Navigator

Now, next and how for business

Germany report

HSBC

Germany

Exceptionally well positioned, but supply constraints loom

German firms enter 2018 in euphoric mood. They expect the buoyant global economy to drive up demand for their products, as businesses broaden their already-extensive global reach, at the same time as deepening ties with traditional trading partners in booming Europe. Risks from protectionism are balanced with new opportunities elsewhere, but labour and skills shortages pose risk long-term.

Short-Term Snapshot

The synchronized global upswing and the Eurozone transitioning from recovery to expansion pushed the German economy into overdrive in 2017-2018. The global trade surge and investment revival have played to the traditional strength of German industry, adding momentum to the already-robust domestic economy.

Survey data suggests that close to three-quarters of firms have a favourable outlook of trade prospects also in 2018, more than in France (66%) and in line with the average across high-income economies. Continued strength in Eurozone trade partners, and the impact on US household spending power from tax reform, will both support trade momentum in the coming couple of years.

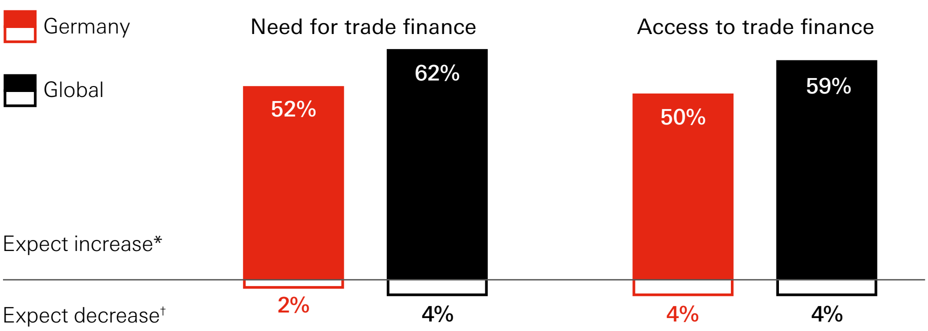
Our survey data also suggests that the availability of skilled labour domestically will be a key driver of trade growth. Given Germany's well-known demographic challenges (with the population of working age set to resume falling from 2019), firms will increasingly import lower-cost manufacturing inputs, in order to free up scarce labour at home for higher value-added activities.

Just over half of German firms expect a rising need for trade finance according to our survey. That is well below the global average of 62%, and a sign that many already have ample financial resources with which to back trade. Only 4% of respondents were worried that their access to trade finance could be curtailed, should they have demand for it.

Action points for business

- Firms should continue to invest in key staff and productivity-enhancing steps, to prepare for the looming demographic challenges. Making the case for further immigration reform could also help in this respect.
- Bundling more services with goods exports could help boost the weak outlook for services trade, but firms should also consider campaigning for a better regulatory environment e.g. regarding faster internet access.

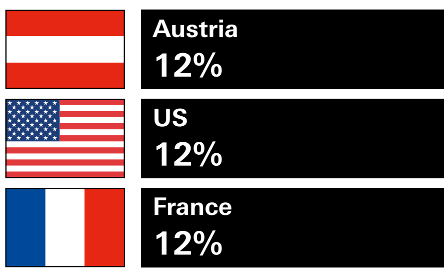
Outlook for trade finance need and access in the next 12 months



*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?



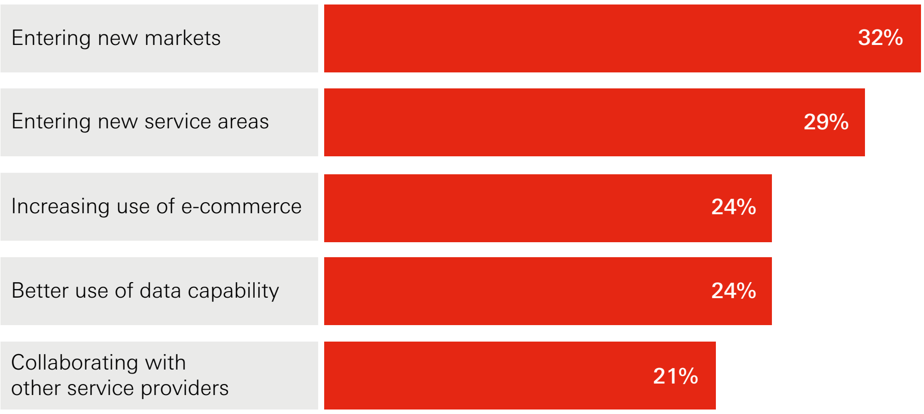
Source: TNS Kantar

Service exports have continued to lag goods through recent years though. Services' share in total exports has remained relatively low, at around 16%, since 2010. Moreover, its fate is closely tied to that of the goods exporting sector with transportation standing for close to 20% of services exports in 2016 (reflecting the cost of transporting high value and often bulky machinery). This is double what it is in the more services oriented United Kingdom. In contrast, the greater propensity of Germans to travel overseas means tourism is a particularly important sector for imports, and service imports account for around 20% of total imports.

The role of services looks unlikely to change much in the near term with only 51% of firms expecting rising trade in services trade, well below the global average of 61%, and 22pp lower than German expectations for total trade.

The synchronized global upswing is playing to German firms' strengths as they continue benefitting from their high competitiveness and global reach.

How do you plan to grow your services business?



Source: TNS Kantar

Around a third of firms plan to enter new markets and services areas to boost services trade, a similar proportion to the global average. Digitalisation plays a big role for firms in that approach as 70% of businesses judge easier access to data as creating a level field for trade.

German strength in manufacturing provides a key crossover to transport services.

Trade Policy Developments

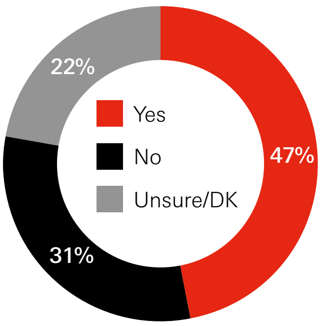
The implications of the eventual post-Brexit arrangements for the bilateral trade relationship with the EU is currently the key issue. The UK was the fourth largest German export destination and fifth most important import source in 2017 for goods and even more important for services firms. The increasingly protectionist bent in US policy circles is also a worry, given the US has been Germany's top goods export market for the past three years and a target for regular criticism from President Trump.

These risks are clearly reflected in the survey data. Over a third of German firms expect a negative impact of Brexit on their business, more than in France (30%) and globally (25%). They are also more concerned with the US policy outlook with negative views outweighing positive ones, which contrast with an on balance positive view globally. While some more clarity on Brexit should emerge in 2018, the threat of protectionism from the US could persist much longer.

Action points for business

- German firms are strongly exposed to the potential fallout from Brexit and should ensure they understand the supply-chain effects of the various possible trade policy scenarios. Emergency plans to relocate production to account for possible US trade restrictions might be advisable.
- Opportunities in regions with growing trade opportunities, like Asia, should be pursued, but a strong footing in the European home market can shelter firms from adverse regulatory and policy measures abroad.

Are governments becoming more protective of their domestic business?



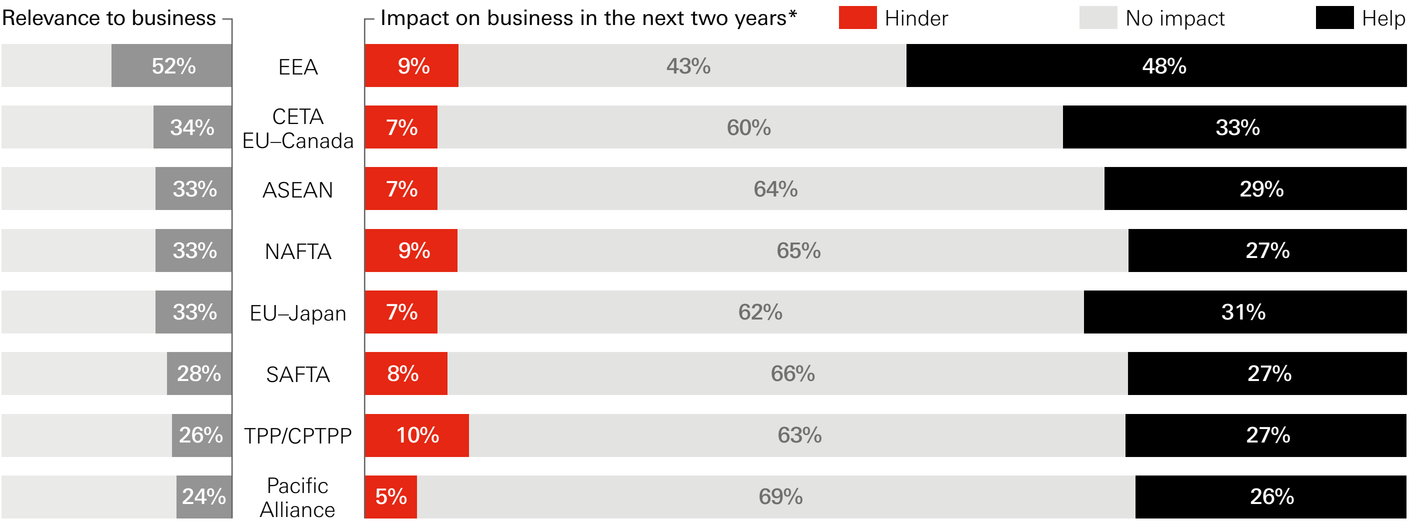
Note: may not total 100% due to rounding

Source: TNS Kantar

Top 3 impacts of protective policies on my business

Source: TNS Kantar

Relevance and impact of trade agreements



Source: TNS Kantar

*May not total 100% due to rounding

Despite this backdrop German firms are overall less concerned with protectionism than their global counterparts. Only 47% see governments becoming more protectionist compared to 61% for all survey participants as German firms continue to search for trading opportunities in Asia more than firms in either France or the US do. That includes initiatives such as Belt and Road and ASEAN 2025, which compensates for wariness over potential barriers to trade with the US and UK.

German firms are concerned with US policies and Brexit but look for new opportunities in Asia as an offset.

Long-Term Outlook for Trade

Germany's world class manufacturing sector with its focus on sophisticated machinery and luxury cars will continue to drive its trade performance. Firms are well placed to take advantage of the ample opportunities in growing emerging markets especially in Asia as these continue their relentless catch-up growth. Successfully exploiting these opportunities would let firms further build on their existing but mature trade links in Europe and the US. In goods exports, machines, chemicals and transport equipment such as cars and aircraft will continue to dominate, while the services sector is set to tap into that strength benefitting transport and ICT providers.

Opportunities and challenges abound. Germany's strong links and good reputation in Asia mean that initiatives such as Belt and Road infrastructure development and ASEAN 2025 provide plenty of opportunity, just as potential Free-Trade Agreements between the EU and other major economies. However, Germany needs to do more to help deal with demographic challenges, and the government needs to do more to help firms prepare for the digital future.

Cutting edge machinery to continue to boost trade with Asia
Germany will remain in pole position in several key export sectors. We forecast the industrial machinery sector to be the largest growth driver, expanding its exports by 6% per year until 2030. Demand from developing countries building up their own export industries will continue to be crucial, and the sector will contribute close to a third of overall export growth in the 2020s. Firms will build on decades of experience in producing highly customized machines in close collaboration with their clients. E-commerce provides a key channel for further enhancing this specialism, if properly harnessed.

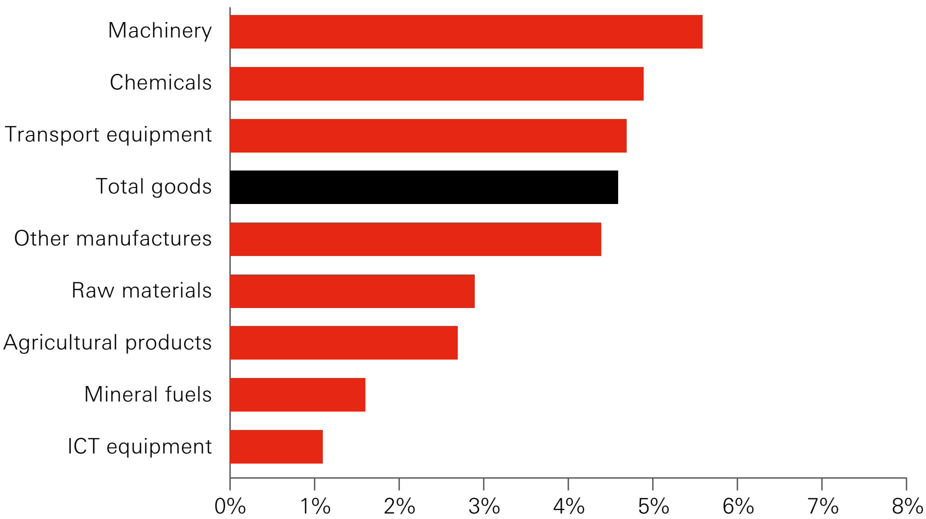
The world-renowned chemicals and transport equipment sectors (both growing by 5% per year) won't be far behind industrial machinery in terms of export performance. The growing middle-class in emerging markets will continue to boost demand for German luxury cars. In their expansion plans, firms across sectors will have to bank even more on their suppliers, though. Given the domestic demographic challenges and the growing concentration on high value-added production by domestic firms, producers will likely have to rely even more on foreign suppliers in the future.

Action points for business

- German firms will need to maintain their technological edge, keeping abreast of new opportunities presented by digitalisation, and ensuring "first mover" advantage is not lost to competitors.
- Supply of skilled workers will likely remain the Achilles heel of the German economy for decades to come and business would do well to continue lobbying for immigration reform and higher education spending.
- The public's perception is dominated by world-class goods exports, but services firms may want to better highlight their contribution to the economy and lobby harder for an improved regulatory environment.

> Germany is set to defend its leading position in the production of high-tech machinery.

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	China
2	France	USA
3	UK	France
4	China	UK
5	Poland	Poland

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

Source: Oxford Economics

Emerging markets will be increasingly-important markets for German goods exports in the years ahead. China is set to move from fourth-largest market in 2016 to the top spot in 2030, taking more than 9% of German goods exports. Meanwhile we expect German goods exports to India to more than triple.

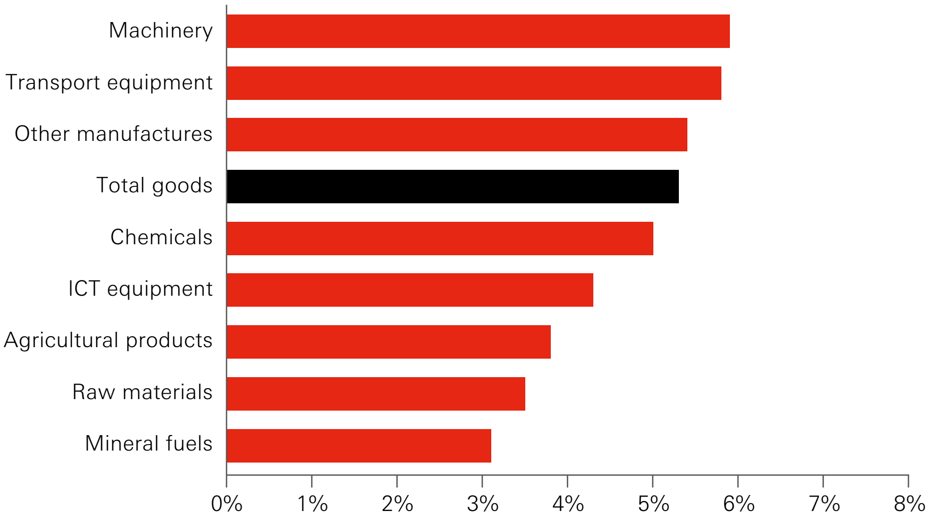
However, traditional trading partners and those closer to home will also remain key markets for Germany. The US, the UK, France and Poland should all stay in the top-5 as existing trade links deepen. However, exports to the UK are likely to underperform that of other EU partners given the expected impact of Brexit.

By 2030, China could well be Germany's biggest goods export market as well as its leading source of imports.

China to also become biggest import market

The same five countries that are Germany's top export markets also make up the leading sources of imports, underlining the importance of supply-chain relationships. From a sectoral perspective, machinery imports should lead the pack contributing close to a quarter of German import growth in the 2020s, a similar contribution to growth as seen in exports. However, in lower value-added sectors such as ICT equipment, Germany will continue to cede market share to lower-cost manufacturers, with imports in this category growing at an average rate of 4.3% per year to 2030.

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



Top 5 Hotlist origins of goods imports

Rank	2016	2030
1	France	China
2	China	France
3	Poland	Poland
4	USA	USA
5	UK	UK

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

Source: Oxford Economics

We forecast that China will become the leading source of German imports by 2030 as its industrial firms continue to climb up the value chain, surpassing and likely outpricing competitors from other countries. That means France will lose its top spot becoming the second most important import provider with a share of 18%, but Poland will be close behind with 17% as the country's firms become more sophisticated, and play an ever-greater role in supply-chains for German firms.

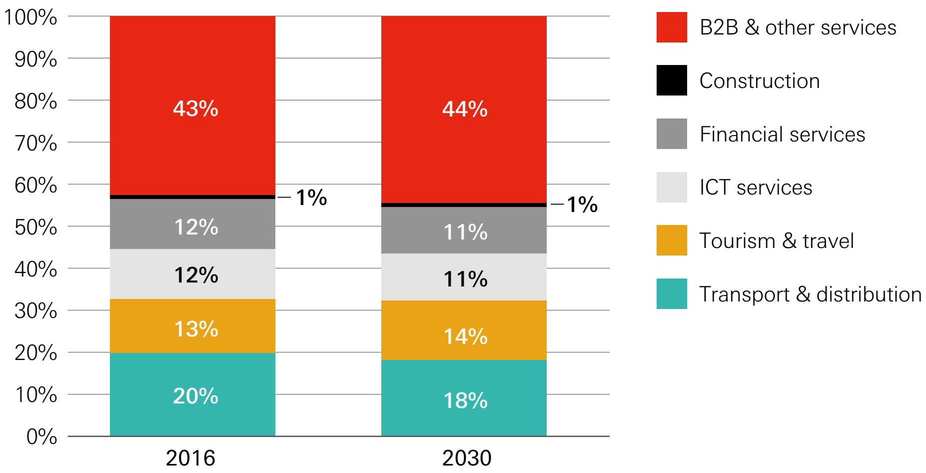
Services exports to gain in importance as digitalisation progresses
Services exports should benefit from the encouraging demand outlook for German goods exports over the coming years. Transportation services play an outsized role in Germany standing for 20% of services exports in 2016 given the large and successful manufacturing sector. However, the digitalisation of German industry, including through Industry 4.0 and similar initiatives should help support exports of a more diverse range of services, including ICT services.

However, firms will only be able to fully exploit that potential if the government makes swift progress on establishing a fibre-optic network. Moreover, insufficient focus on new technologies in schools combined with the ageing of the population could become an obstacle in delivering the promises of technological advances.

Tourism is another sector that could make a substantial contribution. We forecast its share in services exports to increase from 13% in 2016 to 14% in 2030. Within this, we expect a surge in Chinese visitors. China accounted for less than 6% of total tourism exports in 2017 but our forecast is for this to triple to close to 19% in 2030. The increasing trade links of the two economies in goods trade will help support this process, given the flow of business travellers to support goods trade, and the deeper cultural understanding this will help promote.

Digitalisation will boost ICT exports, but to fully exploit the potential Germany will have to put in place better internet access and education reforms.

Sectoral shares in total services exports



Source: Oxford Economics

Top 5 Hotlist destinations of services exports

Rank	2016	2030
1	USA	USA
2	UK	UK
3	France	China
4	China	France
5	Ireland	Poland

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

Source: Oxford Economics

Closer ties with China will make China the third largest export market for German services by 2030, overtaking France. However, the United States and the United Kingdom will still reign supreme as destinations for services exports standing for 15% and 10% of the total in 2030. However, in both cases the risks from Brexit and protectionist moves in the US are clearly tilted to the downside. In terms of growth dynamics India is expected to stand out. German services exports to India could nearly quadruple by 2030, but given a low starting point the country would still rank relatively low in terms of its overall importance for German firms.

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.

For media enquires please contact:
Natasha Plowman
HSBC Global Communications
Natasha.Plowman@hsbc.com

Or go to www.business.hsbc.com/trade-navigator

Photo Credits
Page 1: Pulsar Imagens / Alamy Stock Photo
Page 3: Prabash Hettiarachchi, HSBC Middle East, #HSBCphotographer

Issued by HSBC Bank plc
8 Canada Square
London E14 5HQ
United Kingdom

www.hsbc.com

HSBC