

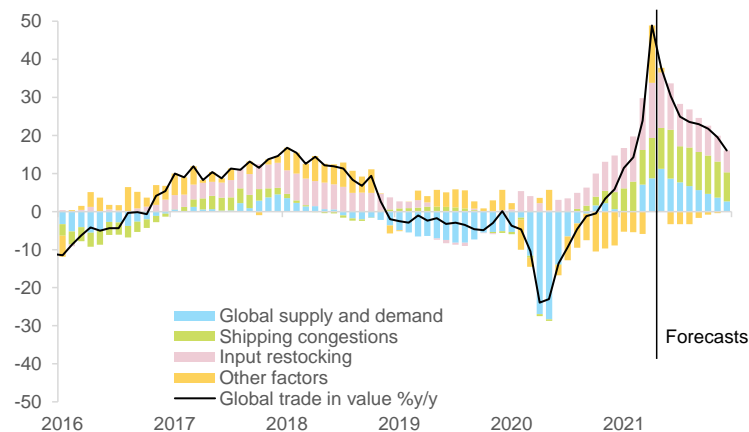
GLOBAL TRADE: SHIP ME IF YOU CAN!

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So far this year, global trade has bounced back faster and stronger than expected, especially in value terms (+8.6% q/q in Q1 2021 vs. +3.4% q/q in volume terms), driven by price and capacity pressures. Despite peaking in 2021, these are likely to continue in 2022 as lower tariff rates won't make up for a slow normalization and structural changes in trade flows. While global supply and demand explained most of the yearly contraction in trade in 2020, they account for only c.15% of the average y/y growth of global trade in value since the beginning of this year (see Figure 1). Instead, input restocking explains c.50% of the rise. More specifically, US and European companies are managing their inventories to respond to a strong rebound in local demand, which is dependent on inputs and goods manufactured and shipped out of Asia¹.

Figure 1 – Global trade in goods in value, %y/y growth



Sources: CPB, IHS, Bloomberg, Euler Hermes, Allianz Research

The global race for inputs is supporting trade volumes and, more importantly, pushing prices up. The race leads to the just-in-case model of inventories management being more widely adopted, which can lead to a form of micro speculation in which companies rush to acquire inputs, to protect against further price increases. Such a strategy adds further pressure to the ongoing global supply-demand imbalance, caused by renewed Covid-19 restrictions and power shortages in Asia-Pacific alongside accelerating demand from the grand reopening² in the US and Europe. The result is that trade volumes are sustained, and prices keep

¹ For example, Asia represents nearly 90% of global semiconductor exports and c.75% of installed manufacturing capacities – with a high concentration among markets and firms, e.g. more than 20% in Taiwan. Accordingly, a strong correlation between production shortfall in Taiwan and input shortage in the US and Eurozone can be observed since 2012.

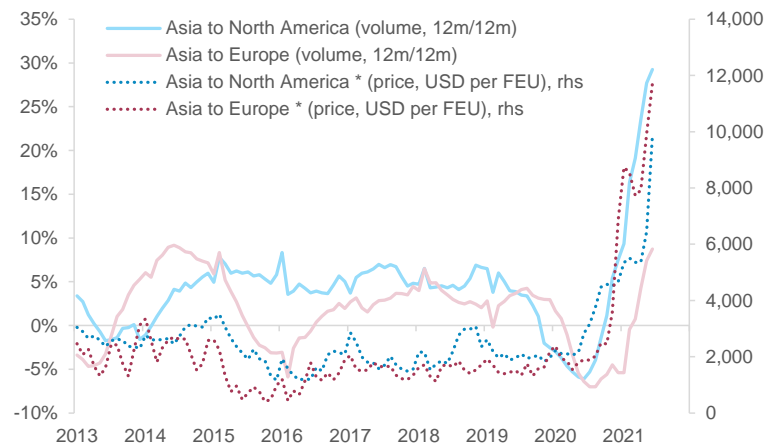
² See our recent report [Grand reopening: New opportunities, old risks](#).

accelerating.

Shipping constraints³ explain another c.35% of the rise in trade flow value this year.

Vessels are currently being used at almost full capacity and available containers remain scarce. After continuously rising in the second half of 2020, there are signs that maritime shipping delays are plateauing, but overall performance remains the worst it has been in ten years of records (the share of vessels not arriving on time has remained around 60-65% since the beginning of the year vs. 25% in July 2020 and c.20% on average in 2019). Importers are thus probably willing to pay more for their orders to be transported. Indeed, the traffic volume from Asia to North America is rising sharply, denoting strong demand, while freight rates increased earlier and faster for shipping from Asia to Europe (see Figure 2). North America is thus capturing available containers out of Asia, while Europe has been forced earlier on to pay higher prices to access shipping capacity.

Figure 2 – Container shipping volume and price indicators



* Average of routes between Asia and North America, and Asia and Europe
Sources: Drewry, Bloomberg, Euler Hermes, Allianz Research

Against this backdrop, trade flows in value terms will continue to overshoot: We expect global trade to grow by +7.7% in volume terms in 2021 (vs. -8.0% in 2020) and by a much higher rate of +15.9% in value terms (vs. -9.9% in 2020), with even an upside risk to this forecast. Sequential growth could prove to be more bumpy, with Q2 in particular under pressure (in part due to temporarily softer activity in Asia), followed by a mild rebound in Q3. The large gap between the volume and value yearly numbers reflects the recovery but in particular price pressures caused by input and container shortages. Strong demand for shipping capacity coming from Asia is set to continue as US retailers currently face an exceptionally low level of inventories⁴. The shipping industry is unlikely to normalize in the short-term (2021-2022), due to a number of reasons: 1/ the continued uneven recovery around the world, 2/ underinvestment over the past few years in the maritime shipping industry, 3/ new capacity only slowly becoming operational (probably not before 2023 as it takes one and a half years to build a new vessel) and 4/ few alternatives to ocean freight⁵.

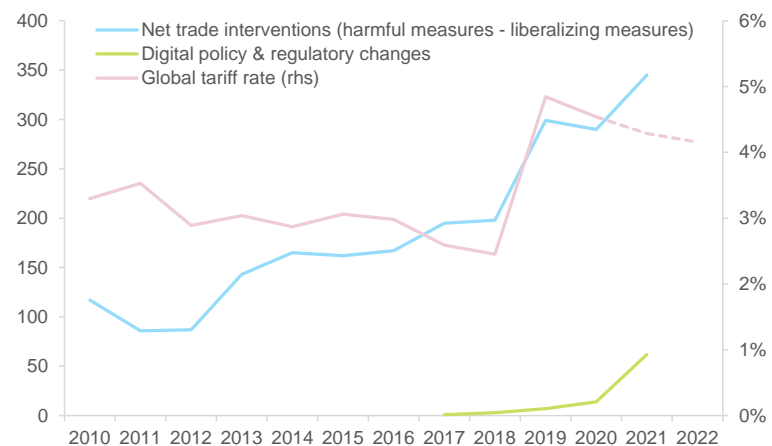
³ Issues we started to look into in our report [Is the Chinese ox reflating the world, one container at a time?](#)

⁴ The inventories-to-sales ratio for the US retail sector excl. autos is at just 1.04 in April 2021, a 30-year low. The situation for European retailers is not yet as tense (later recovery of discretionary spending), but the upcoming rebound could be problematic in the context of global shortages.

⁵ Air cargo has been gaining a competitive advantage, thanks to faster delivery and in particular the currently lower relative freight rate

In 2022, price and capacity pressures are likely to stay on, even though they should have peaked in 2021. Lower tariff rates will not make up for structural changes that are likely to keep trade costs elevated. Reflecting only a slow normalization, we expect global trade growth to remain above-average in 2022, at +6.2% in volume terms and +8.4% in value terms. Global demand will continue to be sustained in 2022, thanks to the new infrastructure cycle⁶, fiscal stimuli, residual savings (especially in advanced economies) and the relaxation of trade tariffs. Indeed, we estimate that the global tariff rate already declined by -0.6pp in 2021 compared to 2019, reversing nearly one third of the rise seen under the Trump administration and representing USD110bn of global export gains (see Appendix). It could continue to decline in 2022, notably thanks to the likely ratification of the Regional Comprehensive Economic Partnership (RCEP) in Asia-Pacific⁷, with -0.1pp impact on the global tariff rate. However, at the same time, the number of protectionist measures accelerated in 2021 (see Figure 3) and continued tensions (especially between the US and China) could lead to further non-tariff barriers keeping trade costs elevated (see Appendix for our trade policy scenarios). Measures supporting the green transition, e.g. related to carbon border adjustments⁸, could also work as non-tariff barriers and embody a new form of protectionism.

Figure 3 – Trade interventions and Global tariff rate



Note: global tariff rate (applied, trade-weighted mean) is based on our estimates between 2018 and 2020, and based on our central scenario forecast for 2021 and 2022.

Sources: Global Trade Alert, World Bank, Euler Hermes, Allianz Research

Structural changes in trade flows could also contribute to transportation costs staying higher than before the crisis. Notably, e-commerce seems to be capturing a larger share of global maritime container shipping capacity, c.30% in 2020-2021 compared with c.15% on average over 2016-2019, according to our estimates. Products ordered through e-commerce, more consumer-driven, typically have a higher tolerance for cost increases than industrial goods. Looking at the US more precisely, e-commerce and

(<https://www.iata.org/en/iata-repository/publications/economic-reports/competitive-advantage-of-air-cargo-not-only-speed-but-also-price/>).

However, in volume terms, air freight is insufficient to alleviate ongoing bottlenecks in ocean freight, which represents c.90% of global trade.

⁶ See our recent report [Joe Biden's infrastructure plan: Defying gravity](#).

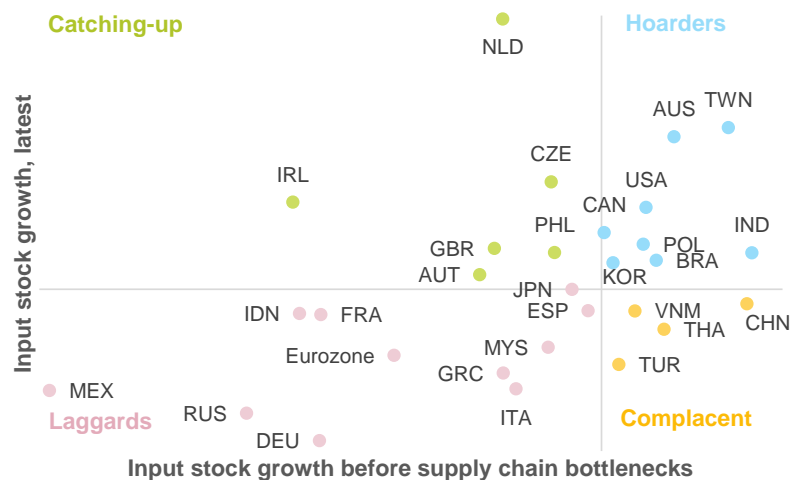
⁷ Tariffs and quotas should be removed on over 65% of goods traded within the area (<https://asean.org/asean-hits-historic-milestone-signing-rcep/>), and tariff rates on non-agrifood goods could decline progressively to 0% in 15 years (Itakura, Ken and Hiro Lee, 2019, Estimating the effects of CPTPP and RCEP in a general equilibrium framework with Global Value Chains).

⁸ See our recent report [EU climate policy goes global](#).

retail sales of goods typically imported from Asia have been standing at unusually high levels since the beginning of 2021⁹. The two-year correlation between non-store retail sales and Asia-to-North America maritime shipping volumes reached an average of 72% this year, higher than the 56% for in-store retail sales (vs. around 30% on average for both over 2016-2019).

Which countries and sectors are most vulnerable? Europe (Germany in particular) is overall lagging in terms of input stock, while the US and some economies in Asia seem to be hoarding inputs. Indeed, input inventories in the US and several economies in Asia-Pacific (e.g. Taiwan, Australia, South Korea) were already at relatively high levels before the current supply chain bottlenecks emerged and are now still seeing a rising trend – see Figure 4. Asia is probably less impacted by input shortages, given high regional trade integration¹⁰ and sectoral positioning that is prioritized by suppliers¹¹. In contrast, most countries in Europe are struggling to restock already low levels of inventories. The Netherlands and Ireland appear as exceptions, likely thanks to their trade platform status and specialization in the tech, chemicals and pharmaceutical sectors. The more pronounced shortage of inputs for the region overall is all the more worrying, given that demand is very dynamic (see Figure 5). Manufacturers thus have to pay higher prices to obtain inputs and/or are unable to fully match demand.

Figure 4 – Manufacturing sector input inventories management, by economy



Note: the axes cross at the values for the world. Input stock growth is the 3-month average of the stocks of purchases index in manufacturing PMI surveys. Before supply chain bottlenecks is October 2020, latest if May 2021.

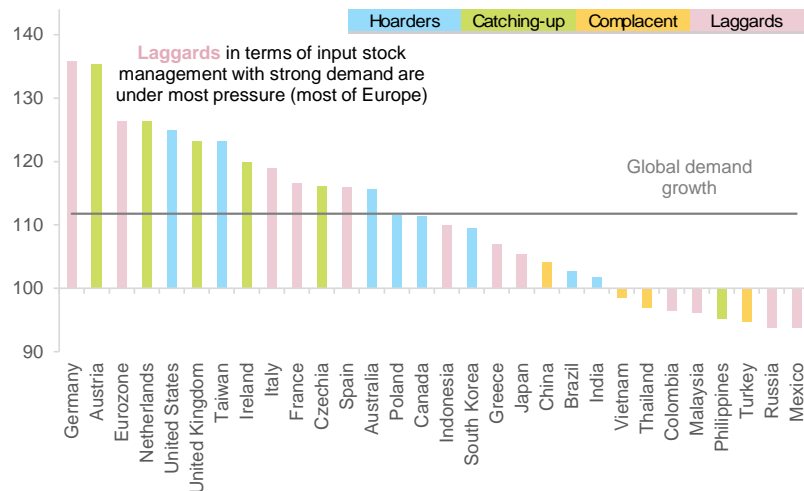
Sources: IHS, Euler Hermes, Allianz Research

⁹ Year-to-date sales for 2021 have been +22% higher for e-commerce retailers compared with the same period in 2020, which had already been +16% higher than 2019 (vs. +24% and -5% respectively for store retailers).

¹⁰ Around 75% of Asia-Pacific trade is done within the region, compared with c.60% for the EU, c.40% in North America and c.15% in Latin America.

¹¹ In the case of semiconductors, there is a divergence between well-established dominant final markets (consumer electronics, mobiles and computers are nearly 70% of semiconductor sales) vs. growing but still secondary final markets (automotive and industrial uses represent 20%).

Figure 5 – Manufacturing sector demand growth, by economy (and respective input inventories management)

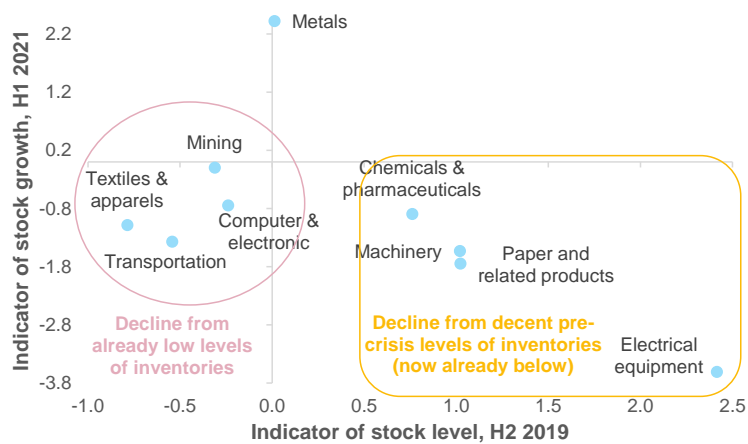


Note: demand growth based on new orders and backlogs of work of manufacturing PMI surveys (3-month average as of May 2021).
Sources: IHS, Euler Hermes, Allianz Research

The ongoing rise in prices will also negatively impact even further companies that went into the crisis with low levels of inventories. For example, the just-in-time model, which aims at minimizing the need to stockpile, was widely adopted in the automotive sector. We find indeed that the transportation sector, along with textiles & apparel and computer & electronics, are currently seeing declining inventories from already low pre-crisis levels (see Figure 6).

At the global level, beyond this year, manufacturers will have to deal with the peak of the demand cycle (around mid-2022) at a time when inventories will be above average following the ongoing race for inputs.

Figure 6 – Inventories indices, by sector



Note: indicator of stock level normalized over 2010-2019. The indicator of stock growth is a sequential difference of this indicator of stock level.
Sources: Bloomberg, Euler Hermes, Allianz Research

APPENDIX

Major policy events supporting global trade in 2020 and 2021

2020
US-China: decline of tariffs following Phase One Deal US reduces by half the extra tariffs (from 15% to 7.5%) on USD101bn of imports (list 4A) from China China reduces by half the extra tariff (from 15% to 7.5%) on a subset of USD75bn of imports from the US
EU-Vietnam: free-trade agreement Vietnam removes duties on 65% of imports from the EU EU removes duties on 71% of imports from Vietnam

2021
China reduces most-favored-nation tariff rates
US-EU: temporary suspension of extra duties linked to the large civil aircraft dispute (5 years) US on EU: on USD7.5bn worth of goods EU on US: on USD4bn worth of goods Extra tariffs were 15% on aircrafts and 25% on non-aircraft products
US-UK: temporary suspension of extra duties linked to the large civil aircraft dispute (5 years)
UK removes tariffs on USD77bn worth of imports in its new tariff profile
EU-Vietnam: free-trade agreement Vietnam removes duties on remaining EU imports (35%) over 10 years EU removes duties on most of remaining imports from Vietnam (29%) over 7 years

Sources: National sources, Euler Hermes, Allianz Research

Trade policy scenarios for 2022 onwards

2022 onwards - Central scenario (60% likelihood)
RCEP: ratification in early 2022 Tariffs and quotas will be eliminated on over 65% of goods traded We estimate that 10% of non-tariff barriers removed leads to the equivalent of -0.2pp decrease in the global tariff rate Tariff rates on non-agricultural goods are assumed to decline gradually to 0% over 15 years
US-China: Status quo on tariffs Continued tensions on strategic and technological sectors (e.g. through non-tariff barriers)
US-EU: TTIP unlikely but potential for smaller transatlantic agreements that decrease tariffs on certain product categories (e.g. industrial goods) and enable mutual recognition of standards and norms
CPTPP: No inclusion of China and the US, the UK is likely to join

2022 onwards - Optimistic scenario (15% likelihood)
US-China: Relaxation of tariffs on Section 301 - List 1 products (USDbn34 worth of goods) and/or removal of extra tariffs on List 4A products
US-EU: TTIP with tariff decrease and progressive removal of non-tariff measures We estimate that 10% of non-tariff barriers removed leads to -0.1pp decrease in the global tariff rate
CPTPP: Inclusion of the US, the UK and South Korea

2022 onwards - Pessimistic scenario (25% likelihood)
US-China: Increase in non-tariff barriers and increase in tariffs (e.g. on list 4A products, where tariffs had been reduced in 2020)
US-EU: No agreement (TTIP or smaller ones), and no renewed tensions
CPTPP: No new member

Sources: Euler Hermes, Allianz Research

These assessments are, as always, subject to the disclaimer provided below.

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The statements contained herein may include prospects, statements of future expectations and other forward-looking statements that are based on management's current views and assumptions and involve known and unknown risks and uncertainties. Actual results, performance or events may differ materially from those expressed or implied in such forward-looking statements.

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