

TRADE FORECAST REPORT

GERMANY



2H 2015

HSBC 

GERMANY : IN BRIEF

- German firms remain positive about the outlook in spite of problems in major emerging markets, which have provided such great growth opportunities in recent years. Recovery in advanced economies will boost demand for German capital and consumer goods.
- Over the long term, we expect Germany's import and export bases to become more diversified geographically, with South and South East Asian countries taking an increasing share of the German market.
- Specialisms in industrial machinery and transport equipment have served Germany well in recent years, and we expect this to continue. Wobbles in emerging markets do not undermine the longer-term path of rising consumer incomes and increasingly sophisticated manufacturing in these economies – trends Germany is well placed to support.

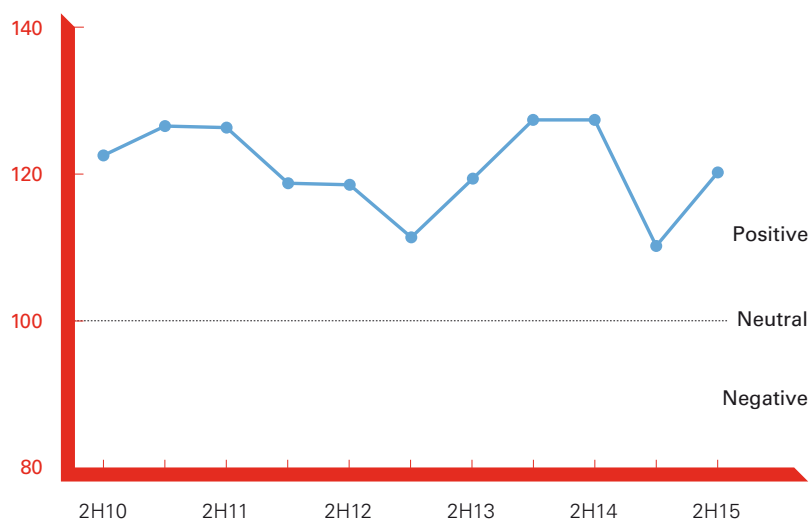
Competitive and innovative manufacturing firms have enabled Germany to ride out the Eurozone crisis by expanding into new markets. In the near term, the slowdown in emergers should be offset by recovery in advanced economies. So while exporters are concerned about weaker growth in Asia, they remain positive overall. Over the longer run the shrinking working age population poses a risk to trade growth.

SHORT TERM SNAPSHOT

HSBC TRADE CONFIDENCE

On balance German firms became more optimistic over the past six months – the proportion expecting the global economy to boost their trade remained broadly stable at around 70%, but within this a growing proportion (21% versus 3% in our last survey) expected a “strong” positive impact. Perhaps as a result of cheaper energy and a weaker Euro, the proportion worried about tougher competition fell from 70% six months ago to just 20% in 2015 H2.

TRADE CONFIDENCE SCORE



Source: HSBC TCS data

The slowdown in China and problems in MENA are clearly affecting German firms' export success – the proportion exporting to Asia fell by 25% points (from over 70% and to just 20% for MENA (down from 50%). In addition, the positive impact of the Euro depreciation seems to have worn off, with only 25% reporting that favourable exchange rates would be a major factor to boost international business over the next six months, compared to three quarters in our last survey. That said, advanced economies continue to provide a source of demand growth for German firms, with the proportions exporting to Europe and North America stable.

German firms seem keener to sustain progress in improving the bottom line than those in other major European economies. The proportions reporting that they were seeking to grow revenue or reduce costs fell notably, as elsewhere, but remained above 50% in both cases. Moreover, German firms are increasingly worried about financial risk, with the proportion citing worries about payment default, suppliers failing to honour commitments, and the cost of borrowing all rising by a few percentage points.

LONG TERM OUTLOOK

ECONOMIC OUTLOOK

Germany's economy has led the Eurozone's recovery, thanks in large part to its deepening trade links with China over recent years. Even though China's economy is now slowing somewhat, the payoff for Germany has been a strengthening labour market and ever-firmer domestic demand. As such, although Germany is well-placed in the near-term to benefit from the weaker Euro, the recovery is now largely dependent on domestic demand and rising wages and spending.

Looking beyond the near term though there are serious constraints on growth. Chief amongst these is Germany's deteriorating demographic profile – the working age population will peak in 2017 and fall every year thereafter. Barring a step-change in productivity this will mean annual GDP growth falls from close to 1.5% per annum in 2015-2017 to just over 1% in the longer run. This has clear implications for the economy's potential export capacity, as well as the growth of household spending and imports.

That said, Germany's manufacturers have long been envied by other countries for their ability to innovate. For example, the integration of countries in Central and Eastern Europe into Germany's supply chain over recent years has allowed German firms indirect access to low-cost labour. Further progress in this respect, or in using physical capital in place of labour, could allow Germany to sustain more robust export and import growth than in our forecast. Barring such achievements though, it seems likely German firms will increasingly outsource production outright, focussing only on the highest-value added parts of the value chain in Germany itself.

EXPORT CORRIDORS TO WATCH

Germany's industrial specialisations are unlikely to change much over the coming couple of decades, with industrial machinery, transport equipment, chemicals & pharmaceuticals accounting for the top four shares of exports in both 2014 and in 2030. Industrial machinery is forecast to grow by almost 6% per annum to 2020, accounting for over half the total growth in German goods exports by value over this period. Chemicals & pharmaceuticals and transport equipment will grow by around 4% per annum to 2020, contributing an additional 43% of total export growth over this timeline. Over the longer run a similar composition of export growth will prevail, with these top three categories contributing around 70% of total growth between 2021 and 2030.

SECTOR CONTRIBUTION TO INCREASE IN EXPORTS



Source: Oxford Economics

Despite near-term concerns over the slowdown of growth in China, we expect China to regain its position as Germany's fastest growing export market over the medium term (amongst the 24 trade partners in the HSBC Trade Forecast), with annual growth averaging 8% per annum between 2021 and 2030. This will result in China overtaking France as Germany's top export destination by 2030. Ongoing integration between Germany's manufacturing sector and supply chains in Central Europe means Poland will remain Germany's 5th biggest export partner, with France, UK and USA making up the top 5. Amongst high-income economies, exports to Canada will grow fastest, by an average of 5% a year from 2021-2030.

TOP 5 HOTLIST EXPORT DESTINATIONS

Rank	2014	2030
1	France	China
2	UK	France
3	USA	UK
4	China	USA
5	Poland	Poland

*Ranking among the 24 trade partners covered in the HSBC Trade Forecast

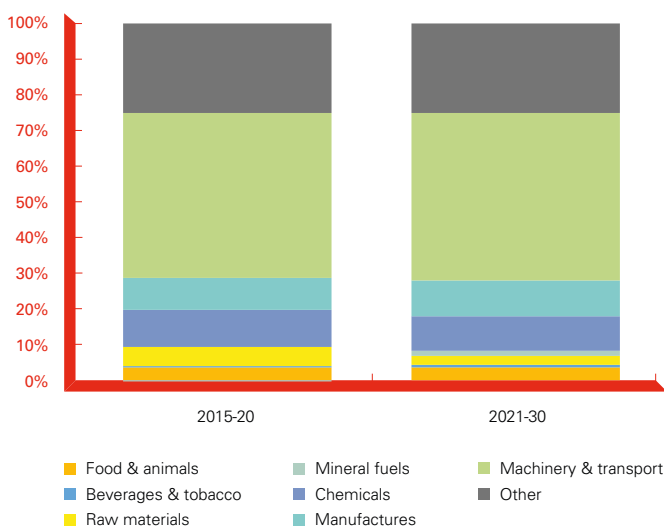


IMPORT CORRIDORS TO WATCH

Germany's imports tend to be focussed around similar high-tech and research-intensive products that it exports. In part, this reflects cross-border supply chains and cooperation initiatives with companies in other European countries in certain markets involving critical mass, such as the automotive and aerospace sectors. Overall, industrial machinery and transport equipment are expected to contribute around 38% of the projected growth in Germany's imports in 2015-30.

Other inputs to Germany's manufacturing sector, such as scientific apparatus and minerals manufactures will continue to provide a key part of the economy's import growth – 6-7pp each from 2015-2020, with some easing in the share for scientific apparatus over the longer term. Imports to support business services and retail activity (ICT equipment and clothing/apparel respectively) will each contribute 9-10% of total growth in both the near and longer-term.

SECTOR CONTRIBUTION TO INCREASE IN IMPORTS



Source: Oxford Economics

With annual growth in imports from China of 4% from 2015-2020 and 7% over the longer run, China will be Germany's top source of imports by 2030 (amongst the 24 trade partners in the HSBC Trade Forecast). Other high-growth import sources are Bangladesh, Vietnam and India – 7-8% per annum in each case over the long run, reflecting these countries' comparative advantage in clothing and apparel trade. In Europe, the fastest growing sources of Germany's imports are likely to be Ireland and Poland, reflecting these economies' advantage in low-cost manufacturing (relative to other EU economies). Nevertheless, in spite of not being amongst the ten fastest growing source of imports into Germany over the long run, France is set to remain the second largest source by 2030, given the high degree of integration between the two economies.

TOP 5 HOTLIST IMPORT ORIGINS

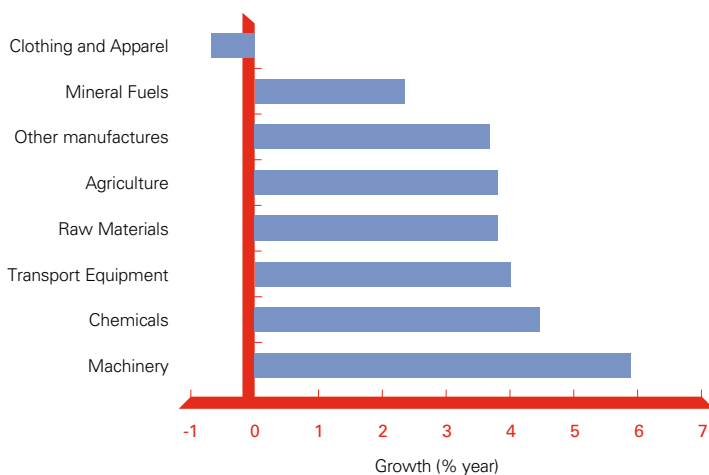
Rank	2014	2030
1	China	China
2	Singapore	USA
3	USA	Singapore
4	Japan	Korea
5	Korea	Japan

*Ranking among the 24 trade partners covered in the HSBC Trade Forecast

DRIVERS OF RECOVERY

- German exports over the coming few years will benefit from the confluence of ongoing recovery in advanced economies, a weaker Euro as ECB and Federal Reserve policies increasingly diverge, and the competitiveness boost of lower global energy costs. Overall, we expect the value of German merchandise exports to gradually accelerate from around 1.5% in 2016 towards 5% by 2018-20.
- Recovery in advanced economies is a key driver of German export success given the country's global lead in capital goods and machine tools, which will be increasingly in demand as firms in other economies increase their investment expenditure. Germany has benefited substantially from the investment boom in China over recent years, providing machinery to facilitate housing construction and factory expansion, and with China's growth rate slowing the ongoing recovery in advanced economies comes at exactly the right time.
- Alongside this, exchange rate movements are likely to be supportive of German competitiveness in global markets for these types of goods. Although the euro is expected to appreciate modestly in the quarters ahead, at \$1.10 in 2016Q3, it will remain around 20% weaker than two years previously. This will aid German exporters in US markets, as well as in other economies whose currencies are pegged to the dollar (such as Hong Kong and the Middle East).
- Finally, global demand for energy intensive goods such as industrial machinery and transport equipment should be supported looking forward by lower energy costs than might have been anticipated relatively recently. Given its specialisations in these sectors, Germany will be well-placed to benefit.

EXPORTS BY SECTOR



Source: Oxford Economics

WE EXPECT THE
VALUE OF GERMAN
MERCHANDISE EXPORTS
TO GRADUALLY
ACCELERATE FROM
AROUND 1.5%
IN 2016 TOWARDS

5%

BY 2018-20

ABOUT THE HSBC TRADE FORECAST

The Trade Confidence Survey (TCS) is a quantitative indicator of the short-term outlook for global trade. The survey is the largest of its kind, and conducted on behalf of HSBC by TNS. Over 6,300 businesses globally – from small and mid-market to large corporations – are interviewed about their expectations towards global trade and business growth over the next six months.

In 2H15, the survey data collection method changed to online in 11 markets: Australia, Brazil, China, France, Germany, Hong Kong, Mexico, Poland, Singapore, UK, and USA. The past data has been calibrated to account for this change and to preserve the trends.

Oxford Economics has tailored a unique service for HSBC which forecasts bilateral trade in goods, based on HSBC's own analysis and forecasts of the world economy. A top-down approach is employed, with Oxford Economics' suite of models used to ensure consistency between HSBC's forecasts for economic growth and exchange rates in key countries and the more granular projections for bilateral trade flows presented here.

Oxford Economics employs a global modelling framework, with headline bilateral trade forecasts constructed as a function of final demand in the destination market and the exporter's

competitiveness (as measured by relative unit labour costs). Exports, imports and trade balances are identified, with both historical estimates and forecasts for the periods 2015-20 and 2021-30.

These headline bilateral trade forecasts are also disaggregated by sector, using Oxford Economics' Industry forecasts to inform future production trends. Sectors are classified according to the UN's Standard International Trade Classifications (SITC) system at the two-digit level and grouped into 30 sector headings.

Oxford Economics produces a global report for HSBC, as well as country specific reports on the following 23 countries: Hong Kong, China, Australia, Indonesia, Malaysia, India, Singapore, Vietnam, Bangladesh, Canada, USA, Brazil, Mexico, Argentina, UK, France, Turkey, Germany, Poland, Ireland, UAE, Saudi Arabia, and Egypt. The analysis also includes trade with Japan and Korea for a total sample of 25 key trading nations.

All trade flows data are reported in nominal US-dollar value terms (using market exchange rates) unless otherwise specified. This means that fluctuations in a country's terms-of-trade due to relative price and exchange rate effects are reflected in the data.