Navigator

Now, next and how for business

China report

Mainland China

Domestic upgrading will enhance trade

China's share of global merchandise trade will keep expanding along with the country's productivity. Services will gain importance in the export mix as workforce skills and digital infrastructure improve. As Beijing emphasizes innovation, the environment, the Made in China 2025 initiative, and moving up the value chain, the composition of imports and exports alike will change in 2018 and beyond.

Short-Term Snapshot

Steady export performance and healthy domestic demand got China's economy off to a strong start in 2018. Robust global demand should continue to support China's exports, and despite increased trade frictions with the US, we consider a full-blown trade war unlikely. Economic growth should cool as more restrictive policies are implemented, but at a gradual and modest pace, since stability remains a priority for the government.

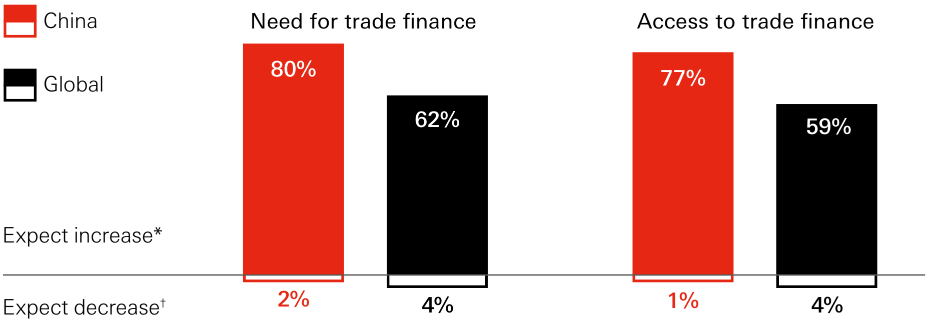
Chinese firms rank among the five most optimistic respondent groups in our survey. A remarkable 89% of Chinese companies expect to see trade volumes rising through 2018, compared with 77% of respondents globally. Interestingly, despite fast growth in Asia's emerging economies, Chinese companies see established trading partners in North America and Australia as their most promising markets (perhaps reflecting the size of these markets and the fact that Chinese goods remain competitive on price).

More than three-quarters (80%) of businesses in China expect to seek additional trade financing in 2018, and a similar proportion (77%) are confident about meeting their finance needs. Like their counterparts in other markets, Chinese firms cite high transaction costs as the main barrier to accessing trade finance. And China may need to do more for its small businesses as respondents say their company's size can limit their access to credit.

Action points for business

- Firms should understand their competition, take advantage of new sources of demand, and leverage technology to enter new markets.
- Small businesses should ensure they are aware of the full range of funding options available to them, so that financing does not constrain their future growth.

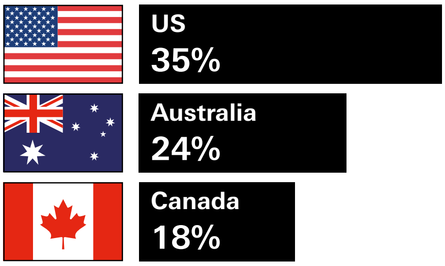
Outlook for trade finance need and access in the next 12 months



*Expect increase = Increase significantly + Increase slightly
†Expect decrease = Decrease significantly + Decrease slightly

Source: TNS Kantar

Which are the top 3 markets where your business will look to expand in the next 3-5 years?



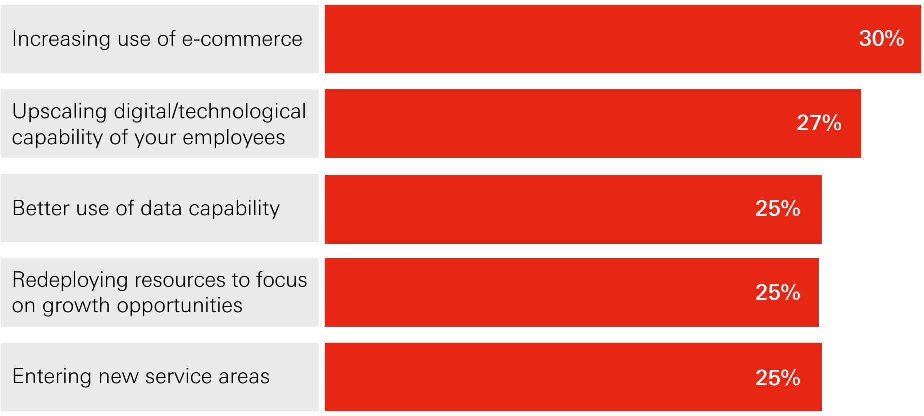
Source: TNS Kantar

While China enjoys a significant trade surplus in goods, it is a net importer of services. And thanks to a rapidly growing middle class, tourism and travel are likely to continue driving service import growth.

Almost three-quarters of Chinese firms expect to see their service trade rise through 2018, compared with 67% in the APAC region overall. The survey results also reflect China's digital ambitions: Nearly a third of firms say e-commerce will help them expand their services trade, and 27% say the same about leveraging their employees' technology skills.

> Thanks to the favourable economic environment, trade optimism among Chinese firms is nearly universal.

How do you plan to grow your services business?



Source: TNS Kantar

Trade Policy Developments

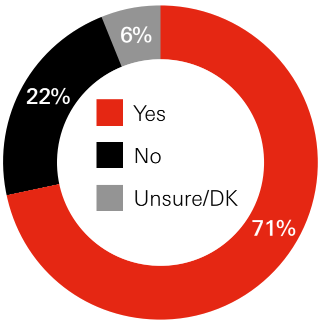
As the US administration gears up to get tough on China, trade frictions are likely to increase in the near term. Chinese exports most at risk of protectionist measures are those that compete with US-based production and whose supply chains consist mainly of Asian companies. The US has already targeted steel and aluminium, as well as washing machines and solar panels. Although the US could take further remedial action, we feel that a full-blown trade war remains unlikely, and any economic damage should be limited.

Still, it is perhaps not surprising to find that 71% of respondents in China felt that foreign governments were becoming more protective of their domestic businesses. Almost half (48%) of respondents felt that this was increasing the cost of doing business internationally.

Action points for business

- Firms should develop alternate strategic plans for various potential trade scenarios, so they can respond quickly to policy or economic shifts without disrupting their sourcing or their sales.
- Chinese firms looking for overseas opportunities, particularly in emerging markets, must carefully assess the debt, foreign exchange, and geopolitical risk in target markets.

Are governments becoming more protective of their domestic business?



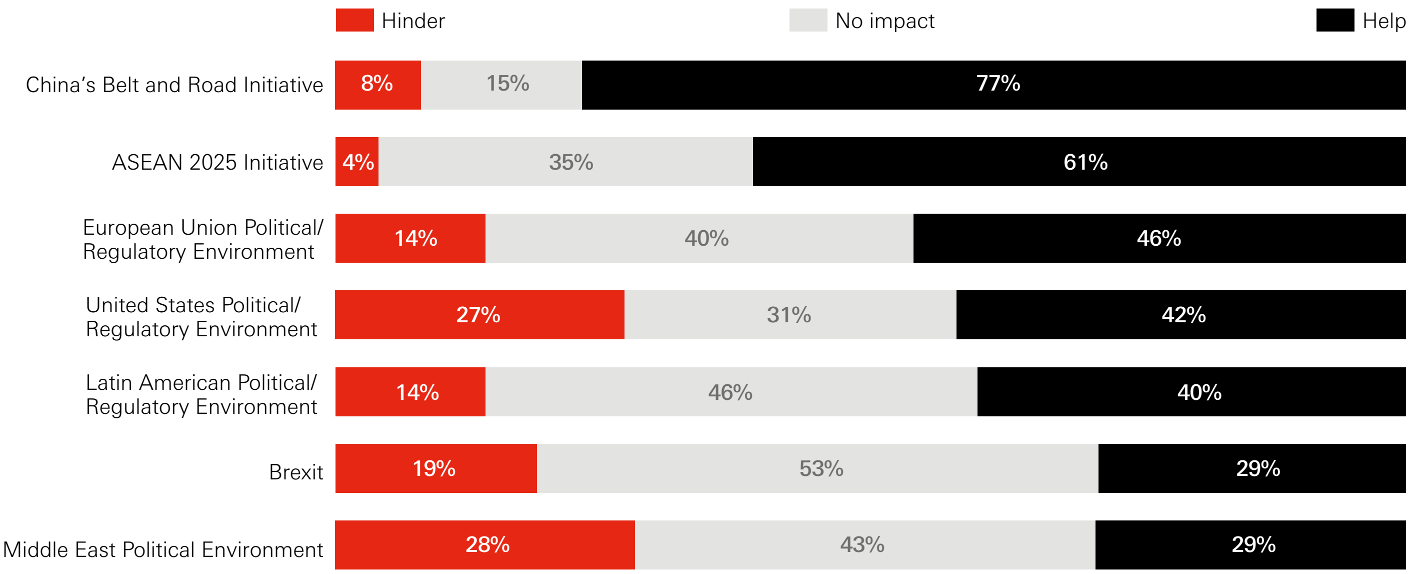
Note: may not total 100% due to rounding

Source: TNS Kantar

Top 3 impacts of protective policies on my business

Source: TNS Kantar

Impact of government/economic policies on my business in the next 2 years*



Source: TNS Kantar

*May not total 100% due to rounding

In the longer term, China's trade performance will benefit from the Belt and Road initiative, whose infrastructure improvements across Eurasia will facilitate trade and investment, create new market demand, and contribute to global development. Over three-quarters (77%) of Chinese respondents to our survey expect Belt and Road to benefit their businesses in the next two years.

Chinese firms are enthusiastic about government policy initiatives, especially Belt and Road.

Long-Term Outlook for Trade

The structural shifts under way in China suggest its economic growth will moderate over the coming years. However, as businesses use technology to move up the value chain, goods exports should continue rising at a healthy pace over the medium to long term. Service exports, meanwhile, will account for a growing share of total exports, again thanks to technological advances and the Chinese economy's growing sophistication.

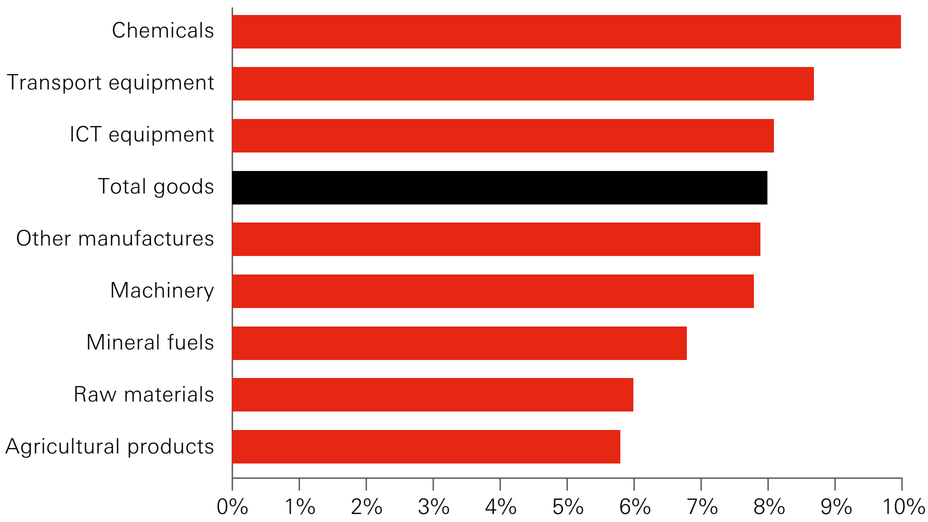
At the 19th Party Congress last October, China's senior leaders set out new policy priorities, aiming to shift the economy toward cleaner, fairer, and more innovative growth. This has significant implications for the import mix. China is likely to buy more industrial and office machinery, consumer goods, and services, while importing fewer raw commodities as construction growth slows.

Emerging markets are the fastest-growing export destinations
We expect China's overall goods exports to grow on average 8% a year, by value, between 2017 and 2030. Other manufactures (which includes a range of consumer products) will continue to be the largest category of exports—but the share of this category will gradually fall as China diversifies its manufacturing base. ICT equipment is expected to capture a growing share of exports, as China moves up the value chain, but chemicals and transport equipment exports should grow most rapidly.

Action points for business

- In the face of growing competition from low-cost emerging market exporters, Chinese manufacturers need to build more sophisticated technological capabilities and pursue growth through innovation.
- Firms should take advantage of financial and policy support from major government initiatives like Made in China 2025, Belt and Road, and ASEAN 2025.
- As China's economy evolves, companies will need to respond to shifts in demand. Is your supply chain flexible enough to handle volatility?

Exports of goods by sector, 2017-30 (average annual growth)



Source: Oxford Economics

Top 5 Hotlist destinations of goods exports

Rank	2016	2030
1	USA	USA
2	Hong Kong	Hong Kong
3	Japan	India
4	Korea	Vietnam
5	Germany	Japan

Note: Ranking among the 24 trade partners covered in the forecast

Source: Oxford Economics

Over the coming decades, China's exports to emerging markets will grow faster than exports overall, as incomes in these countries rise and market access improves. Demand in several emerging Asian economies will be particularly buoyant. We expect India and Vietnam to be the fastest-growing export destinations in 2021–30, replacing Japan and South Korea as China's third and fourth largest export destinations by the end of the periods. Exports to other Asian countries such as Bangladesh and Malaysia will also grow at a solid pace. Looking beyond Asia, the UAE, Saudi Arabia, Poland, and Turkey rank among the fastest-growing export markets for China in 2021–30.

While the US is expected to remain China's largest export market, its share of China's total exports will slip from 19% in 2017 to 17% in 2030; US growth is unlikely to revert to pre-crisis levels. Meanwhile, Hong Kong's position as a regional entrepôt for physical goods will support continued growth in merchandise trade flows.

> New technology, higher value-added industry and improved product quality will support China's manufacturing growth.

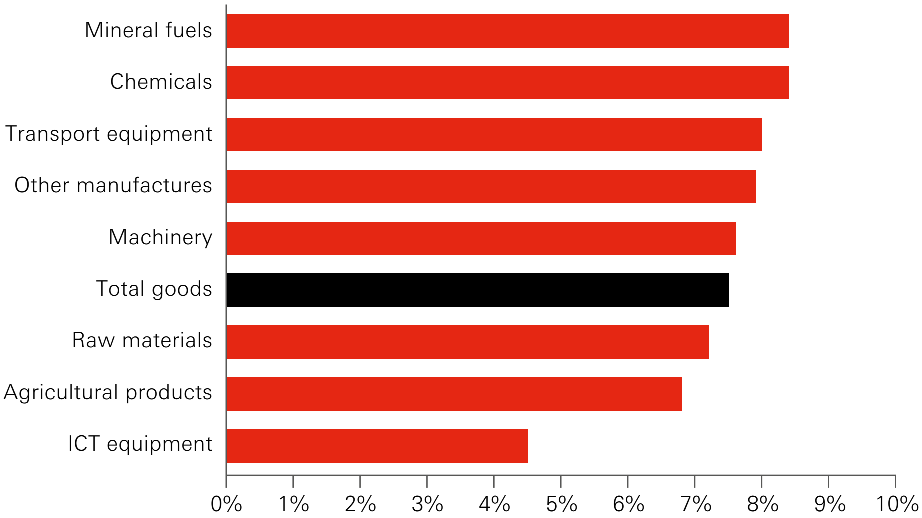
Structural shifts imply a change in import mix

China's goods imports will grow at a similarly robust pace as its goods exports—close to 8% a year on average in value terms—between 2017 and 2030, reflecting both intermediate goods for processing and final goods to satisfy China's increasingly wealthy population.

China's industry will require increased imports of high-tech machinery to upgrade manufacturing processes, while its shift up the value chain into products such as chemicals and transport equipment will also generate strong demand for inputs to these sectors. Meanwhile, imports of ICT equipment are likely to grow more slowly in coming years, as China gradually shifts away from the low value-added assembly plants that characterised its early industrialisation. Indeed, the composition of ICT imports is also likely to shift away from parts & components and toward final goods, as urbanisation continues apace and newly affluent consumers buy more imported consumer electronics. Likewise, raw materials will play a waning role, as China's economy shifts from investment toward a consumption-led growth model.

As China's economy evolves, imports of commodities will slow.

Imports of goods by sector, 2017-30 (average annual growth)



Source: Oxford Economics

Top 5 Hotlist origins of goods imports

Rank	2016	2030
1	Hong Kong	Hong Kong
2	Korea	USA
3	USA	Korea
4	Japan	Japan
5	Germany	Germany

Note: Ranking among the 24 trade partners covered in the forecast

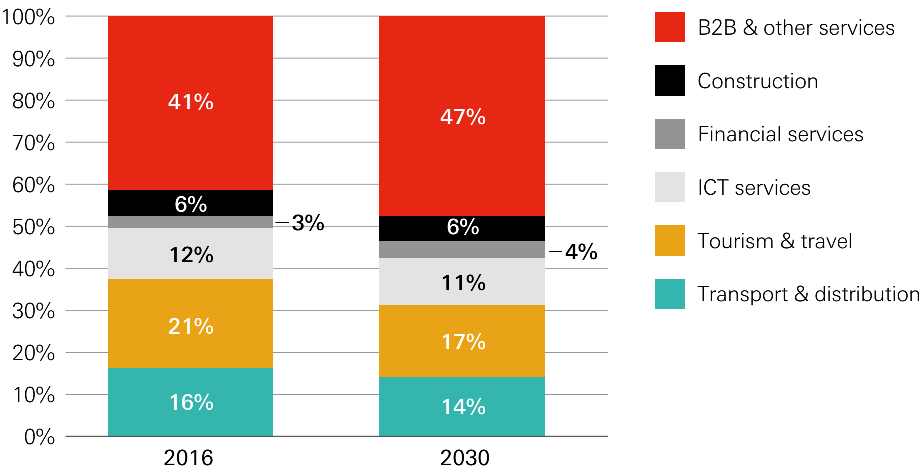
Source: Oxford Economics

Asia will sell China the most imports; those from Vietnam and India should grow the fastest in 2021–30, followed closely by Malaysian goods. Australia, on the other hand, will drop off the top 10 list of fast-growing import sources for China over the next decade, as Chinese demand for iron ore and other raw commodities gradually eases. As a regional trading hub and gateway to the mainland, Hong Kong will remain the biggest source of mainland China's imports, followed by the US and Korea. But by 2030, the three markets together will supply 47% of China's total goods imports, down from 50% in 2017.

Services will feature more prominently in the export mix
As technology makes services more tradable and China's links to the global economy strengthen, we expect the value of its service exports to grow by around 9% a year to 2030. B2B and similar services will play the biggest role in driving this growth, accounting for nearly 50% of total service exports by 2030. Meanwhile, although tourism and travel will remain the second-largest service export sector, its share in total service exports is expected to moderate to 17% from 21% in 2016. Thanks in part to Belt and Road projects, which will require financing and advisory services, we expect financial services exports to outpace the total.

Belt and Road to support China's services exports.

Sectoral shares in total services exports



Source: Oxford Economics

Top 5 Hotlist destinations of services exports

Rank	2016	2030
1	Hong Kong	Hong Kong
2	USA	India
3	Korea	Korea
4	Japan	USA
5	Singapore	Singapore

Note: Ranking among the 23 trade partners covered in the forecast

Source: Oxford Economics

Over the medium to long term, Hong Kong should remain the largest destination for Mainland China's service exports, although its share will gradually decline to 11% in 2030 from 12% in 2016. Mainland China's tourism and transport services continue to dominate these exports, thanks to Hong Kong's geographical proximity and lively goods trade between the two. Service exports to India, however, will see the fastest growth in 2021–30; by the end of the period, India will overtake South Korea and the US to become China's second-largest services export destination, buying 7% of the total vs. 4% in 2016. China's service exports to countries along the Belt and Road, including Indonesia, Turkey, Malaysia, and Saudi Arabia, will also grow briskly.

About the HSBC Navigator

The HSBC Navigator presents a blend of survey evidence, policy analysis, and economic modelling to generate unique and timely insights into the changing landscape for global trade.

The business survey is a quantitative indicator of the short-term outlook for global trade. The survey, which is the largest of its kind, is conducted on behalf of HSBC by Kantar TNS. It is compiled from responses by decision-makers at over 6,000 businesses – from small and mid-market to large corporations – across a broad range of industry sectors in 26 markets. Interviewees were polled on a range of questions including expectations around future growth in trade, trade finance needs, attitudes toward trade policy developments and strategic business plans.

The survey represents a timely source of information on the fast-evolving trade environment. And it can provide a useful contextual setting for interpreting developments in official data. In this way, economists at Oxford Economics are able to blend insights from the survey with their own analysis and modelling of developments in trade.

Oxford Economics has tailored a unique service for HSBC which forecasts bilateral trade in goods and services, in part 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 demand in the destination market and the exporter's competitiveness (as measured by unit labour costs in nominal USD terms). Exports, imports and trade balances are identified, with both historical estimates and forecasts for the periods 2017-20 and 2021-30.

These headline bilateral trade forecasts for goods and services are also disaggregated by sector, using Oxford Economics' Industry forecasts to inform future production trends and taking into account the historic relationship between output and exports in each sector, by market:

- For trade in goods, 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.
- For trade in services, we identify five broad sectors: B2B and other services, tourism & travel, transport & distribution, financial services, ICT services and construction.

Drawing on the Kantar TNS survey results and Oxford Economics' long-term forecasts, Oxford Economics produces in consultation with HSBC a global report and specific reports on the following 23 markets: Argentina, Australia, Bangladesh, Canada, China, Egypt, France, Germany, Hong Kong, India, Indonesia, Ireland, Japan, Malaysia, Mexico, Poland, Saudi Arabia, Singapore, Turkey, UAE, UK, USA and Vietnam. The analysis of trade in goods also includes trade with Brazil and Korea for a total sample of 25 key trading markets; for trade in services the analysis also includes Korea for a total sample of 24 key trading markets.

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