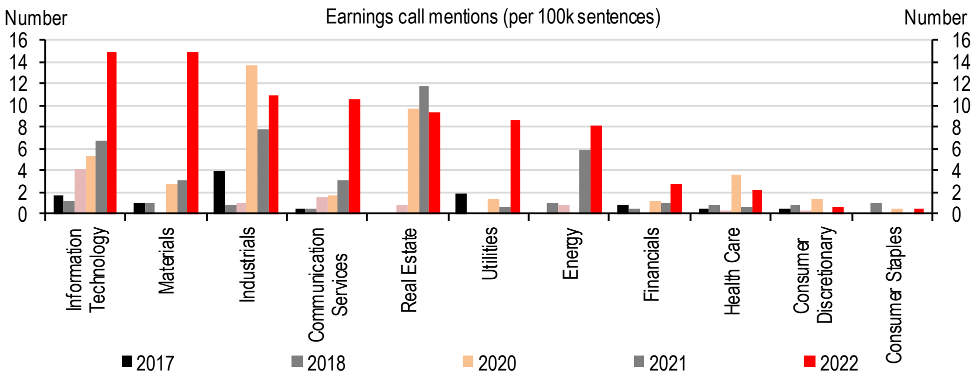
Source: HSBC, Bloomberg. Note: 2023 data has too few companies for all regions to be comparable.

By sector, however, there is a notable difference. Materials, IT and communications firms appear to discuss the phenomenon much more widely than consumer goods sectors, such as consumer discretionary and consumer staples firms.

[1] Apple explores moving some iPad production to India, sources say, CNBC, 5 December 2022

[2] Nearshoring is happening faster than expected, Strategic Risk, 5 January 2023

23. Some sectors may see more trade rotation than others

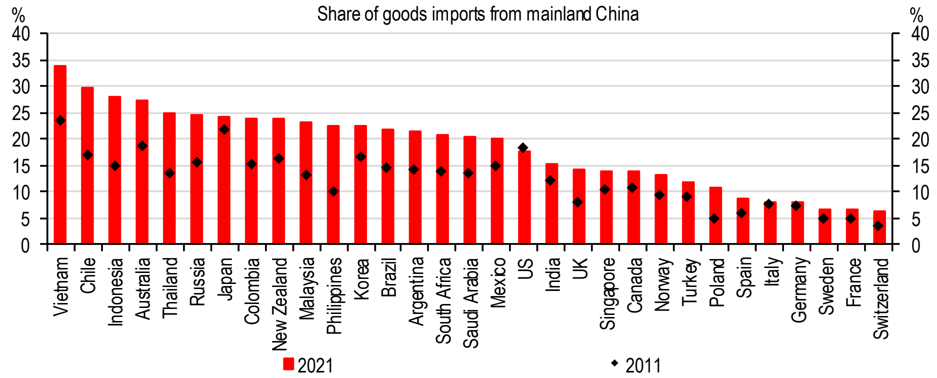


Source: Bloomberg, HSBC

Rotations, not declines?

But firms discussing it and doing it are quite different things, and we'll have to monitor some of the data in the coming years to see how things evolve. But as Frederic Neumann, Chief Asia Economist, alludes to in the aforementioned report, Asia's role in global trade is so large that it may be hard to move all production from the region entirely, particularly if there is any hysteresis in global supply chains.

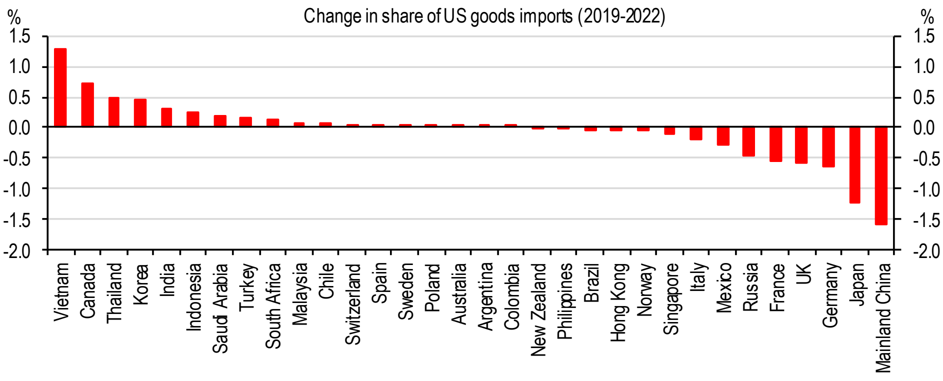
24. Mainland China's role in global trade has increased across the board



Source: IMF DOTS

And even so, the data suggest, at least for now, that it's a story of 'trade diversion', rather than 'trade destruction' – with mainland China seeing its share in US imports fade as imports from Vietnam, Thailand, Korea and India take prominence alongside Canada (although Canada's data may be supported by energy prices). During this time, US import demand has proven to be robust – growing very strongly during the pandemic, despite a recent sign of slowdown.

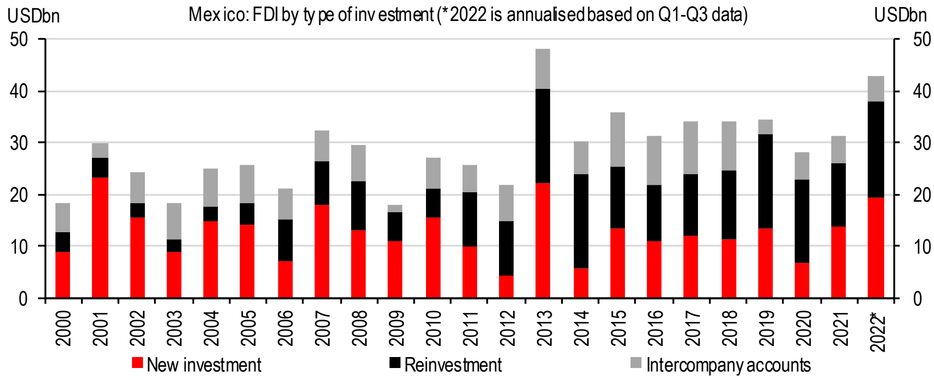
25. A rotation in import partners is what we've seen in recent years



Source: Refinitiv Datastream, HSBC. Note: 2022 is YTD to November.

And there's a sense of this rotation in global trade coming through in some key economies, too. Mexico, it stands to reason, is a key beneficiary of US firms wanting their production to be closer to home, and FDI has started to pick up substantially in 2022. Through the first three quarters, data are running at an annual pace that would make it the second biggest year for FDI flows this century and a big leap from the pandemic period. While some of this may be a pandemic-related bounce, we believe that nearshoring is a key opportunity for Mexico given its large manufacturing sector and openness to the US.

26. Mexico is seeing an FDI surge



Source: Ministry of Economy, Refinitiv Datastream

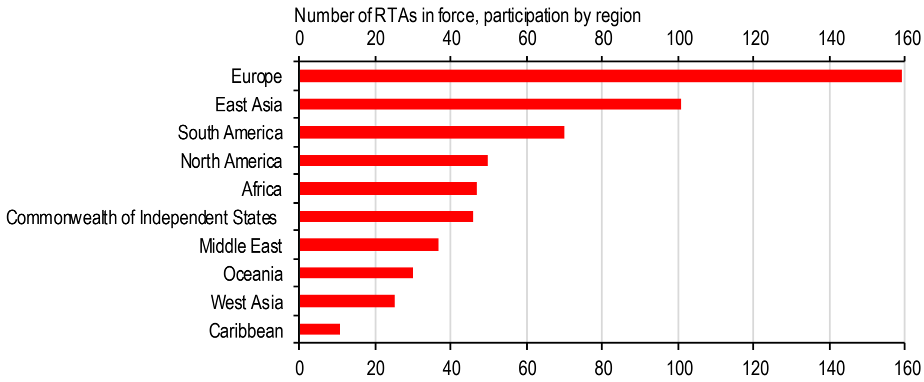
In Asia, we're seeing a similar trend, with Chinese FDI into ASEAN rising quickly as intra-regional supply chains are rejigged, too – with production costs in ASEAN still a fraction of that in mainland China (wages in Vietnam or the Philippines are roughly 40% of those in mainland China).

Overall, it appears that, at least for now, global trade is yet to go into reverse. 2023 may be challenging on a cyclical basis, and there are many challenges ahead on the geopolitical front. But the changing shape of global trade may not necessarily push down overall levels of global trade – it may be that there are simply different winners and losers.

Regional shifts?

However, regional trade agreements persist as a force for free trade. European countries participate in the largest number, followed by countries in East Asia and South America (chart 27). However, in Europe, when ignoring the post-Brexit spike, over the last decade, growth in the number of new agreements has faded. In East Asia, momentum has held-up, which will aid further trade growth in this region.

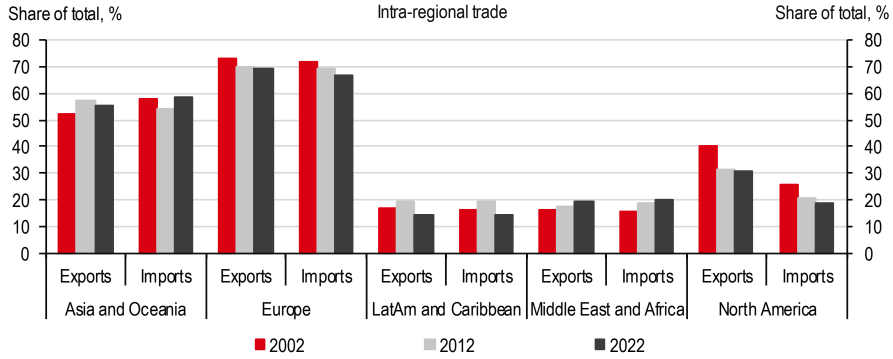
27. Regional trade agreements are popular



Source: WTO. Note: RTAs involving countries/territories in two (or more) regions are counted more than once

There has been a notable leap in regional policy cooperation, too. The stand out global trade deals in recent years – the Regional Comprehensive Economic Partnership (RCEP) and the Comprehensive and Progressive Agreement for TransPacific Partnership (CPTPP)[3] – are regional in nature, and we've seen closer cooperation within the EU in recent years as well as the signing of the African Continental Free Trade Area Agreement, which came into effect in 2019. This may well mean that while intra-regional became relatively less important as globalisation trends dominated in the 1990s and 2000s, the recent trend of regional trade deals means regionalisation may once again become more dominant in the coming years.

28. In many regions, trade has got more global – this could change going forward



Source: IMF DOTS

What could this mean?

Globalisation and the opening up of the global economy is credited with boosting productivity and economic growth, reducing prices and helping to lift millions out of poverty. Despite the additional logistical and transportation costs involved in diversifying and/or shifting operations to new territories, emerging economies helped lower the cost of labour and other inputs for firms and increased profits, although this came at a cost for many workers in the west. On the whole, globalisation has been seen as lifting growth and helping to lower inflation.

Moreover, it goes without saying that the events of recent years emphasise the advantages of globalisation beyond its impacts on global growth. The challenges of COVID-19 and climate change, not exclusively, highlight the continuing benefits of global collaboration and interconnectivity.

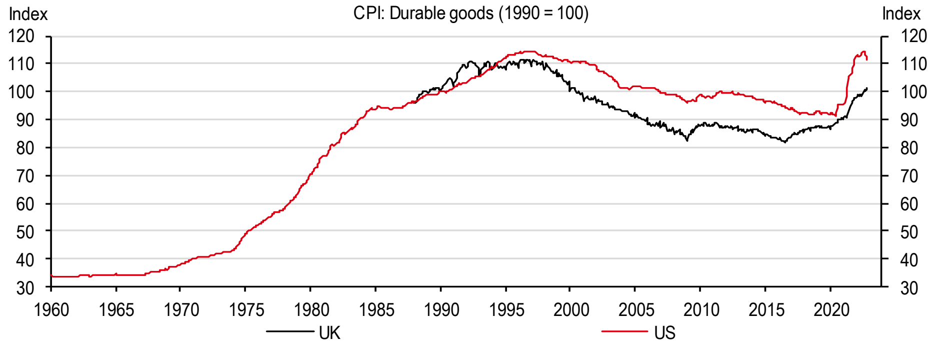
Consequently, a move in the opposite direction, to a less globalised world, makes many worry about whether this will lead to a reverse of some of the positive impacts that globalisation brought about in the first place, such as:

- We could see an increase in inequalities between countries if foreign companies were generating fewer jobs, which in particular could be deepened by the dominance of advanced technologies. There is little financial incentive for more technologically developed nations to physically venture into emerging economies to share enhanced capabilities. This could slow the convergence between EM and DM economies and come at a cost of jobs growth in the emerging world. This may also mean less technology sharing, less specialisation and less resilient supply chains, which could prove to be a gradual inflationary force.
- In the opposite way to how outsourcing production helped push down prices, relocating could see an increase in operating costs for firms as costs of production from wages as well as fresh capital investment lift costs. One of the major reasons behind continually falling goods prices may be disappearing. This may, in theory, put a closer link between domestic wages and inflation. However, if manufacturing is returned to developed economies, it is likely that automated processes will play a key role, and break at least some of that link.

[3] RCEP comprises the ASEAN economies, plus mainland China, Korea, Japan, Australia, and New Zealand. The CPTPP includes Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, and Vietnam

- If there is less trade, domestic monopolies (or larger firms) may be able to exert more market power, reducing competition and lifting inflation as these firms may find it easier to exert their pricing power, especially if supported by policy which favours domestic production.
- There could be a labour supply shock in western economies seeing (or soon to see) shrinking working age populations, higher wage bargaining power for workers and higher prices of less skilled labour could lift production costs in the coming years. The caveat, of course, is the role of automation – be it on the lower skill end or the higher end of the skill spectrum.
- If inflation is therefore higher for any given growth rate, interest rates may sit at a higher level: a constraint to growth. While on the other hand, if firms are unable to pass on higher prices, profit margins would be hit, which may hinder growth through a likely fall in investment spending and lower employment.

29. Globalisation has been credited with playing a key role in falling goods prices



Source: Refinitiv Datastream

However, there are two sides of every coin, and it's not all likely to be bad news. Shifting production closer to end consumers reduces the risk of supply chain disruptions. Indeed, the challenging consequences of global supply chain bottlenecks were felt first hand during the pandemic. Without having to rely on as many international trade flows, firms could manage more consistent inventory levels, which may see fewer price spikes arising from demand and supply imbalances. Furthermore, with suppliers closer to home, critical situations would be easier and cheaper to respond to. And, finally, positive climate implications stem from a reduction in international trade levels.

It's also worth considering the micro decisions being made by firms. Whilst the initial shock (supply chain concerns or geopolitics) may create concerns or lift costs, from here any movements in a supply chain will be for their benefit – either in terms of costs or reliability – and so may not have as strong an upside impact on inflation as we might think. Reshored or relocated production processes may carry an initial cost, but are much more likely to use more automated systems, limiting further cost increases, rather than being exposed to rising wages in fast-growing economies, such as mainland China.

Other impacts on trade flows and data could be notable

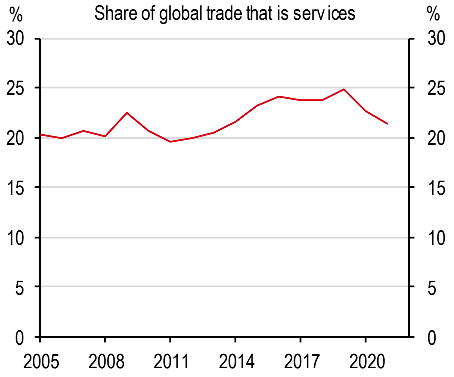
While much of the outlook for global trade focuses on geopolitical tensions, deglobalisation and re-shoring of production – it's quite likely that other structural forces also weigh on global trade flows. Something we flagged in September 2020 was how a much more digitised economy may be one with much less goods trade. As more physical items become digital products – think CDs to downloads – and 3D technology continues to improve, we could well see that goods trade flows face a natural headwind.

The problem is that services trade data are hard to capture – both accurately and in a timely manner, something we flagged in a report back in 2016. The World Bank even flags these data collection issues in the notes to its Trade in Services Database[4].

[4] It says: "*As a word of caution it should be added that the quality of trade data in services is still far away from being comparable to trade data for merchandise goods. Due to the long tradition of tariff revenues, trade data for goods have been collected with quite high quality and accuracy. Due to intangibility and non-storability of services, at-the-border-duties cannot be applied to services, thus having resulted in much weaker compilation practices with considerably less accuracy. Thus, services statistics has ample space for improvement in terms of measurement. In particular, with respect to modes 3 and 4, measurement is up to date difficult and incomplete. Ongoing revisions and refinements of the BOP classification*

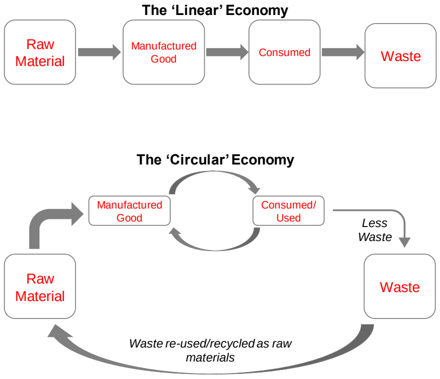
As a result, we need to treat services trade data with a certain degree of scepticism. UNCTAD data suggest that the share of services in global trade had edged up between 2011 and 2019, from c20% to c25%, only to decline in 2020/21, largely due to the sharp drop in tourism flows. But the size of global services trade may be getting harder to pick up. More of our consumption is being done via apps and digital services, while services exports spreading to economies such as India, rather than the more "traditional" hotbeds such as the US, the UK and Sweden may mean that statistical collection also has to catch up, too. With more of the world becoming connected, services trade will likely continue to get structurally bigger in the coming years.

30. Global trade's share that is services has been remarkably stable



Source: UNCTAD

31. A more circular economy may lower global trade



Source: HSBC

A greener economy, too, will impact trade flows. This is likely to lift demand for environmentally sustainable products, but reduce demand for goods with high carbon content and for fossil fuels energy. An example of this could be within a more circular economy, where a greater role for sharing, reusing and recycling of products may mean a drop in production and trade volumes, artificially lowering both industrial production and global (goods) trade figures. Additionally, if more economies shift towards generating electricity from renewable (local) sources, be it via solar, wind or hydroelectric power, this may chip away at trade in fossil fuels, particularly if electric vehicles continue to build market share.

As a result, global trade may be entering a phase where mismeasurement becomes an even bigger challenge. Firstly, some things may not be traded that previously were, and secondly the rotation from goods to services may make trade data much harder to capture, particularly in a timely manner. Global trade faces many structural headwinds, but the data may make things look worse than they actually are.

Conclusion

The landscape for global trade is clearly changing. Political tensions and trade barriers are rising, and firms, concerned by this and shocked by supply chain issues in recent years, may be starting to react. But for now, the evidence is more of a reshuffling of global supply chains rather than an outright deglobalisation story.

But even that may bring challenges. The world may be losing one of the big supports of recent years and this may usher in a period where growth is weaker and inflation is higher. For now, it's worth tracking the data – what firms are doing with their supply chains, what's happening with trade policy and what's happening in the trade data – something we showcase over the coming pages to highlight how global trade is evolving.

This is a Free to View version of a report with the same title published on 09-Feb-23. The full report contains a further look at the current state of trade. Please contact your HSBC representative or email AskResearch@hsbc.com for more information.

work towards solving these issues. As such, the Trade in Services Database should be seen in this light as the best currently available approximation to a comprehensive picture of global trade flows in services."

Disclosure appendix

The following analyst(s), who is(are) primarily responsible for this document, certifies(y) that the opinion(s), views or forecasts expressed herein accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: James Pomeroy and Harriet Smith

This document has been issued by the Research Department of HSBC.

HSBC and its affiliates will from time to time sell to and buy from customers the securities/instruments, both equity and debt (including derivatives) of companies covered in HSBC Research on a principal or agency basis or act as a market maker or liquidity provider in the securities/instruments mentioned in this report.

Analysts, economists, and strategists are paid in part by reference to the profitability of HSBC which includes investment banking, sales & trading, and principal trading revenues.

Whether, or in what time frame, an update of this analysis will be published is not determined in advance.

For disclosures in respect of any company mentioned in this report, please see the most recently published report on that company available at *www.hsbcnet.com/research*.

Additional disclosures

1. This report is dated as at 09 February 2023.
2. All market data included in this report are dated as at close 07 February 2023, unless a different date and/or a specific time of day is indicated in the report.
3. HSBC has procedures in place to identify and manage any potential conflicts of interest that arise in connection with its Research business. HSBC's analysts and its other staff who are involved in the preparation and dissemination of Research operate and have a management reporting line independent of HSBC's Investment Banking business. Information Barrier procedures are in place between the Investment Banking, Principal Trading, and Research businesses to ensure that any confidential and/or price sensitive information is handled in an appropriate manner.
4. You are not permitted to use, for reference, any data in this document for the purpose of (i) determining the interest payable, or other sums due, under loan agreements or under other financial contracts or instruments, (ii) determining the price at which a financial instrument may be bought or sold or traded or redeemed, or the value of a financial instrument, and/or (iii) measuring the performance of a financial instrument or of an investment fund.

Disclaimer

Issuer of report
HSBC Bank plc
.

[1208097]