TRADE FORECAST REPORT
GLOBAL

2H 2015

HSBC

GLOBAL: IN BRIEF

- The global Trade Confidence Score fell to 120 in H2 2015 from 124 six months earlier[1], signalling that businesses are less confident - though still positive - regarding near-term trade prospects. A majority of respondents (64%) expect trade volumes to increase over the next six months.
- The weakness of global trade this year is linked in part to the downturn in industrial production in China and the knock-on effects to supply chains and general demand. But a stabilisation of conditions in China should reduce the drag on global trade from weaker demand and lay the foundations for a moderate recovery in global trade growth from next year.
- The economies of Asia are expected to be the main drivers of global trade growth over the medium term, with 'south-south' flows representing the fastest-growing trade corridors.

World trade growth has slowed sharply this year, with import volumes in leading emerging markets, such as China, Brazil and Russia, especially weak. The recent downturn appears more cyclical than structural in nature, giving reason for optimism that a stabilisation of economic conditions in these economies should lay the foundations for a moderate recovery in global trade growth from 2016. Despite the near-term challenges facing emerging markets, many of these economies benefit from strong economic fundamentals, meaning they are likely to be an important driver of global economic growth and trade over the medium term.

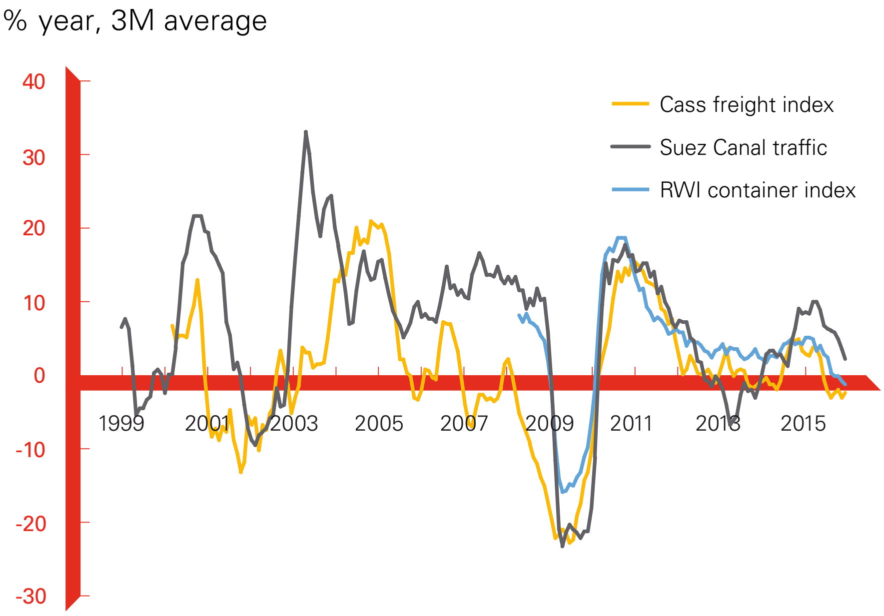
[1]The Trade Confidence Score (TCS) is a composite index, constructed as an average of seven sub-indices measuring respondents' viewpoints regarding different aspects of the outlook for trade over the next six months. A score above the 100 threshold indicates sentiment is positive regarding the outlook for the next six months, whilst a score below 100 indicates a downturn in confidence.

SHORT TERM SNAPSHOT

The performance of world trade has been a big disappointment this year. Merchandise trade growth slowed abruptly in the first half of 2015 and we now expect that it will expand by just 1% in volume terms over the year as a whole, down from 3.1% in 2014. The recent weakness of goods trade looks even worse when expressed in US dollar value terms, due to falling prices for key commodities and the further strong appreciation of the US dollar – we expect a contraction of roughly 13% in 2015 on this basis.

Although the latest quarter for which we have largely complete world trade data is Q2 2015, timelier high frequency data indicate that subdued conditions persist in the second half of this year. For example, the US Cass freight Index was down 2.4% on the year in September (based on a 3-month moving average) and the RWI/ISL container trade index (which is based on data from 75 ports, covering around 60% of worldwide container traffic), showed container throughput was down by 1.1% over the same period. Meanwhile, growth in traffic through the Suez Canal slowed sharply to 2.3% in the year to September from an annual rate of 10% at the start of this year.

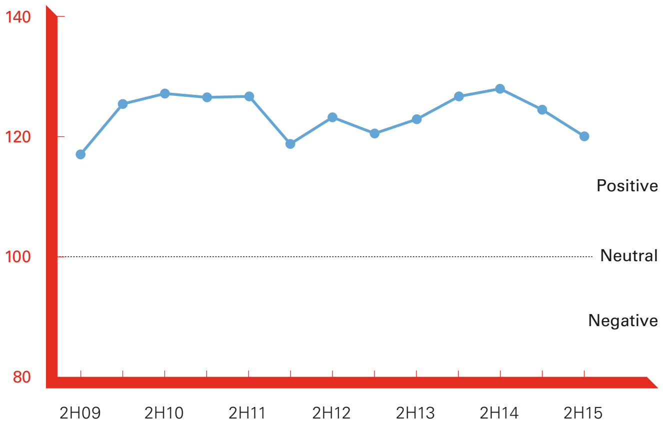
WORLD: ALTERNATIVE TRADE INDICATORS



Source: Oxford Economics/Haver Analytics

This slowdown in trading activity is also reflected in the global Trade Confidence Score (TCS), which fell to 120 in H2 2015 from 124 six months earlier. Though still in positive territory, the indicator is signalling more subdued levels of confidence regarding near-term trade prospects among businesses across the world. Although the majority of respondents (64%) expect trade volumes to increase over the next six months, the share is 11 percentage points lower than in H1 2015.

WORLD: TRADE CONFIDENCE SCORE



Source: HSBC TCS data

With the pre-crisis average pace of growth in the volume of merchandise trade around 6-7% a year (equating to 9% a year in US dollar value terms), this recent subdued performance is more consistent with periods of global recession than periods of recovery. Excluding the global financial crisis year of 2009, the last time growth in world trade volumes dipped below 2% was in the 'dotcom bust' period of 2001. Even in the early 1990s recession, world trade growth was stronger than it is at present.

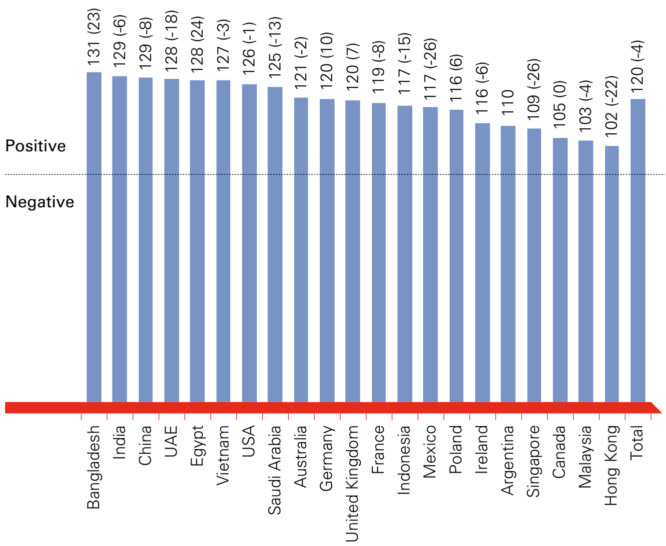
Previous editions of the HSBC Trade Forecast have highlighted how the weakness of world trade over recent years has both cyclical and structural elements. On the cyclical side, these include the slow recoveries of key world economies from the global financial crisis and characterised in many countries by a weak pace of investment; on the structural side, lack of progress in trade liberalisation, rising shares of services in the world economy and the maturing of global supply chains may have altered the ratio of world trade growth/GDP growth. Although structural elements remain a drag on growth, cyclical elements currently appear more prominent, relating especially to developments in emerging markets.

One key factor dragging down world trade growth this year is the weakness of merchandise imports in leading emerging markets. For example, we estimate that import volumes in China will contract by around 6% in 2015 as a whole, while Brazilian imports will contract by close to 8% and Russian imports will fall by a startling 26%. In fact, the drag on world trade from emerging markets this year looks comparable to that seen in 1998 and 2001. In contrast, we expect import volumes in the US and Western Europe to expand by around 5-6% this year, helping to hold up world trade.

This view was also reflected in our TCS survey, as less than a third of respondents (32%) now view Asia as having the best opportunities for trade expansion in the next six months, down from 39% in H1 2015 and 40% a year ago. Meanwhile, developed markets have gained favour, with 30% of respondents identifying Europe as having the best prospects (up from 25% in H1) and 17% choosing North America (up from 15% in H1).

At the country level, there was a general improvement in sentiment amongst the developed economies, with Germany and the UK posting solid gains. The sharpest declines in sentiment occurred in emerging markets, with Singapore and Hong Kong suffering the largest declines of more than 20 points, reflecting the heightened exposure of these trading hubs to the effects of a slowdown of regional trade in Asia. On the other hand, Bangladesh also stood out amongst emerging markets with a very strong 23-point jump in its TCS to a level of 131, representing the highest score in our sample. The upturn in sentiment in Bangladesh appears to reflect the recovery of demand for clothing & apparel in key Western markets.

TRADE CONFIDENCE SCORE



Source: HSBC TCS data

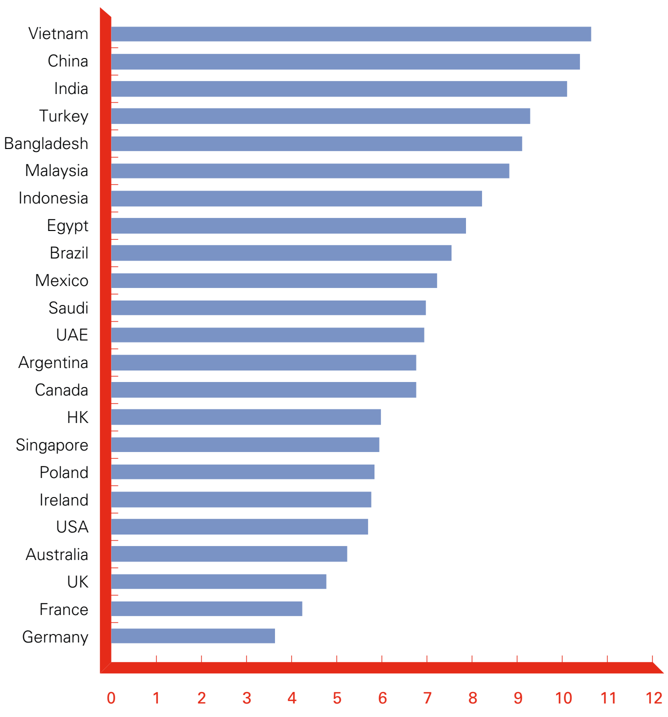
On a positive note, over half of respondents (52%) reported that exchange rate movements would have a favourable impact on trade volumes, compared to just 26% a year ago. This likely reflects the boost to export competitiveness of the further sharp appreciation of the US dollar over the past year, given that 55% of respondents report the US dollar as being their main trade settlement currency. Respondents also reported that credit conditions had eased, with 48% of respondents reporting an improvement in their capacity to access trade finance over the next six months, compared to just 9% who reported a decline in their ability to access trade finance.

LONG TERM OUTLOOK

TRADE CORRIDORS TO WATCH

Despite the near-term challenges facing emerging markets, these economies benefit from strong economic fundamentals linked to generally favourable demographics and continued scope for further convergence toward income levels in the West. Longer-term development patterns in these countries are therefore likely to be an important driver of global economic growth and trade over the coming decades. Over the medium term, we expect the economies of Asia to see the fastest growth in merchandise exports, with India and Vietnam averaging over 10% annual growth in US dollar value terms over the period 2021-30, and China not far behind. Goods exports from the advanced European economies of the UK, France and Germany are forecast to expand more slowly, at around 3-4% a year, while the USA is set for trade growth to average around 6% a year.

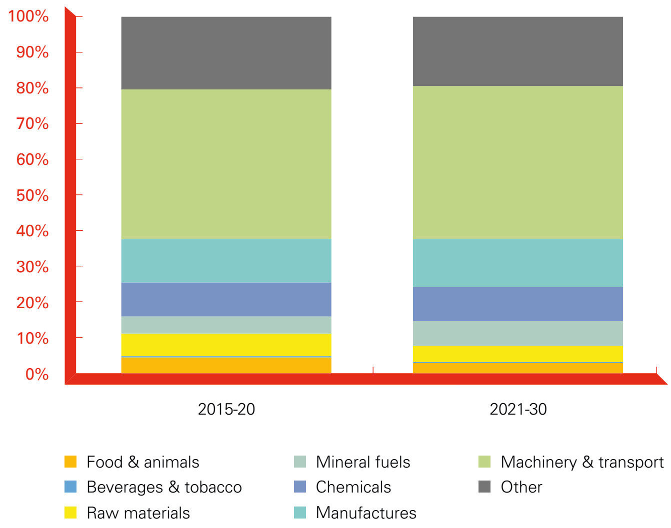
GROWTH IN MERCHANDISE EXPORTS, 2021-2030



Source: Oxford Economics

As the emerging market economies of Asia mature and their middle class expands, these economies will also become the fastest-growing source of final demand in the global economy. This will strengthen so-called 'south-south' trade corridors, as trade between emerging markets expands rapidly, a process that we expect to be facilitated by renewed progress on regional trade agreements over the coming decade as well as initiatives such as China's One Belt, One Road project and the Asian Infrastructure Development Bank (AIIB).

SECTOR CONTRIBUTION TO INCREASE IN TRADE



Source: Oxford Economics

By far the largest contribution to the projected growth in traded goods will come from machinery and transport equipment, reflecting the ongoing evolution of global supply chains and strong final demand for both consumer and capital goods from emerging Asia. Increased spending on infrastructure projects throughout Asia will provide an opportunity for countries able to supply these investment goods, particularly for Germany and other developed economies. But this market will become increasingly competitive as emerging economies develop their technical expertise, underscoring the need for industrialised economies to focus on maintaining their competitive advantage in research-intensive, high-technology products.

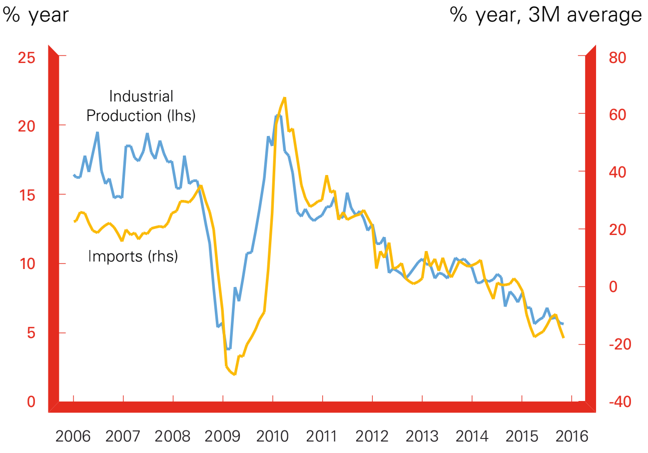
DRIVERS OF RECOVERY

The recent downturn in global trade appears to be linked in part to the slowdown in China's manufacturing output and consequent decline in commodity prices. Although current conditions may be conducive to pessimism regarding the outlook, we believe a cyclical stabilisation in China will reduce negative spillovers to trade in coming months. A recovery in trade growth may therefore be just around the corner.

CHINA'S ECONOMY IS STABILISING...

Although the current environment may be conducive to ongoing pessimism regarding the outlook for global trade, we believe that a cyclical recovery will unfold over the next few years, allowing growth to gradually climb back towards its long-term average pace. With the performance of China being a key determinant of the pace of trade in the world, our projections in part reflect evidence of a cyclical stabilisation in the Chinese economy. This follows the negative growth shock to manufacturing output earlier this year, which had negative knock-on effects for supply chains in the regions as well as commodity prices and has likely been a major driver of the recent downturn in world trade.

CHINA: INDUSTRIAL PRODUCTION AND IMPORTS



Source: Oxford Economics/Haver Analytics

While China's structural slowdown and rebalancing is not complete, monetary and fiscal policy stimulus should gain traction in coming months and reinforce the cyclical recovery in property. There is also now a substantial infrastructure project pipeline, as the government has expedited project approvals, recapitalised policy banks and improved local government funding. This will feed into higher investment growth over the coming year.

... AS INCREASED POLICY STIMULUS SUPPORTS DEMAND

Investment spending has a higher import component than consumer spending, so this should help to support renewed moderate growth in Chinese import volumes, reducing the drag on global trade from weaker demand. But China's excess capacity in sectors such as steel, autos and ship production will take longer to adjust, implying continued downward pressure on exports from regional competitors in these sectors for the next couple years at least.

Stabilisation and renewed moderate growth in China's manufacturing sector is also unlikely to be sufficient to drive a rapid upturn for commodity exporters. Resource-rich economies therefore face a more extended adjustment to the decline in their terms of trade and excess capacity generated by the preceding commodity boom. Demand for commodities will only rise slowly to meet this capacity, but we do think commodity prices will eventually recover some of their recent losses – for example, we anticipate that oil prices will pick up from current levels of around US$50 per barrel to around US$70 per barrel by 2019/20.

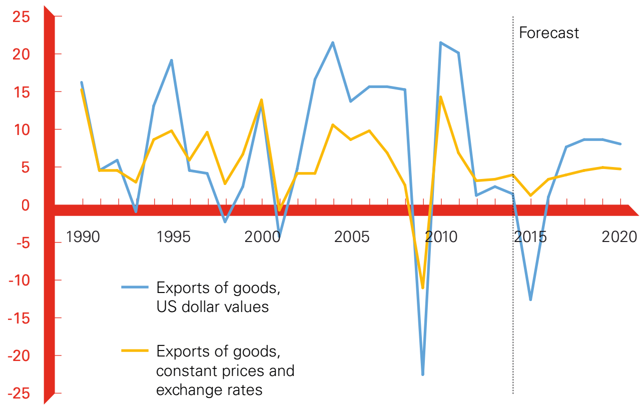
TRADE FLOWS TO ACCELERATE OVER THE NEXT FEW YEARS

In developed markets, the negative shock emanating from China and emerging markets this year has been largely offset by domestic policy stimulus and lower bond yields. The US and Eurozone should continue to support world trade over the next couple years, as our forecasts look for GDP growth in both economies to continue to expand at a similar pace in 2016-17. Specifically, the pick-up in investment growth in the US and in the three largest Eurozone economies through 2016 should spur demand and trade in capital goods sectors. Meanwhile consumer spending in the developed economies should grow at broadly similar rates in 2016 versus 2015, underpinning trade growth in consumer sectors.

These factors contribute to our expectation that growth in global merchandise trade volumes will recover to around 3% in 2016, with growth picking up further to 5% a year by 2018-20. In US dollar value terms, we expect positive growth of around 1% next year (a further modest appreciation of the US dollar exchange rate will dampen values), with growth accelerating toward 8% a year by 2018-20.

WORLD MERCHANDISE EXPORTS

Annual % changes



Source: Oxford Economics/Haver Analytics

At the product level, we expect cyclical sectors such as transport equipment to be the greatest beneficiaries of the upturn in the near term as is detailed overleaf, although intermediate inputs such as chemicals and machinery will increasingly benefit as global investment strengthens. The projected recovery in commodity prices should also support trade in raw materials and mineral fuels in value terms.

THERE REMAIN DOWNSIDE RISKS TO THE OUTLOOK…

Of course, the projected recovery in world trade growth is still subject to significant downside risks, as underscored by the disappointing performance of the past few years. Key risks include the possibility that a cyclical rebound in China's manufacturing sector will take longer than expected to materialise, the potential for demand in the US and Europe to soften, or the possibility that political or social strains in emerging markets could complicate their macro-economic adjustment. However, we believe that these recent setbacks will in hindsight prove to have been temporary obstacles in the broader context of a longer-term trend towards increasing globalisation, communication and travel.

… BUT THERE COULD ALSO BE UPSIDE GAINS FROM TRADE LIBERALISATION

As the cyclical recovery of trade unfolds, we also expect that some of the structural impediments to growth will begin to recede, as trade liberalisation efforts gain traction. These policy moves hold the potential to provide an upside surprise to the performance of global trade.

Notable progress in this regard includes the recent expansion of the WTO's Information Technology Agreement (ITA). The original ITA agreement guarantees zero-tariff and duty-free trade in around 250 electronics products, but the second phase of the agreement has added a further 200 products, covering global trade flows worth around $1.4 trillion.

Further reason for optimism on trade liberalisation efforts came with the agreement on the Trans-Pacific Partnership (TPP). This is the largest new trade agreement in 20 years, covering 40% of the global economy. The deal still needs to be ratified by the 12 participating nations, but it promises to provide a significant boost to trade flows by eliminating tariffs on most products as well as lowering non-tariff barriers to trade.

And there are also a number of other important agreements that are making progress, including the WTO's Trade Facilitation Agreement (which seeks to simplify customs procedures and is now out for ratification) and the Transatlantic Trade and Investment Partnership (a proposed free trade agreement between the EU and the US). These deals offer the hope of unleashing large gains in trade flows for the participating countries.

BEYOND MERCHANDISE GOODS TO SERVICES

These agreements are pertinent not only for visible trade, but increasingly for services also. Trade in services fell less sharply than trade in goods through the course of the global crisis and has grown more robustly in recent years. In the US, services imports in 2015Q2 were 14% higher than their pre-crisis peak, compared to 10% in the case of goods. Moreover, with the difficulties in measuring the cost of services, growth in volumes may well be higher than official statistics show. Looking ahead, we expect the ongoing integration of global services markets to support further trade in goods – particularly in the ICT sector that facilitates global communication.

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.