

Trade, inflation & demand

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Economics - Global

As the tides turn

- ◆ Goods trade flows remain strong but growth may start to slow as demand for pandemic-related products normalise...
- ◆ ...and rising prices lead consumers to curtail their spending, while some retailers look to draw down excess inventory
- ◆ Mexico, Canada, India and mainland China are key economies that may be vulnerable to a slowdown in US consumer demand

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Over the past couple of years, we have written much about the sharp rebound and strength in global goods trade. But the economic tides are turning and, with that, so too might the fortunes of trade.

Although our economists are not currently forecasting a global recession, the question of how likely one might be is at the top of minds for corporates and investors alike. Rising prices could lead to a downturn in consumer demand, with early signs that consumers in Western economies are already looking to curtail their spending on some tradeable goods. And, in the face of slowing consumer demand, there is a risk that some companies could be left holding excess supply after building up buffer stocks over the past couple of years, with inventories of S&P 500 companies topping USD1.1trn in the latest quarter.

And, even if a global recession does not materialise, the sharp bounce in global goods trade seen during the pandemic is bound to fade as spending on services picks up and demand for certain goods normalises. Already, consumer spending in the US is starting to rotate away from goods towards services, while the US National Retail Federation expects containerised retail imports to decline slightly y-o-y in both, September and October this year.

According to our analysis based on OECD data, exporters in economies such as Mexico, Canada, India and mainland China are most exposed to a slowdown in US consumer demand. In fact, our Chief Asia Economist recently cautioned that a trade recession could be on the horizon for the region amid slowing economic growth in the US and EU and a muted recovery in demand in mainland China.

On the other hand, a slowdown in goods trade flows could help to ease pandemic-related supply chain pressures. Spot container freight rates are already down 40% on their peak in September 2021, some shipping lines are doing away with surcharges levied during the pandemic, and delivery times for chips are showing initial signs of improving. However, it's worth bearing in mind that logistics disruption is not yet over. Key ports are still congested and the war in Ukraine has renewed supply chain pressures for food and energy trade, in particular.

Therefore, it is clear that even through trade volumes are likely to remain high this year, a slowdown in international trade growth may be unavoidable in the near term.

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Past the boom, into the slowdown

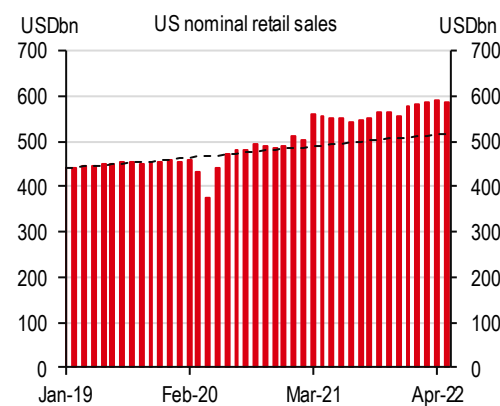
Slowing consumer demand

The pandemic-demand boom is slowing...

Western consumers have spent significantly over the past couple of years to the benefit of exporters in emerging markets, mainly Asia. In nominal terms, US retail sales are currently around 30% above what they were pre-pandemic, though there are signs that we may be approaching the end of the pandemic-demand boom (Chart 1). US retail sales have declined y-o-y each month since March 2022 in real terms, while spending on goods is starting to slow as COVID-19 restrictions lift and consumer expenditure rotates towards services (Chart 2).

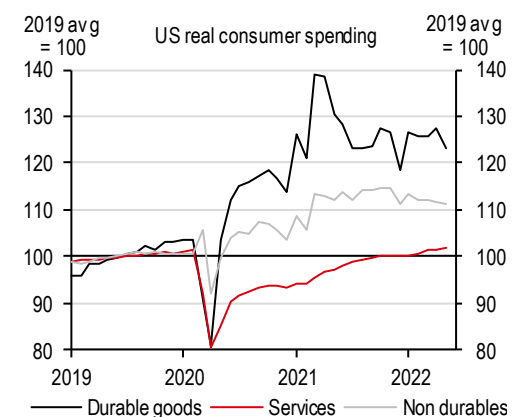
It's a similar story in the UK where retail sales volumes have been falling since summer 2021, with food store sales continuing to trend downwards and sales at household goods stores also down from their peak in May 2021 (Chart 3). On the other hand, clothing store sales have remained relatively stable, rising by 2% m-o-m in May 2022, with some retailers suggesting that the latest increase was due to customers buying new clothes for their summer holidays (Chart 4). The rise in online shopping, which helped support the boom in demand during the past two years, has also declined in relative importance for British consumers as the UK did away with COVID-19 restrictions. Today, online shopping accounts for 26% of total UK retail sales, down from 38% in January 2021 (Chart 5).

1. US retail sales remain strong...



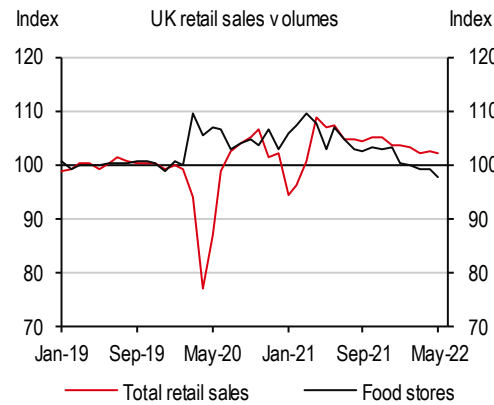
Source: Refinitiv Datastream. Note: Latest data point for May 2022.

2. ...though consumer spending is starting to rotate away from goods to services



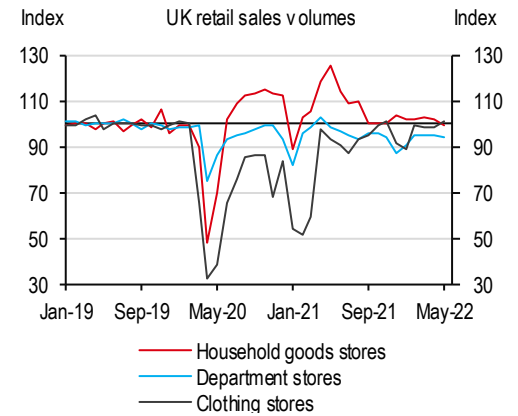
Source: Refinitiv Datastream. Note: Latest data point for May 2022.

3. UK retail sales volumes are slowing...



Source: Refinitiv Datastream. Note: 2019=100, latest data point for May 2022.

4. ...although spending on clothing is holding up...



Source: Refinitiv Datastream. Note: 2019=100, latest data point for May 2022.

5. ...despite the relative importance of online sales declining

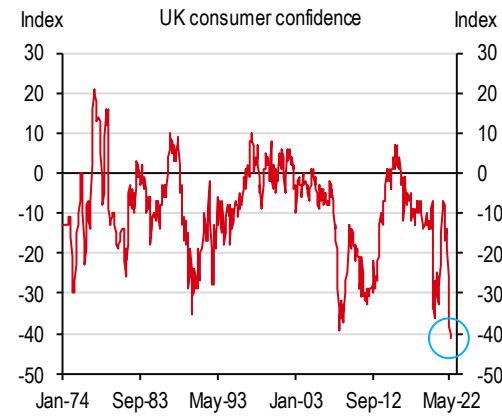


Source: ONS. Note: Total retail excludes automotive fuel.

...and rising prices are squeezing consumers...

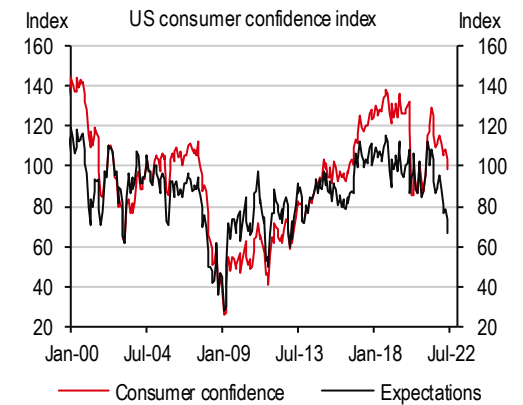
Rising prices are also putting the squeeze on consumers, although as our global economists recently noted, additional savings accumulated by many households during the pandemic are currently helping to sustain robust consumer demand. But the longer prices stay elevated, the more likely it is that consumers will temper their spending. Already, we are seeing consumer sentiment indicators starting to tumble in the developed world. UK consumer confidence plunged to its lowest level on record (-41) in June 2022, while US consumer confidence fell to a 16-month low in June (98.7) and American consumer expectations about future income, business and labour conditions declined to its lowest level in nearly a decade (66.4), according to The Conference Board (Charts 6 and 7).

6. Consumer confidence is tumbling in the UK...



Source: Refinitiv Datastream. Note: Latest data point for June 2022.

7. ...and in the US



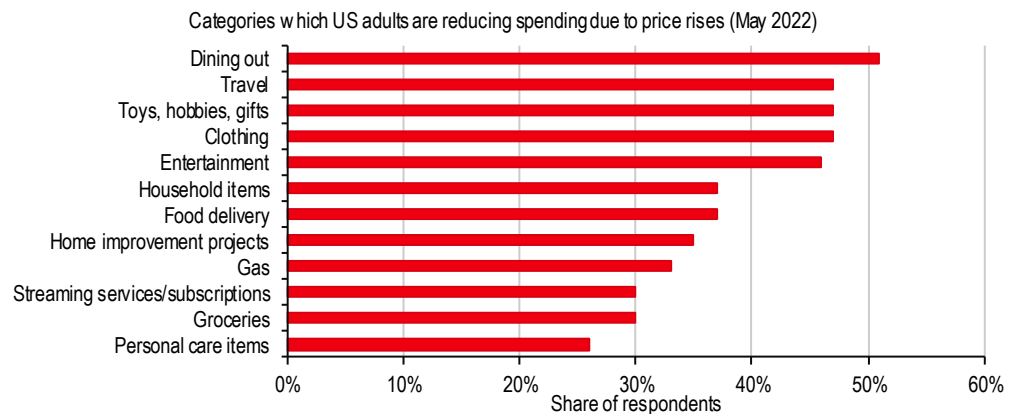
Source: Refinitiv Datastream. Note: Latest data point for June 2022.

...who are now looking at ways to curtail spending

As a result of mounting price pressures, US consumers have said that they are likely to cut spending on meals out and on goods such as clothing and toys, while a July 2022 ONS survey found that 62% of UK households are spending less on non-essentials and 38% are shopping around more (Charts 8 and 9).

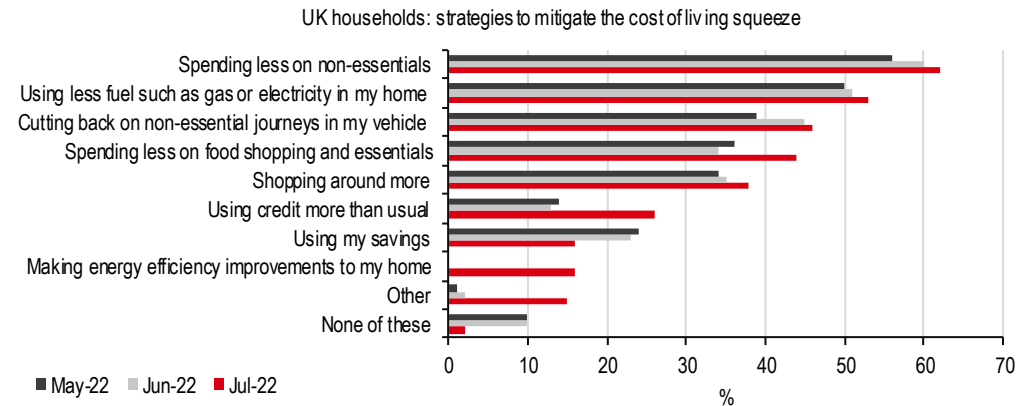
And these shifts in spending will have implications for trade, particularly in discretionary goods, going forward.

8. US consumers are paring back spending on certain categories...



Source: eMarketer, CivicScience

9. ...as are UK households

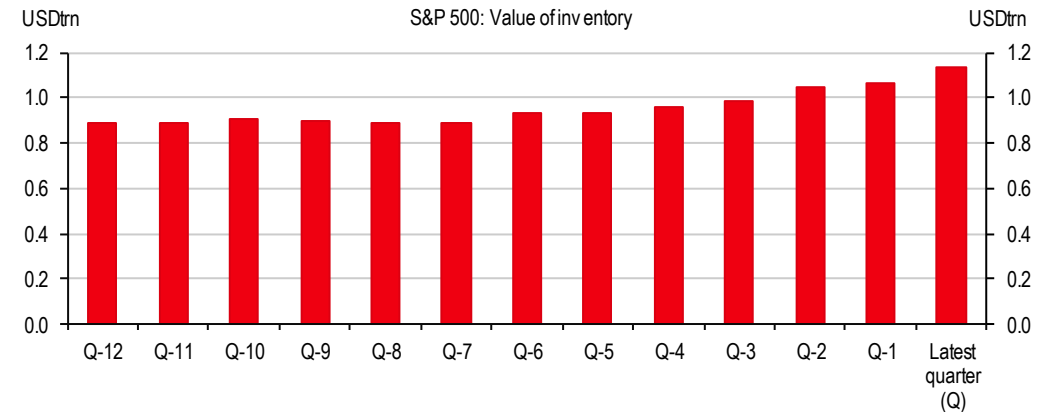


Stocked up

Many companies built up buffer stocks during the pandemic...

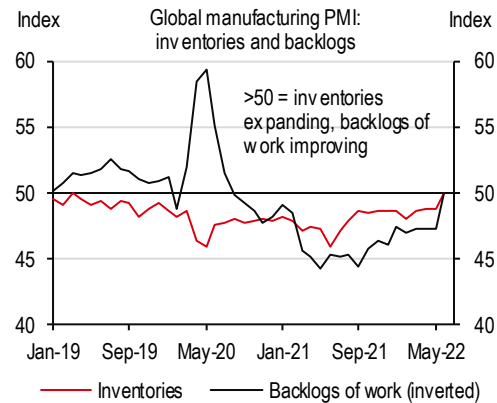
Another factor that could weigh on trade prospects is the level of stock already held by businesses. Inventories for some companies and sectors are currently running high as businesses built up buffer stocks during the pandemic to help mitigate supply chain disruptions. For example, S&P500 companies were collectively holding around USD1.1trn worth of inventory based on the latest earnings data this year, up by around 18% y-o-y (Chart 10).

10. US companies are carrying a lot of inventory



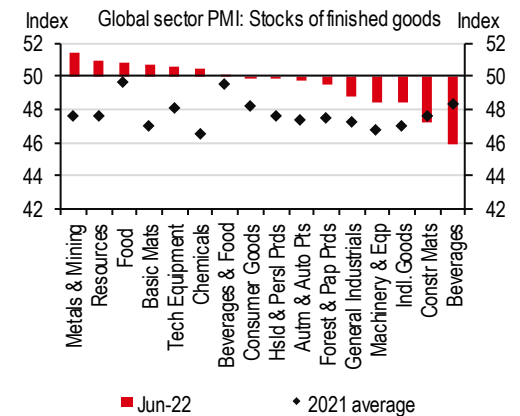
Globally, backlogs of work are showing signs of improving as pandemic-related disruptions slowly ease, while the overall level of finished goods held by businesses remains in contractionary territory but is improving (Chart 11). Inventory levels for businesses in the metals, resources, food and tech sectors expanded in June 2022, while stock levels for companies in the beverages, construction, machinery and autos sectors remain depleted (Chart 12).

11. Backlogs of work are improving...



Source: S&P Global. Note: Latest data point for June 2022.

12. ...while some sectors have expanded inventory levels

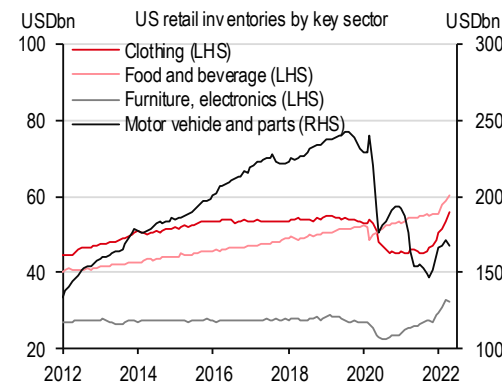


Source: S&P Global

...and US retail inventories ex autos are back to pre-pandemic levels

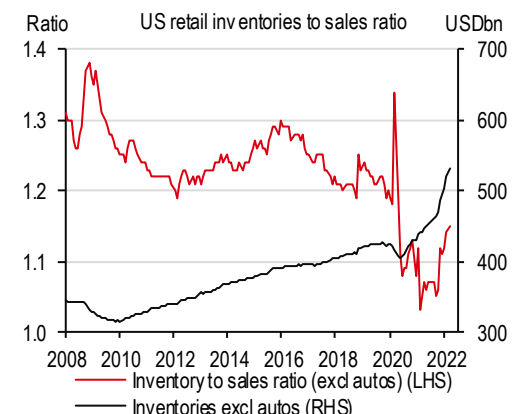
Retail inventories in the US are also back to pre-pandemic levels for a number of sectors excluding autos. However, the ratio of inventories to sales (excluding autos) is currently around 1.15 – about 6% below its 2019 average – suggesting that, at this stage at least, we aren't quite seeing a large build-up of inventories relative to sales in the macro data (Charts 13 and 14). But deteriorating consumer confidence that translates into reluctance to spend, along with the ongoing rotation away from spending on goods towards services could see this change rapidly.

13. US retail inventories are mostly back at pre-pandemic levels...



Source: Refinitiv Datastream. Note: Latest data point for April 2022.

14. ...while sales also remain strong, for now



Source: Refinitiv Datastream. Note: Latest data point for April 2022.

There is a risk that businesses could be left holding excess supply as consumer demand slows, with some companies recently cautioning about this in their earnings calls (clients can refer to the full note for examples).

Some companies are cautioning about excess inventory, while others are stocking up more

Which products and economies are vulnerable?

So, which countries and product categories might be more vulnerable to a slowdown in demand? As noted above, it is likely to be those tied to discretionary goods. One way we could look to answer this question a bit more precisely is to determine in which categories consumer prices are rising quickly and import intensity – that is, the share of final consumption expenditure due to both direct and indirect imports – is high.

In the UK, prices for other food products – a category that includes condiments and prepared baking products, with an import intensity of over 37% – rose by 12.5% y-o-y in May 2022, while prices of garments (import intensity: nearly 40%) and new cars (import intensity: 60%) were up 7.2% and 6.8% y-o-y in the latest month, respectively (Table 15). However, while consumers may look to cut back on their grocery bills by forgoing certain products or switching to cheaper alternatives, British imports of food products are unlikely to be curbed drastically given these are staple goods. On the other hand, it might be reasonable to expect UK consumers to start cutting back on spending on clothes, household furnishings, and outdoor recreational goods.

15. UK consumer prices for some products sourced from abroad are rising quickly

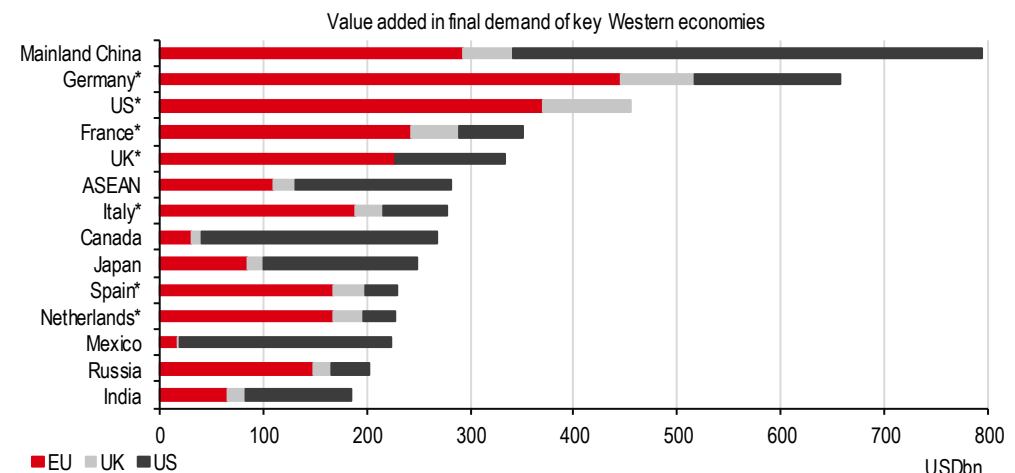
Product category	UK inflation rate, May 2022 y-o-y%	UK import intensity %
Liquid fuels	122.6	30.5
Gas	95.5	25.0
Electricity	53.5	23.2
Fuels and lubricants	32.8	30.7
Second-hand cars	23.4	60.1
Passenger transport by air	21.8	28.6
Oils and fats	18.4	38.0
Furniture and furnishings	16.2	30.1
Materials for maintenance and repair	16.1	22.6
Glassware, tableware and household utensils	13.0	23.2
Food products (not elsewhere classified)	12.5	37.8
Meat	9.9	41.7
Motorcycles and bicycles	7.6	52.4
Garments	7.2	39.8
Fish	6.9	39.0
New cars	6.8	60.1
Vegetables including potatoes and tubers	6.6	44.9
Fruit	5.5	47.6
Footwear including repairs	5.4	46.4
Spare parts and accessories	4.5	65.1
Appliances and products for personal care	2.9	38.4
Spirits	1.9	9.3
Beer	1.8	9.3
Major durables for in/outdoor recreation	1.7	50.8
Wine	1.6	9.3
Pharmaceutical products	0.7	46.7
Other medical and therapeutic equipment	0.4	49.4

Source: ONS

Large goods exporters are vulnerable to a slowdown in Western consumer demand...

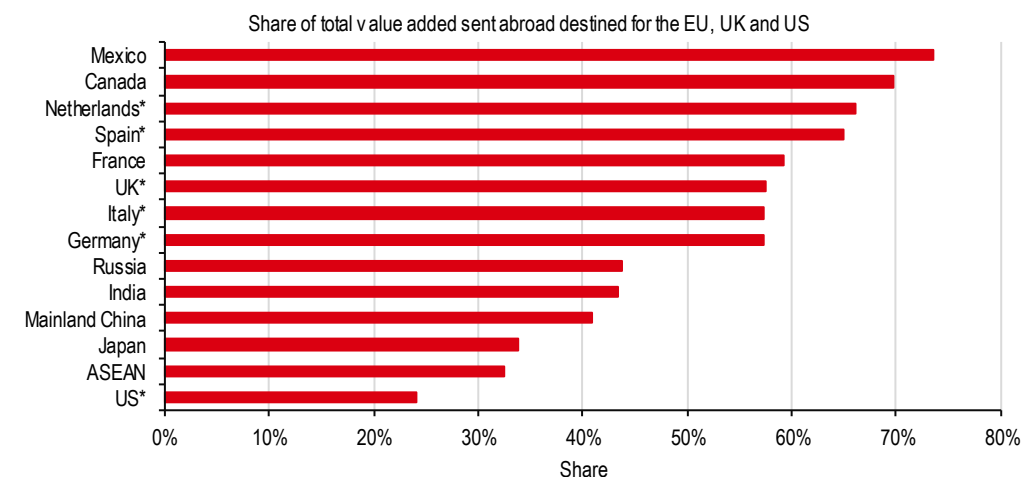
To gauge which exporting economies are most exposed to a slowdown in Western consumer demand, we can look at the share of each country's value added sent abroad that ends up in final demand in the EU, UK and US. Charts 16 and 17 show that mainland China, Germany, the US, France, UK and ASEAN send the most amount of foreign value added used in Western final demand in value terms, although just 41% of China's and 32% of ASEAN's total foreign value added sent abroad is destined for these economies. Markets such as Mexico, Canada, Costa Rica, Colombia, India and mainland China are particularly exposed to a downturn in US consumer demand (Chart 18).

16. EU, UK and US consumers rely on inputs and final goods sourced from abroad...



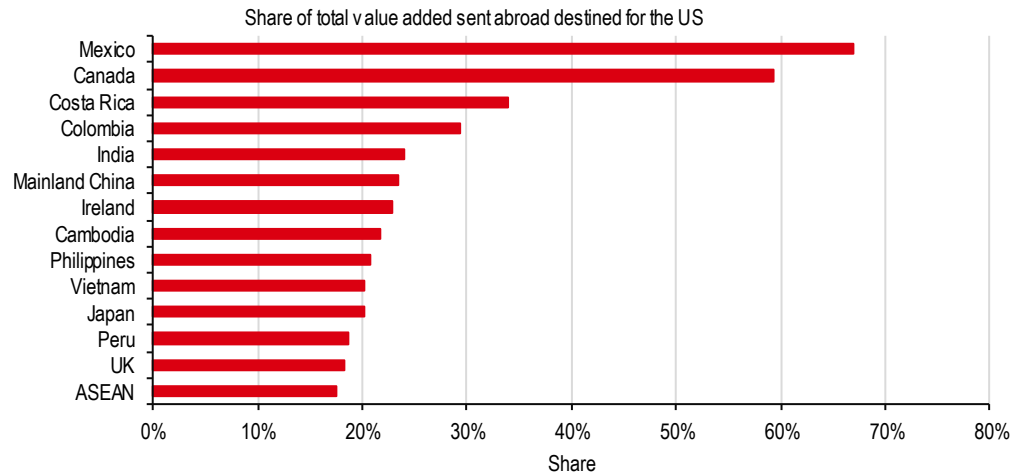
Source: OECD TIVA, HSBC. Note: *Excludes value added in domestic final demand, i.e. For Germany, the chart shows value added in final demand of all other EU members excluding Germany. Similar for the US and UK, where value added in domestic final demand is excluded.

17. ...while some markets are highly dependent on Western demand for export revenue



Source: OECD TIVA, HSBC. Note: *Excludes value added in domestic final demand, i.e. For Germany, the chart shows value added in final demand of all other EU members excluding Germany.

18. Neighbouring and Asian economies are exposed to a downturn in US consumer demand



Source: OECD TIVA, HSBC

Our Chief Asia Economist Frederic Neumann has written extensively about what slowing Western consumer demand and a normalisation in goods demand post-pandemic could mean for Asian exports. Already, there are signs that the electronics cycle is cooling, which could weigh on Asian exports going forward, while Chinese exports of laptops which rose strongly during the pandemic fell by 8% y-o-y in May 2022.

...and this may trigger a trade recession in Asia

Although a pick-up in Chinese demand may help to cushion the trade slowdown, renewed COVID-19 curbs could limit the support to exports. Moreover, the EU and US are key trading partners for Asian markets and, all things considered, our economists think that growing economic growth challenges in the West along with only a limited recovery in demand in mainland China, could potentially trigger a trade recession in Asia in the coming quarters.

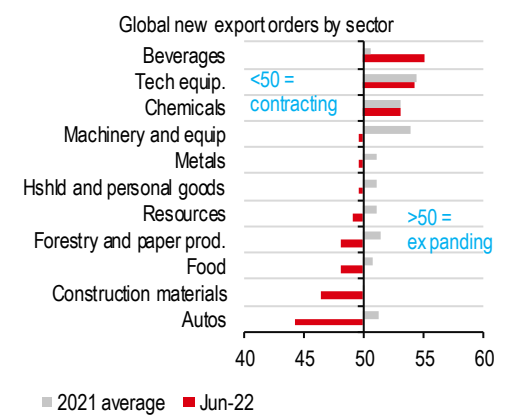
Globally, new export orders have declined each month since March 2022, although there was some improvement in June (Chart 19). New export orders contracted across a range of sectors in June including autos, construction materials, and household and personal goods, while orders for tech equipment grew for the second consecutive month in a row (Chart 20).

19. New export orders are contracting for some economies...



Source: S&P Global. Note: Latest data point for June 2022.

20. ...as demand across a range of sectors slow

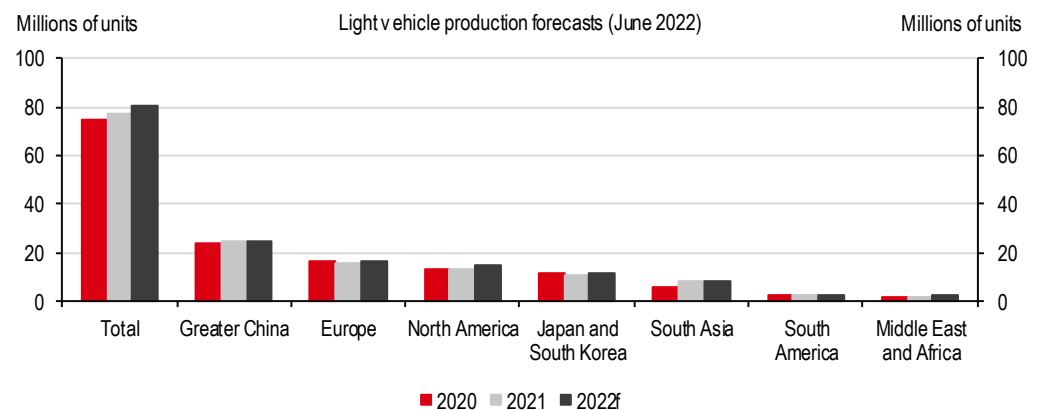


Source: S&P Global

On the other hand, the easing of pandemic-related supply chain pressures could see trade in certain products significantly affected by input shortages over the past couple of years pick up (e.g. the autos industry and chip shortages). For example, delivery times for semiconductors fell by one day to an average of 27 weeks in June – a potential welcome sign for automakers that chip bottlenecks may be starting to abate (Bloomberg, 6 July 2022).

However, this has to be balanced against the cost of living squeeze currently impacting consumers, which could lead to some destruction in demand. For example, IHS recently revised up its forecasts (by 8,440 units) for global light vehicle production to 80m units in 2022, with some automakers reporting an improved supply of chips, while others still face the challenge of getting a consistent supply of key components (Chart 21). However, it cautioned about a reduction in demand due to lower economic growth forecasts.

21. Slowing consumer demand could pose a headwind for the pick-up in autos production



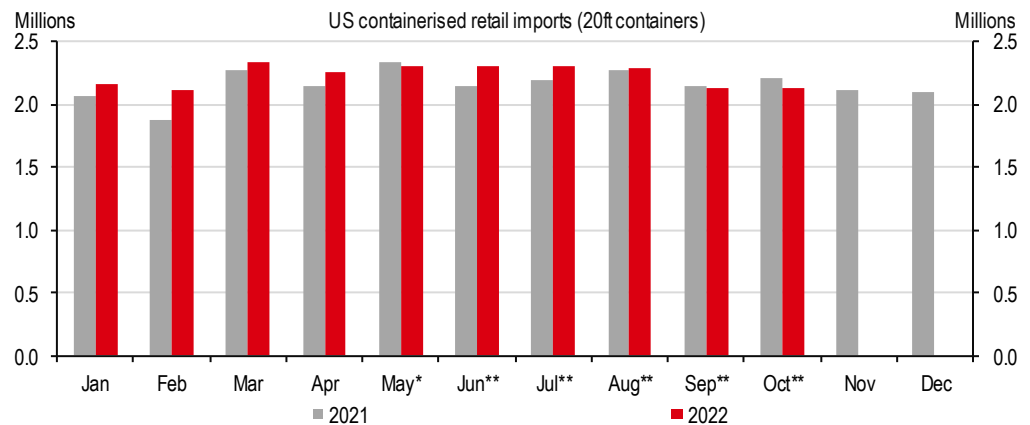
What does this mean for logistics disruption?

A slowdown, or at least a normalisation, in consumer demand for goods would no doubt be a good thing for the easing of pandemic-related supply chain pressures and could help bring container shipping imbalances into line, eventually. At our recent HSBC Annual Transport Conference, held in early-June 2022, most shipping companies acknowledged that they are seeing initial signs of weaker demand but do not expect a collapse, while some expect the peak container shipping season to be longer this year but with volumes not as pronounced as last year due to early restocking. For more on this see: *HSBC 16th Transport & Logistics Conference*, 15 June 2022.

The CEO of Maersk, Soren Skou, also noted that container shipping could be impacted by a “bullwhip effect” soon – whereby demand declines and supply increases – in a reversal of what the shipping industry has experienced over the past two years. According to Mr Skou, this could happen in August or later in 2022 and when it does, “it could go quite quickly” (FT, 19 June 2022). In fact, although the US National Retail Federation now expects containerised retail imports into the US to rise by just 0.3% y-o-y over July to October, with volumes forecast to be down slightly on last year’s number in both September and October (Chart 22).

Normalisation of goods demand could help ease supply chain pressures

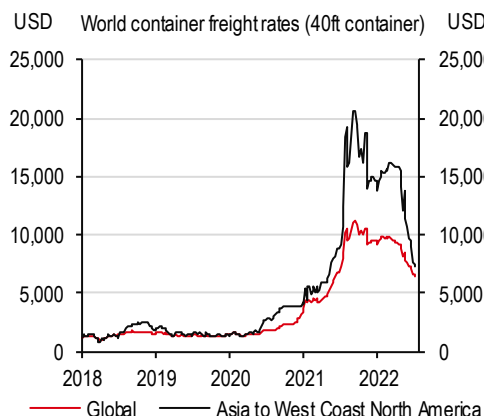
22. US containerised retail import volumes are expected to slow in the coming months



Source: US National Retail Federation. Note: *Estimated, ** Forecast.

In an indication that the tides may already be turning, spot container freight rates are down 40% from their peak in September 2021 and, according to Freightos, some surcharges that shipping lines were levying on customers to ensure containers were actually placed on ships are no longer being applied (Investors' Chronicle, 7 July 2022).

23. Shipping costs are falling...



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