

Trade in 2022

Past the rebound

Free to View
Economics - Global

- ◆ Global trade growth looks set to moderate this year...
- ◆ ...but it will still take months for supply chains to normalise
- ◆ Look out for ongoing tensions, new trade deals and a greater focus on ESG in trade policy this year

What do we expect?

After a strong recovery in global goods trade, world trade growth looks set to moderate this year as movement restrictions are lifted and consumer spending rotates away from goods towards services. However, the nearly two years of trade disruption caused by the COVID-19 pandemic continue to take their toll and the recovery in trade has been uneven. Based on our economists' forecasts, some economies (e.g. US, Thailand, Philippines) will only see export volumes recover to pre-pandemic levels in 2023. For others such as the UK, France and Australia it could take even longer.

Disruptions still persist

Therefore, we enter this year with some caution. The spread of Omicron risks impacting factory and logistics operations and even once bottlenecks start unwinding, it will still take time for supply chains to fully normalise. International travel, which typically accounts for c.25% of global services exports, also remains weak and ongoing COVID-19 restrictions along with consumer caution towards travel could limit a strong revival in services trade.

Trade policy outlook

We expect Geopolitical trade tensions and Brexit-related trade policy uncertainty to continue. Differences between the US and its North American partners over the US government's plan to provide tax credits for US-made electric vehicles risks leading to new tariffs if implemented.

In the wake of the pandemic, governments and companies around the world are likely to continue looking at ways to reduce reliance on single foreign suppliers. However, there is a risk that such measures could lead to protectionist trade actions under the guise of making supply chains more resilient.

We also expect developed markets to take a more assertive stance in tackling ESG issues via trade policy this year. For example, there could be progress in designing carbon border taxes and around mandating corporate due diligence in supply chains, which could impact from where companies source their products.

Meanwhile, the Asia-Pacific welcomed the new year with a new trade deal: The Regional Comprehensive Economic Partnership (RCEP). With new UK, India and EU trade agreements in the pipeline, trade liberalisation looks set to continue this year. However, we don't expect much progress to be made with US deals given domestic priorities.



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We enter this year as we left the last. Supply chains are tangled, logistics disrupted and the risk of further trade disruption due to the spread of Omicron and mainland China's zero-tolerance COVID-19 strategy looms. Therefore, it is clear that the impacts of COVID-19-related trade disruption will still be felt well into this year and it will take many months for supply chains to fully normalise.

But there is cause for optimism. Some indicators suggest that bottlenecks might be starting to unwind and trade liberalisation continues to advance in Asia and the UK. Further disruption notwithstanding, we expect the global trade recovery to evolve in 2022 – to be more about services than goods. However, as we discuss below, the recovery in services trade is likely to be more drawn out than the goods trade rebound and overall trade growth looks set to moderate this year.

Outlook for trade flows

From goods to services

Global trade volumes are well above pre-pandemic levels

The recovery in world trade since the latter half of 2020 has been all about goods, with global goods trade volumes currently sitting around 4.6% above pre-pandemic levels and 6% above what they were in 2020 (Chart 1). On the other hand, the performance of services trade has been very weak given international travel restrictions. Globally, y-o-y growth in services exports only returned to positive territory in Q2 2021 compared to (cf. Q4 2020 for goods), mainly due to base effects, and exports still remain below 2019 levels for key service economies such as the UK and US (Charts 2 and 3).

1. Global goods trade rebounded strongly...



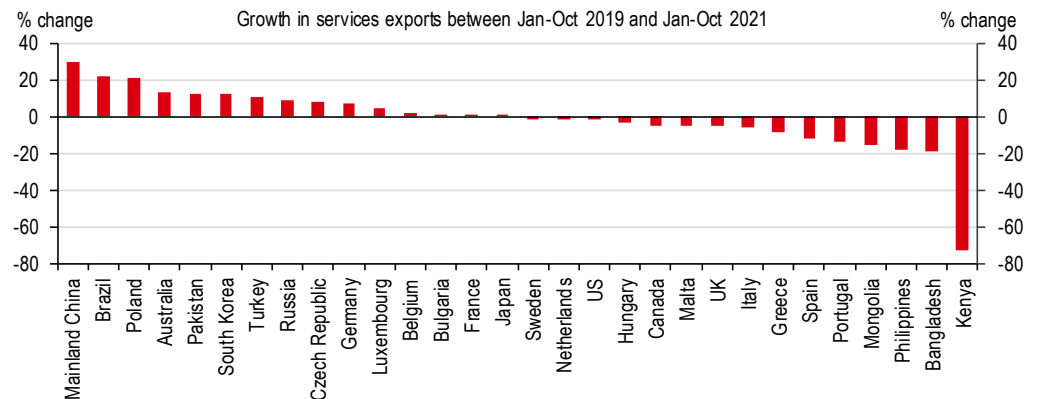
Source: CPB

2. ...and has outpaced services trade growth...



Source: WTO, HSBC. Note: Data for services are based on sum of exports for all economies and are until Q2 2021. Data for goods are up to Q3 2021.

3. ...which remains weak across key economies



Source: WTO, HSBC. Note: Data only available for a select number of economies.

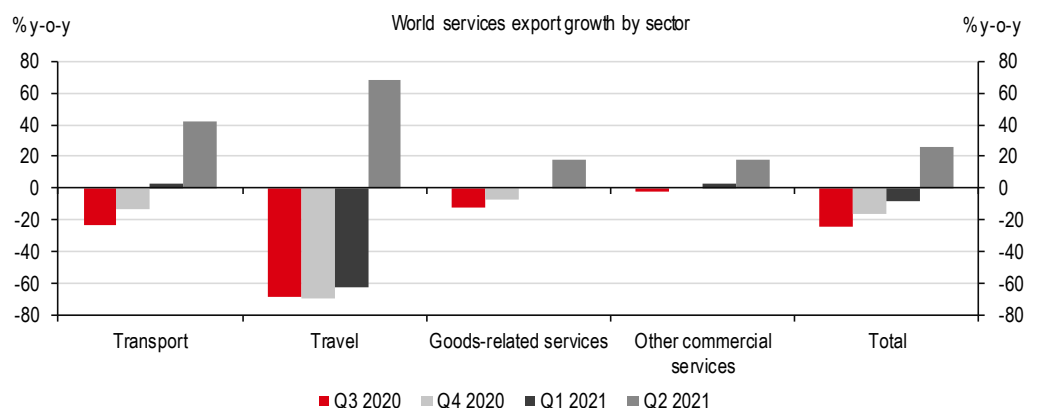
However, momentum in goods trade growth has slowed since April 2021. And although pent up demand for goods affected by input shortages (e.g. autos), inventory replenishment in Western economies, and the shift to e-commerce brought about by the pandemic could continue to support goods trade flows going forward, it is clear that the best of the global goods trade rebound is firmly behind us.

Therefore, we believe the next phase of the global trade recovery will be focused on services. But given that services have typically accounted for just one-quarter of total world exports, the slowdown in global goods trade growth should be enough to temper overall trade prospects this year even if services trade were to recover strongly.

Travel has been the hardest hit component of global services trade

Globally, travel has been the hardest hit component of services trade, while there are signs that trade in more digitised services has held up better through the pandemic – a trend which could be set to continue given most of these services can be delivered remotely across borders (Chart 4).

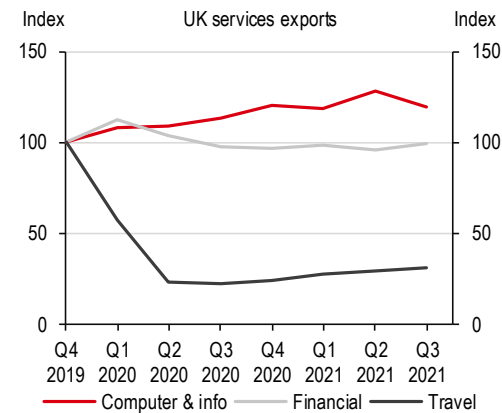
4. Travel services have been hit hard by lockdown restrictions...



Source: WTO

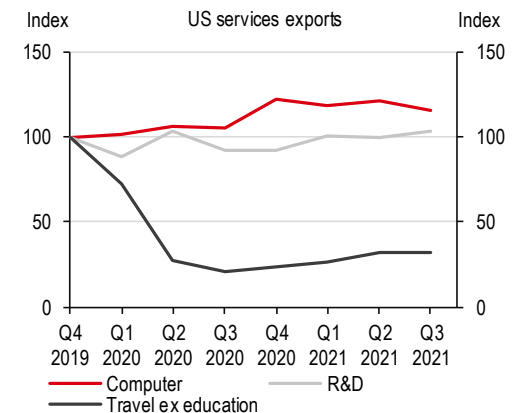
In the UK, for example exports of computer and information services were 20% above pre-pandemic levels in Q3 2021, while travel service exports remained 70% down on 2019 levels at that time (Chart 5). Similarly, US computer services exports were 16% above pre-pandemic levels in Q3 2021 (the latest point we have data for), while US travel services excluding education were also down nearly 70% on pre-pandemic levels at that time (Chart 6).

5. ...while digital services have performed better in the UK...



Source: Refinitiv Datastream, HSBC. Note: Q4 2019 = 100.

6. ...and in the US

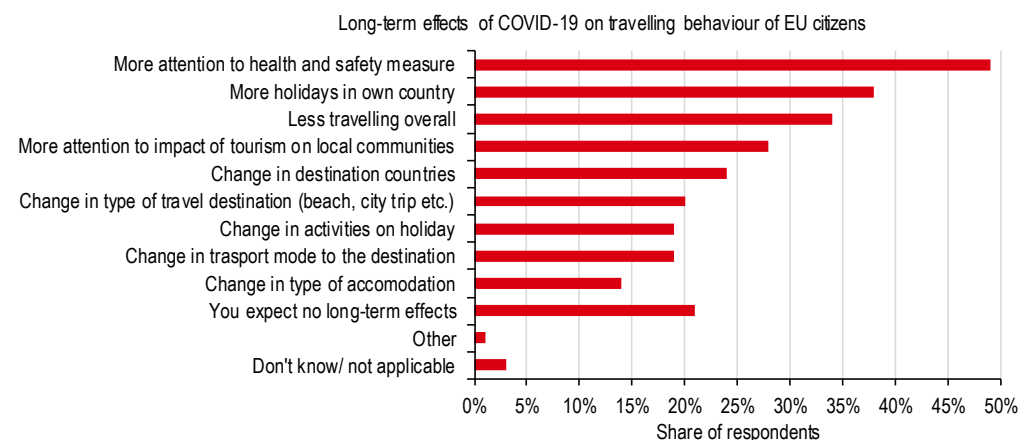


Source: Refinitiv Datastream, HSBC. Note: Q4 2019 = 100.

The services trade recovery will be more drawn out than the goods trade rebound

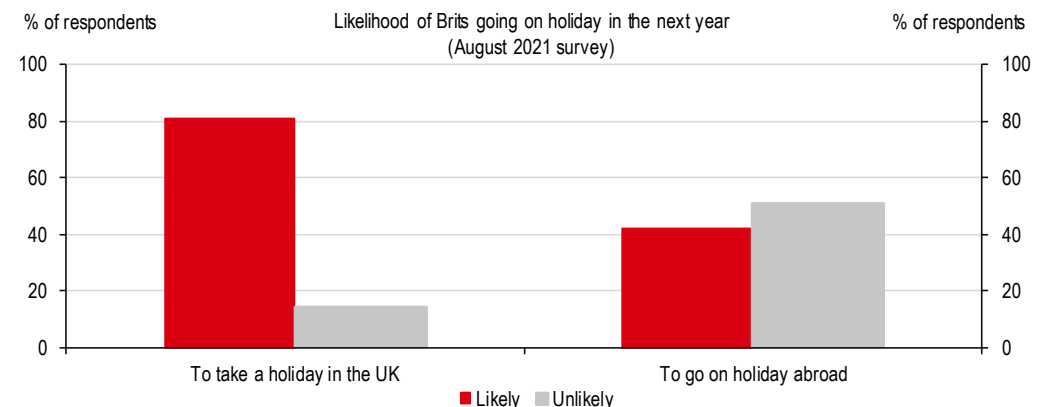
But unlike the earlier rebound in goods trade, the recovery in services trade is likely to be more drawn out and will largely depend on when exactly international border restrictions are lifted and how confident consumers are to resume overseas travel. A recent Ipsos Mori survey found that more than one-third of EU citizens expect that they will travel less overall due to the pandemic, while Brits are divided about the thought of travelling abroad this year (Charts 7 and 8).

7. Some consumers might be hesitant to travel abroad even once COVID-19 restrictions lift...



Source: Ipsos Mori. Note: Survey conducted between 18 and 28 October 2021.

8. ...and may choose to holiday locally instead

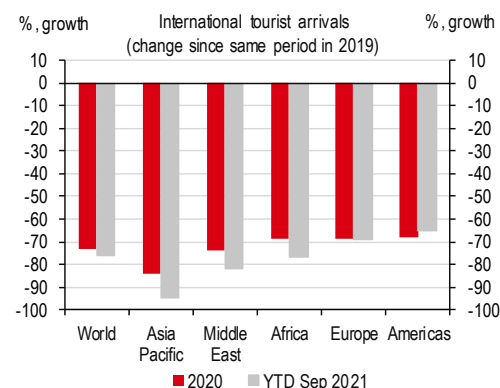


Source: Ipsos Mori

Nearly all economies maintain travel restrictions

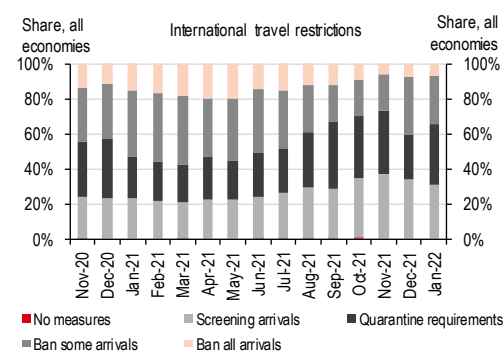
Prior to the pandemic, travel comprised 25% of global services exports – a share that dropped to 11% in 2020. And although international tourism rebounded in the Northern Hemisphere during summer 2021, total global international visitor arrivals were down 76% in January to September 2021 compared to the same period in 2019. Today, nearly all economies maintain some form of restriction on foreign travellers (Charts 8 and 9).

9. International tourism has collapsed across the world...



Source: UNWTO

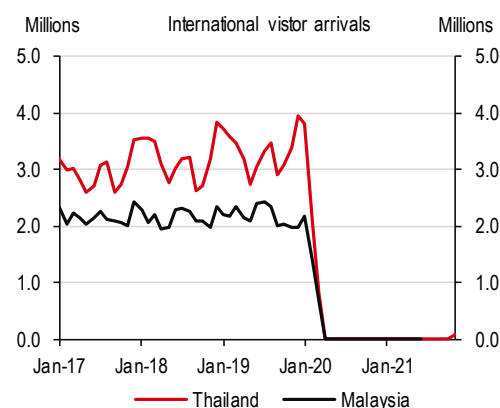
10. ...as nearly all countries maintain border restrictions



Source: University of Oxford, HSBC. Note: Jan 2022 numbers are based on data for 144 economies.

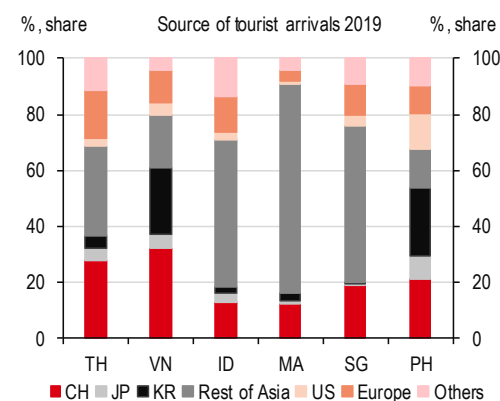
The Asia-Pacific region has been the hardest hit by border closures globally as international visitor arrivals in key Southeast Asian tourist destinations plummeted during the pandemic (Chart 11). However, as our economist Yun Liu points out, in Vietnam the absence of Chinese tourists and a delayed resumption of international flights could limit a V-shaped recovery in Vietnamese tourism in 2022.

11. Tourist hotspots in Asia have seen visitor numbers plummet...



Source: Refinitiv Datastream

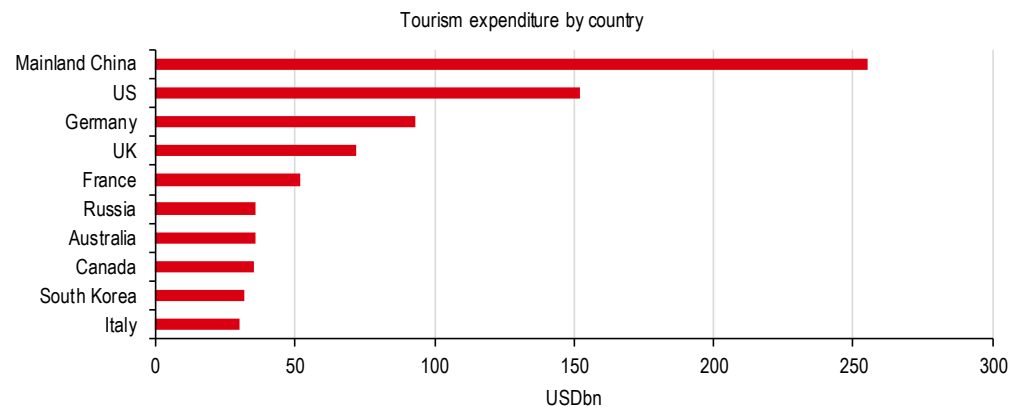
12. ...while the recovery will depend on the revival in mainland Chinese tourists



Source: CEIC, HSBC; CH = mainland China

In fact, survey data suggest that travellers from mainland China – the world's top spender on international tourism – remain cautious about going overseas (Chart 13). According to a China Tourism Academy survey, around 82% of Chinese travellers will only go to a destination with no cases of COVID-19, while a similar proportion said that they would choose to travel domestically rather than abroad in the near term (Dragon Trail International, 22 November 2021). Mainland China's zero-COVID-19 approach and tight border restrictions for international arrivals could also deter Chinese travellers from going abroad even if other economies open up.

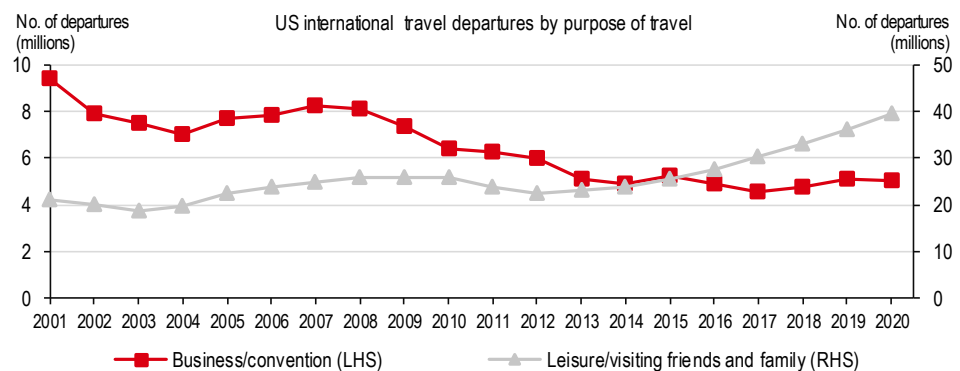
13. Mainland China is the world's top spender on international tourism



The intangible nature of services also means that catch-up demand is harder than it is for goods. For instance, even once travel restrictions do lift, people are unlikely to go on significantly more overseas holidays to make up for lost trips over the past two years. The United Nations World Tourism Organization (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.

Beyond tourism, the recovery in business travel could take even longer based on past trends and given that corporate workers are now more accustomed to working remotely. For example, US business travel has declined since the Global Financial Crisis, while outbound tourism recovered to pre-crisis levels in around five years (Chart 14). Looking ahead, the Global Business Travel Association (GBTA) expects business travel to only recover to pre-pandemic levels (USD1.4trn) by 2024.

14. A rebound in business travel could take even longer than the tourism recovery



Demand drivers for air cargo remain supportive

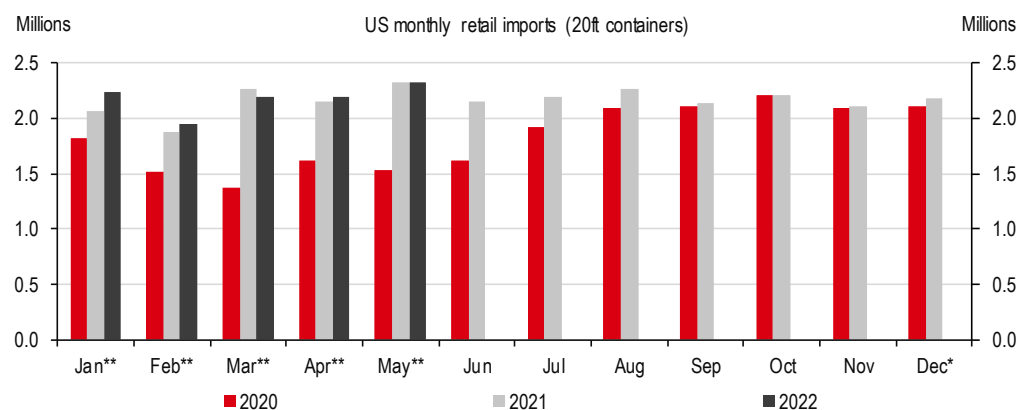
The recovery in international travel will also be crucial for releasing more air cargo capacity. Typically, around 50% of global air cargo volumes are carried in the bellyhold of passenger planes but capacity has been significantly constrained during the pandemic due to the grounding of passenger aircraft fleets around the world. The return of air cargo capacity as travel restrictions lift, along with the easing of shipping disruption, should lead to some relief in airfreight rates over the course of this year. However, we think air cargo costs will remain elevated compared to pre-pandemic rates as shipping bottlenecks will take time to unwind and some businesses still look to make use of air cargo to deliver products quickly.

Support for goods trade

Although the next phase of the trade recovery will be more about services than goods, factors such as inventory restocking, the desire by some companies to build up buffer stocks, pent up demand for certain goods and the shift by consumers to increasingly shop online could provide some support for goods trade in the near term.

US retail inventories of autos and clothing, for example, are still below pre-pandemic levels, which suggests that the build-up of inventory in these sectors still has some way to run and could support trade from large exporters of these products. The US National Retail Federation expects containerised retail imports to increase by 2% y-o-y in the first five months of this year (Chart 15).

15. US containerised retail imports are set to remain robust this year



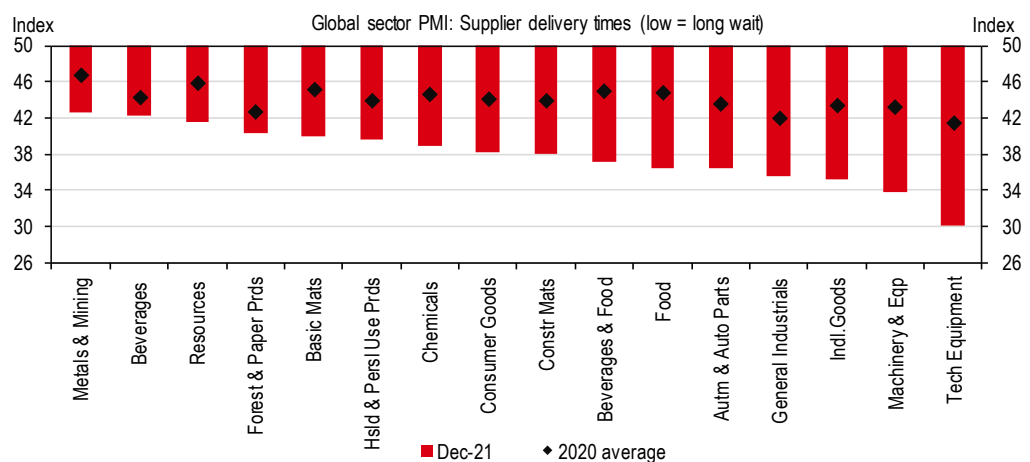
Source: US National Retail Federation. Note: *Estimate for November 2021. **Forecasts for December 2021 and January to May 2022.

Inventory replenishment and precautionary stockpiling to support goods trade

And as we have written about previously, some companies are looking to hold higher levels of inventory going forward to mitigate future supply chain disruption. However, there is a risk that this shift towards more of a Just-in-case manufacturing model could further increase competition for inputs that are already in short supply and potentially exacerbate existing supply chain disruptions.

The autos sector has been particularly impacted by input shortages and could therefore be one where production and trade could recover this year. However, robust semiconductor demand from non-autos sectors and increasing chips content in autos are likely to keep pressure on the semiconductor supply chain in the near-to-intermediate term (IHS Markit, December 2021).

16. Supplier delivery times remains stretched across key sectors



Source: IHS Markit

We expect bottlenecks to ease this year as movement restrictions lift

Risks to the outlook

Looking ahead, we expect goods trade bottlenecks to abate over the course of this year as lockdown restrictions lift, production backlogs clear and demand for pandemic-related products dwindles, while the easing of movement restrictions should help to support the recovery in services trade. However, there is still a lot of uncertainty around when exactly trade disruptions might start to ease, especially given renewed lockdown restrictions in some parts of the world and risks around the Omicron variant. Indeed, as Fred Neumann, Co-Head of Asian Economics Research points out, a rapid spread of Omicron across Asia risks leading to major production disruptions and might prove more disruptive than past waves.

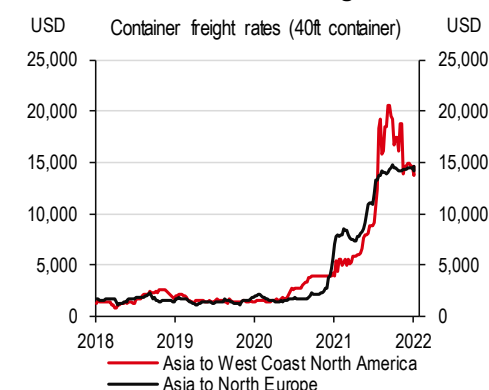
We see three potential scenarios for when trade disruptions might start to abate:

- ◆ Disruptions start to ease after Lunar New Year 2022
- ◆ Disruptions start to abate in H2 2022
- ◆ Disruptions show no signs of easing by end-2022

Overall, it is reasonable to expect some relief in logistics pressures after the Lunar New Year in February, with trade disruptions to start easing more broadly in H2 2022. Even then, however, it would still take many months for supply chains to normalise.

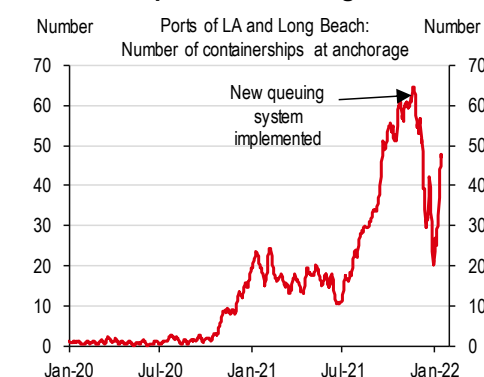
Already, spot container freight rates on Asia-North America routes have eased somewhat, while there are signs that supplier delivery times, although still stretched, are improving. However, US West Coast ports still remain heavily congested, with more containerships waiting further out to sea (rather than at anchorage or berth) due to a new queuing system implemented in mid-November 2021. On 16 January 2022, over 12,000 containers at the Port of Long Beach had been there for over nine days, while there were over 15,000 long-dwell containers (33% of total) at the Port of Los Angeles on 14 January 2022. On a positive note, the Port of LA has taken steps to speed up the clearing of cargo, with vessel productivity up around 70-80% compared to pre-COVID-19 times (CNN, 4 January 2022).

17. Container costs are starting to ease...



Source: Refinitiv Datastream

18. ...but US ports remain congested



Source: Refinitiv Eikon, HSBC. Note: 7-day moving average.

Mainland China's zero-COVID-19 policy risks disrupting supply chains

Mainland China also continues to maintain a very low tolerance for new COVID-19 cases, which could disrupt port operations and exacerbate congestion as key port terminals risk being shut suddenly to contain the virus. For instance, recent COVID-19 cases in the Beilun district, which borders three container terminals of the world's third largest container port – Ningbo-Zhoushan – has led to concerns that port operations could be disrupted if the virus spreads. Although port operations have been unaffected so far, forwarders are reportedly shifting volumes to Shanghai to avoid landside delays due to the suspension of some trucking and warehousing services (The Loadstar, 5 January 2022). In Shenzhen, testing of truckers and other workers' risks slowing down port operations.

Upcoming US West Coast port operator-labour union negotiations may also lead to further disruption later in the year, while economies such as the UK and US continue to grapple with truck driver shortages – an issue that has been building up for some time.

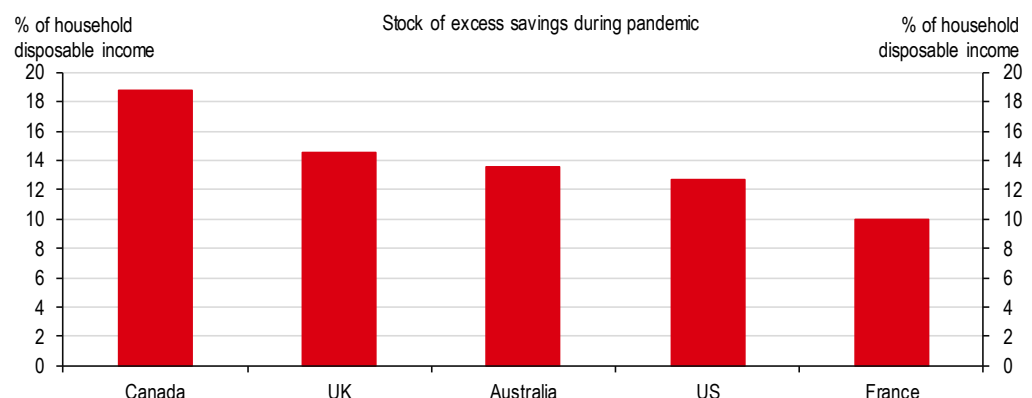
80,000

Estimated shortage of US truck drivers

Ongoing movement restrictions could also impede the rotation in consumer spending away from goods towards services, which would have implications for the rebound in services trade. Having said that, however, even if new pandemic-related restrictions lead to a resurgence in goods demand, we are unlikely to see the same strength in demand for certain products such as laptops and gaming consoles as we did in 2020, given consumers have already purchased these.

On the upside, households (mainly high-income) in developed economies have been saving more during the pandemic (Chart 19). Should these consumers draw down their accumulated stock of savings faster than anticipated, this could help provide support to trade flows, particularly in discretionary goods and services such as tourism.

19. Households in DMs have built up “excess savings” during the pandemic



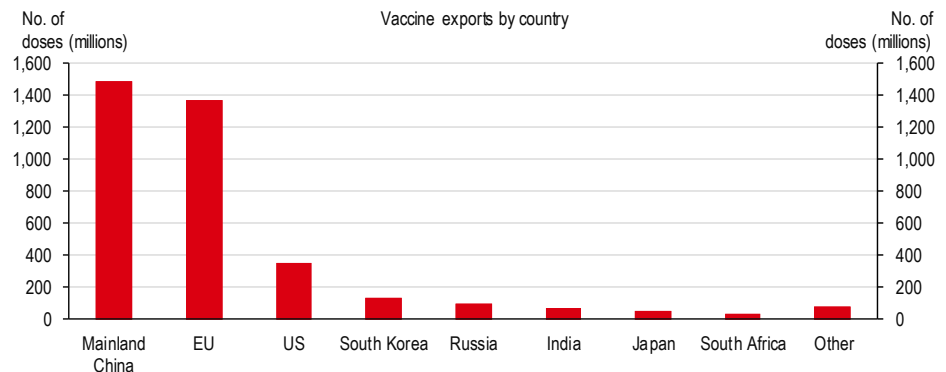
Source: OECD. Note: Excess savings based on the cumulative differences of the net household savings ratio over Q1 2020-Q2 2021 compared to 2019 average.

Trade in vaccines could help support goods trade flows

Trade in vaccines could also help to provide some support to goods trade flows going forward and will also be key in helping unlock border restrictions and in reviving international tourism. According to WTO data, mainland China, the EU and the US have been large exporters of COVID-19 vaccines, while India resumed its COVID-19 vaccine exports at the end of last year after a six-month hiatus (Charts 20 and 21).

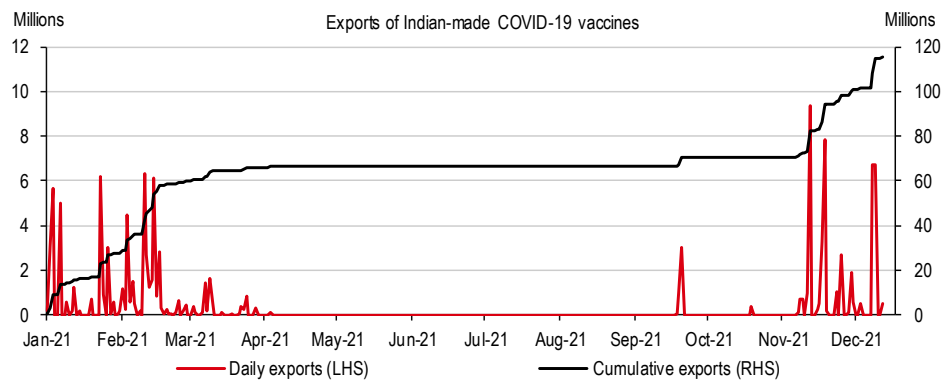
However, vaccine rollouts still remain uneven globally, with low income economies such as the African Union having procured enough supplies to vaccinate just 20% of its population. This compares to Canada, the UK and EU which have secured enough to vaccinate their populations more than three times over. The gap in vaccination rates between developed and emerging markets risks undermining the global economic (and trade) recovery and with that, the lifting of lockdown restrictions and the revival in global services exports.

20. Mainland China and the EU have been top exporters of COVID-19 vaccines...



Source: WTO

21. ...while India recently resumed its exports of the jabs

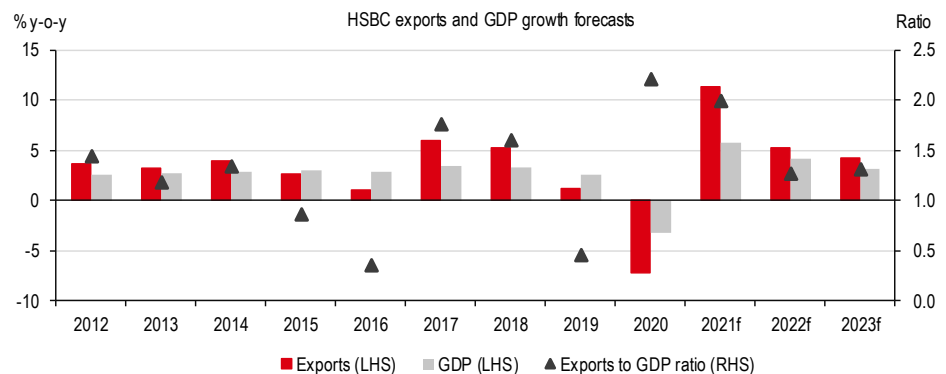


Source: India Ministry of External Affairs, HSBC

Trade forecasts

So what does this all mean for trade growth? HSBC global economists expect world exports of goods and services to grow y-o-y by 5.2% in 2022 and 4.2% in 2023 – around 1.3 times faster than GDP each year – and following estimated annual growth of 11.2% last.

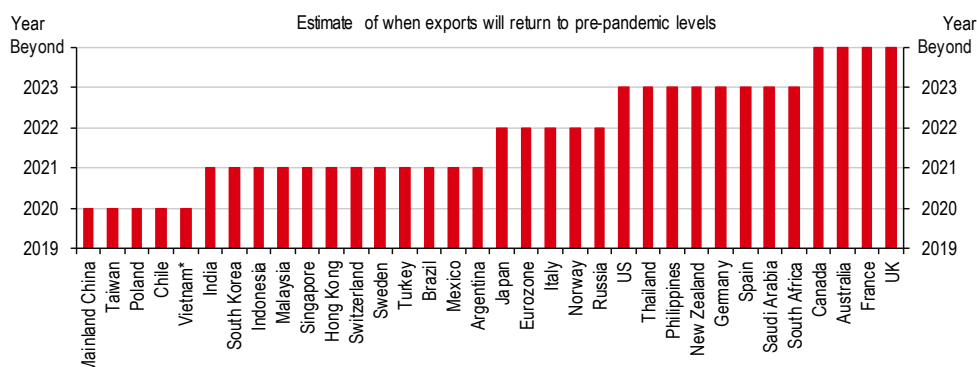
22. Global export growth looks set to outpace world GDP growth this year and next...



Source: HSBC

However, the recovery in global trade is likely to continue to be uneven. Based on forecasts by our country economists, exports of goods and services are only expected to return to pre-pandemic levels in 2023 for the US, Thailand and the Philippines and could take even longer for the likes of the UK, which has also been impacted by Brexit-related trade frictions, Australia and Canada. Some economies such as mainland China, India, Malaysia and Mexico have already reached their pre-pandemic export levels.

23. ...but it will take time for some economies to reach their pre-pandemic export levels



Source: HSBC. Note: Based on forecasts for real exports of goods and services for all economies except Vietnam. *Vietnam forecasts for nominal goods exports.

Trade policy outlook

Turning to trade policy, we take a look at five key themes that we expect to shape global trade in 2022 and beyond: 1) ongoing trade policy uncertainty related to US-China trade tensions and Brexit; 2) lack of reform at the WTO; 3) progress in new trade deals; 4) ESG issues in trade; and 5) efforts to shore up supply chains.

1. Trade policy uncertainty to continue in the US and Europe

US-China trade relations

We expect US-China trade tensions to persist over the course of this year barring any major breakthrough in bilateral talks. Although tit-for-tat tariffs are unlikely to escalate, the US government has not fundamentally changed how it approaches trade with mainland China compared with the previous administration. It still maintains a tough stance on trade with mainland China and, in line with the previous administration, has progressively tightened export and investment restrictions on a number of Chinese companies. However, the US government recently resumed a tariff exclusion process following a review of US-China trade relations.

So what might it take for the US to lift tariffs? Mainland China may have to make commitments in areas such as forced technology transfer, industrial subsidies, support to state-owned enterprises, and cross-border data transfer – issues that were not fully covered in the Phase One deal – for the US to drop its tariffs.

Brexit

In Europe, Ongoing Brexit trade tensions between the UK and EU are likely to persist this year over the Northern Ireland Protocol and outstanding negotiating areas (e.g. fish and financial services). There is a risk that the UK could trigger Article 16 to unilaterally dis-apply aspects of the Protocol if a solution on Northern Ireland trade is not agreed.

Although it has now been over one year since the end of the Brexit transition period, new UK-EU trading requirements are yet to be fully bedded in and as set out in Table 24, the UK will continue to phase in new customs requirements and border checks on EU goods, which could lead to more frictions for traders on both sides.

Europe-China

There is also a risk that EU-China tensions could escalate this year amid political tensions between mainland China and Lithuania. According to press reports, mainland China has informally banned imports from Lithuania, which is also impacting other EU businesses that have operations in Lithuania (FT, 13 January 2022).

At the same time, the European Commission recently proposed a new “anti-coercion” tool that would allow the EU to impose trade restrictions more easily in disputes with other economies. Although the tool still needs to be developed, it could pave the way for the EU to quickly levy countermeasures against economies such as mainland China in the future.

2. Lack of reform at the World Trade Organization

Progress at the World Trade Organization (WTO) remains slow as the long awaited Ministerial Conference was delayed indefinitely at the end of last year due to the spread of Omicron, somewhat reducing the impetus for members to urgently conclude outstanding negotiations. Although a new date for the Ministerial Conference, that was originally meant to take place in 2020, is yet to be determined, the organisation has proposed holding it in March 2022.

On a positive note, the delay does provide members with a bit more time to make progress in some negotiations. Already, 67 WTO members (including EU countries) – accounting for more than 90% of world services trade – managed to conclude negotiations on domestic regulation of services at the end of last year – which was the first set of new rules to come out of the WTO since 2015.

However, not much progress has been made on key issues. For example, the US continues to block appointments to the WTO's appeals court, the Appellate Body, and has given no indication that it is willing to shift its position any time soon. An outcome on vaccine intellectual property waivers also seems far off despite the US injecting some momentum into talks in 2021.

Therefore, we largely expect the WTO to continue on its existing track this year. And while there is a lot of talk about reforming the organisation, we are still waiting for the revival to get started. Armed with a new leader, there is certainly plenty of opportunities for the WTO to get its act together and show that it is serious about reform.

3. New trade deals set to advance

Regional Comprehensive Economic Partnership

Despite ongoing supply chain disruption, trade liberalisation has advanced along certain corridors and looks set to continue this year. In Asia, the mega-regional Regional Comprehensive Economic Partnership (RCEP) deal took effect on 1 January 2022 for 10 of its 15 members, and will take effect on 1 February 2022 for South Korea.

The deal will take effect for remaining members (Indonesia, Malaysia, Myanmar and Philippines,) 60 days after they complete their ratification processes. The accord also remains open for India to re-join at any point now that the deal has taken effect, although we do not expect India to do so without its previous concerns around limited services market access and liberal rules of origin provisions being addressed, which seems unlikely at this stage.

Other economies can also apply to accede to the agreement from 1 July 2023. Hong Kong has previously indicated interest in joining and is supported by mainland China, while Bangladesh's Trade and Tariff Commission has conducted preliminary analysis on the possible benefits of joining the deal and costs of remaining outside the agreement.

Indeed, by staying outside the deal, Bangladesh risks losing its competitive edge in apparel in RCEP members to the likes of Vietnam and Cambodia, which will benefit from preferential access under the agreement. Joining the deal could also help Bangladeshi exporters secure preferential market access in key RCEP markets as the economy is set to graduate from least developing country (LDC) status by 2026, meaning that it will lose duty-free access in Australia and New Zealand.

Sri Lanka could be another potential member, with its State Minister of Regional Cooperation having noted that Sri Lanka is pro-trade and “will explore all multilateral arrangements including the RCEP to explore what they can offer” (The Hindu, 19 November 2020).

CPTPP

We expect some progress to be made in the UK's plan to accede to the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) this year after it formally commenced negotiations with the bloc in September 2021. The CPTPP is currently in effect for eight out of its 11 members: Australia, Canada, Japan, Mexico, New Zealand, Singapore, Vietnam and Peru. The UK is aiming to wrap up negotiations with the trade grouping by the end of 2022, which we think could be feasible given the UK will largely be signing up to the existing terms of the deal and notwithstanding any new red lines from either side.

Mainland China and Taiwan also applied to join the CPTPP in 2021 but these accession processes are likely to take some time and candidates will need to demonstrate that they can meet the bloc's high standards. Beyond these economies, a successful UK accession to the deal could also pave the way for other economies including Thailand, Colombia, South Korea and Philippines to look to join.

Other UK trade deals

In addition to acceding to the CPTPP, the UK could also finalise its bilateral deals with Australia (signed in December 2021) and New Zealand this year. The UK still needs to finalise the text of its deal with New Zealand before it can be signed, while the UK-Australia agreement could take effect in July 2022.

The UK also launched FTA negotiations with India on 13 January 2022 and may commence trade talks with the Gulf Cooperation Council (GCC) this year. The UK has already struck an Enhanced Trade Partnership with India and intends to build on this in a new trade deal. We have previously noted that future UK-India FTA talks are likely to focus on goods and services market access, digital trade and the movement of people between jurisdictions.

The UK-GCC Joint Trade and Investment Review that concluded in June 2021 suggests that parties might be particularly interested in expanding market access in the following sectors as part of future trade talks: professional and business services; agriculture, food and drink; education; healthcare and life sciences; financial services; and environmental green technologies and renewable energy.

UK-US trade deal

On the other hand, we don't expect much progress to be made on a UK-US trade deal this year. The last round of bilateral negotiations took place in December 2020 and striking new trade deals have largely taken a backseat since then. The UK and US are also yet to resolve a spat over additional US tariffs imposed on steel and aluminium imports from various economies, including from the UK.

Although the US recently agreed a deal with the EU on steel (essentially replacing tariffs with a tariff rate quota) and started talks with Japan in December 2021 on the issue, the UK has not been able to secure its own agreement with the US reportedly due to ongoing UK-EU trade tensions over the Northern Ireland Protocol (FT, 1 December 2021). Therefore, there is a risk that UK-US talks may not progress until UK-EU negotiations over Northern Ireland trade are resolved, which could take some time.

Other trade deals

Elsewhere, the EU is also looking to strike trade deals with Africa, Chile, Australia and New Zealand, and finalise its deal with Mercosur. However, EU trade talks are only likely to progress after French presidential elections in April 2022, although progress towards an Australia deal could take longer given France-Australia tensions over the Australia-UK-US security partnership.

In addition to its prospective deal with the UK, India is also hoping to strike a number of "early harvest" deals with the UAE (aiming for March 2022), GCC, Australia, Canada and the EU. These are likely to be smaller trade deals that can be completed quickly, seek to liberalise tariffs on a certain number of goods, and act as a precursor to more comprehensive trade agreements.

Economies set to increasingly tackle ESG issues via trade policy

Given India has not been as prolific as some of its neighbours in striking new trade deals in recent years, these new efforts could help the economy meaningfully reengage in trade liberalisation. However, striking smaller trade deals may not be enough to offset the economic impact for India of leaving RCEP and much will depend on how comprehensive its new deals are and how quickly they can be concluded.

4. ESG to feature more prominently in trade policy

We expect advanced economies to take a more assertive stance this year in tackling ESG issues via trade policy. As we have written about previously, trade and environmental issues are inextricably linked but environmental or sustainability goals have only recently begun to feature more prominently in trade policy.

For example, there could be more progress on the EU's proposal to implement a Carbon Border Adjustment Mechanism. France, which holds the EU presidency for the first half of this year, is keen to broker an early deal on carbon border taxes, while the UK is also reportedly considering implementing a similar mechanism but is reluctant to proceed without international cooperation (Politico, 23 December 2021). Any border levy on high-carbon imports would need to be WTO compliant.

The European Commission will also continue working on an EU-wide proposal to mandate human rights and environmental due diligence in supply chains this year, which would hold companies accountable for ESG issues in their production chain and could change where businesses source their products from. But drafting such rules is complex and economies such as France, Germany and Norway have already pressed ahead with their own national legislation on this issue. According to Politico, there are challenges around "how to enforce the rules, how to hold companies liable, and which types of businesses would have to comply with the future due diligence obligations" (Politico, 9 December 2021). There is also a risk that such rules could push up costs for businesses and may leave EU-based companies at a competitive disadvantage compared to foreign businesses.

In addition, it is likely that Western economies will continue to take actions against Chinese businesses and trade over concerns around forced labour. For example, the US has already moved to ban imports from Xinjiang over labour rights concerns and there are reports that the UK could follow suit (Politico, 20 December 2021). There are also calls by EU lawmakers for the bloc to do the same, although EU Trade Commissioner Valdis Dombrovskis thinks it would be more effective to include such a ban in its due diligence rules – essentially putting the onus on businesses to monitor their supply chains.

5. Efforts to shore up supply chains will continue but risk being protectionist

Governments and companies are likely to continue to take steps to build resilience in their supply chains in the wake of the pandemic in 2022. There are a range of measures that can be taken including diversifying trade, nearshoring, vertical integration and using digital technologies to help build resilient supply chains.

Already, the US, India and Japan have announced policies to boost domestic manufacturing capacity in key sectors and we expect other economies to follow suit. For example, the US conducted a review of critical supply chains (semiconductors, advanced batteries, critical minerals, pharmaceuticals) in June 2021 and set up a Task Force, among other proposed actions, to help address near-term supply-demand imbalances in these sectors.

Longer-term, the review recommended that the US:

- ◆ Provide dedicated funding for domestic chips manufacturing and R&D
- ◆ Provided funding and financial incentives to spur consumer adoption of US-made electric vehicles (EVs)
- ◆ Provide financing to support domestic manufacturing of advanced technology vehicle battery cells
- ◆ Increase funding of advanced manufacturing technologies to increase production of key pharmaceuticals and ingredients

In Europe, the European Commission intends to propose a European Chips Act in 2022 that will aim to secure the EU's supply of chips and encourage innovation, while India previously announced USD1.3bn in funding to reduce its dependence on Chinese active pharmaceutical ingredients (APIs).

However, there is a risk that such policies to strengthen domestic production capacity could be regarded as protectionist and could lead to retaliatory actions by trading partners. For example, Canada and Mexico have threatened to retaliate, potentially with tariffs on US goods, if the US government proceeds with its plan to provide tax credits for US-made electric vehicles – though this is currently tied up in the Build Back Better Bill, which is yet to be passed. The EU, Japan and South Korea have also voiced concerns about the proposal.

Therefore, this year is shaping up to be a constructive one for trade although uncertainty persists around when exactly supply chain bottlenecks will abate and key trade policy issues.

Disclosure appendix

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