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A trade recession before a mild Chinese reopening?

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EXECUTIVE SUMMARY

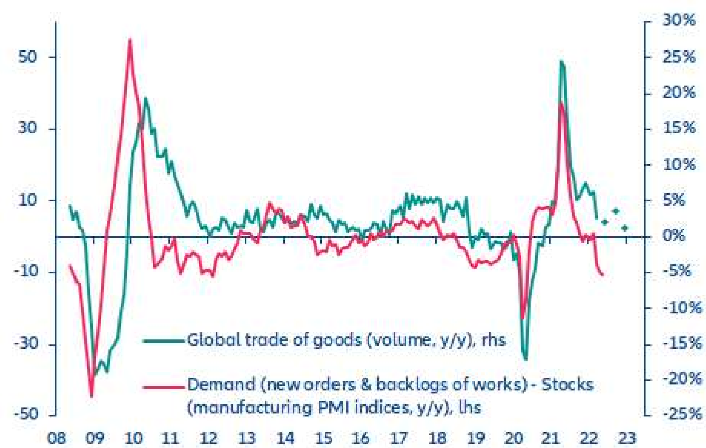
- **A contraction in global trade in Q2 2022…**With the omicron crisis in China prolonging supply-chain bottlenecks and bringing port congestions back to the worst levels seen in 2021, global trade of goods in volume terms should decline by -1.3% q/q. Overall, we now forecast global trade to grow by +3.5% in 2022 in volume terms, down from our previous forecast of +4.0% (and much below consensus ranging between +4.5% and +5.0%). In value terms, global trade is now set to grow by +10.4% in 2022, with the trade price component more than three times higher than what we expected before the war in Ukraine and the lockdowns in China.
- **…But China's mild reopening will help the trade recovery. Global trade should grow by +1.1 q/q in Q3 2022 and +0.8% in Q4.** Barring renewed large waves of Covid-19 infections, we expect stringency at the national level in China to normalize in July – even if the zero-Covid policy remains a risk. This means that industrial activity should recover mildly, and manufacturers dependent on Chinese goods could experience some relief in the fall as it will take two to three months for port congestion to normalize.
- **Improving supply from China would bring the largest production boost to the agrifood, pharma and software & IT services sectors in Europe and the US.** Using our proprietary database to map out global production chains that involve Chinese suppliers, we estimate an increase by over +5% for each sector in the second half of the year compared to last year's levels. This boost in output should be sold or stocked, the latter helping to reinforce the inventory buffer against potential future shocks (e.g. if the zero-Covid policy is maintained throughout 2022 in China).
- **Among major Western economies, Germany could see the largest GDP boost thanks to the improved access to inputs from China**. Our analysis of importing countries, supply-chain links and the sectoral breakdown of value added reveals that the Chinese reopening could help German GDP grow by up to an extra 0.5% in 2022 – all else being equal and assuming that the activity boost fully materializes in additional output through consumption or inventory. In France and the UK, the benefit to GDP would reach up to 0.3%, as their share of the manufacturing sector is lower.

Advanced indicators confirm our forecast for a global trade recession in Q2, partly driven by China's lockdowns.

Global trade in volume terms contracted in Q3 2021 and after the start of the war in Ukraine, we pointed out[1] that the risk of double-dip in global trade in H1 2022 had increased – not only due to supply-chain bottlenecks, but also because of lower demand. The omicron crisis in China led us to confirm this expectation[2]. These consecutive shocks to the global economy have led to an acute mismatch in the global balances of demand and manufacturers' inventories (see Figure 1). In sequential terms, we now expect global trade of goods in volume terms to contract by -1.3% q/q in Q2 2022, followed by a mild recovery in the rest of the year (+1.1% q/q in Q3 and +0.8% in Q4).

Overall, **global trade is set to grow by +3.5% in 2022 in volume terms, down from our previous forecast of +4.0%.** Indeed, this new number takes into account the full extent of China's omicron crisis, which is now largely past but lasted longer than previously expected. The slower Chinese economy is creating an exports shortfall for the rest of the world that is estimated at USD160bn. This comes on top of to the shortfalls triggered by the direct and indirect effects from the war in Ukraine (USD480bn). In total, close to 2% of global trade is at risk of being lost in 2022. As a result, risks remained skewed on the downside. In value terms, global trade is set to grow by +10.4% in 2022 as the price effect from supply-chain bottlenecks and transportation congestions remains high.

Figure 1: Global trade of goods in volume terms (%y/y) and proxy for global demand – stocks



Sources: CPB, Markit, Allianz Research

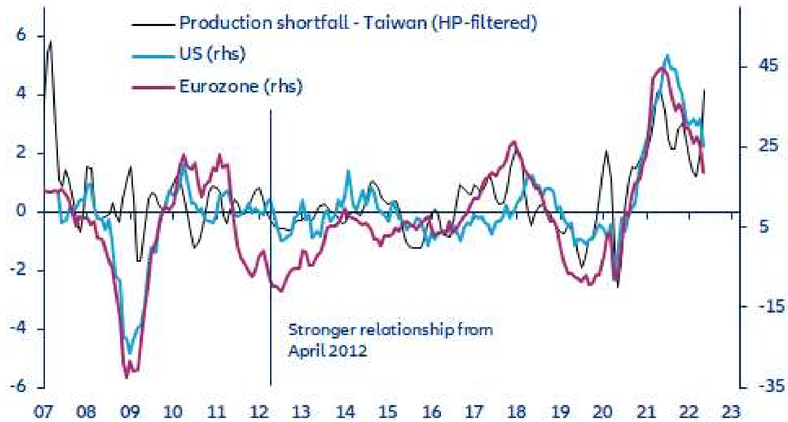
Several critical intermediate goods are produced, transited and shipped out of China and Asia (e.g. semiconductors) but slower industrial activity and congestion in domestic logistics have slowed down exports in the past few months. Looking at the manufacturing sector in Taiwan as a proxy, given its strong exposure to the electronics sector, we see that a production shortfall there clearly contributes to shortages of inputs in the US and the Eurozone (see Figure 2). The imbalance had been easing since the start of the year but remains at a high level, and the index

[1] *See our report "Global trade: Battling out of demand and price shocks".*

[2] *See our report "The cost of zero-Covid policy for China and the world".*

for the production shortfall in Taiwan shot up again in May 2022. As a result, barring a sharp drop in demand, shortages will likely remain in the short-term.

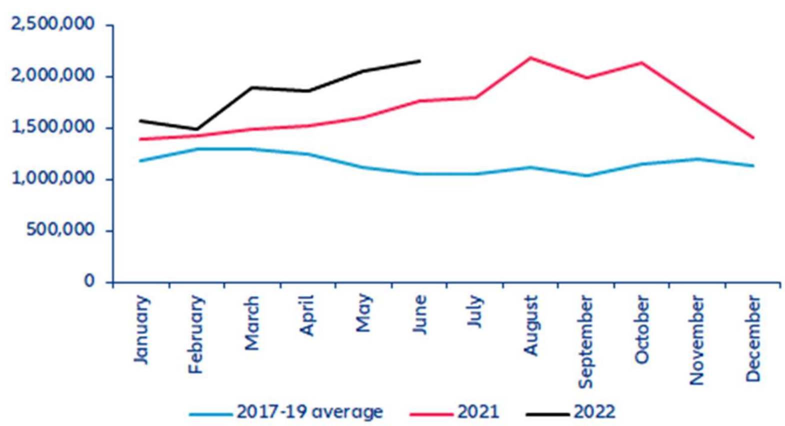
Figure 2: Input shortages in the US and the Eurozone (rhs) vs. production shortfall in Taiwan



Note: these indicators are based on sub-indices of manufacturing PMI surveys.
Sources: Markit, Allianz Research

In addition, global and Chinese port congestion are back to the worst levels of 2021. The volume of container vessels anchored outside ports across the world has averaged 5.9% of annual throughput per month since March, vs. a monthly average of 5.5% in H2 2021 (see Figure 3). The same calculations for China show a congestion level that also already exceeded the worst of 2021: The volume of container vessels anchored outside Chinese ports has been above-normal since March 2022, with the average monthly surplus since March amounting to 5.1% of annual throughput (vs. 3.7% on average in H2 2021). As a result, long delays and elevated costs of shipping are also likely to persist in the short term.

Figure 3: Average daily volume of container vessels anchored outside ports in the world (TEU)

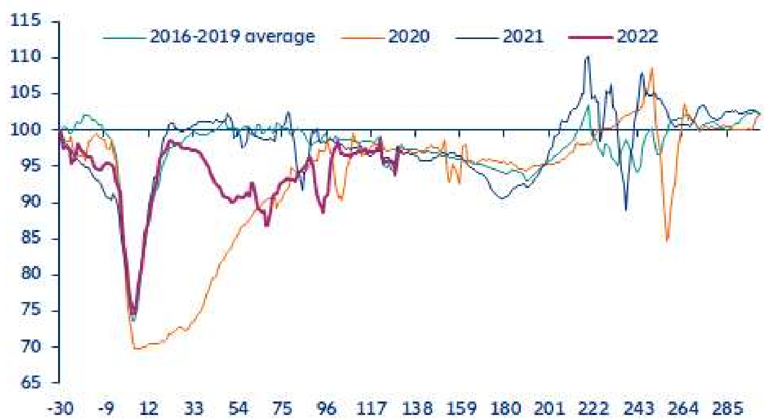


Note: for June, we assume that congestion stays at the level of the latest available data (12 June)
Sources: Refinitiv, Allianz Research

China stringency normalizing should provide a (mild) reopening boost to global trade.

China continues to maintain its zero-Covid policy, but the worst of the latest outbreak is likely behind us. We estimate that Chinese provinces that were under partial or full lockdowns summed up to nearly 25% of national GDP in March-April. The share has since come down to 9% in May and 5% in the first half of June. Our proxy for national traffic congestion (see Figure 4) was down by -6.8% y/y on average in March and -7.6% in April. It has since improved to -2.4% y/y in May. In this context, a return-to-normal at the national level in July is possible (first half of June so far at -0.9% y/y), barring renewed large-scale Covid-19 infections and lockdowns[3], and based on the post-lockdown experiences observed in 2020[4].

Figure 4: Traffic congestion index (population-weighted average of 100 cities), 100 = 30 days before Chinese New Year



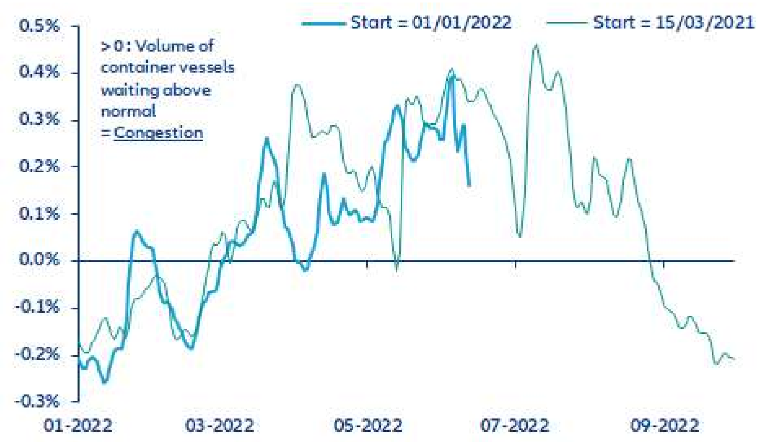
Sources: Ministry of Transport of China, National Bureau of Statistics of China, Allianz Research

Manufacturers in the rest of the world dependent on Chinese goods could see a boost from the end of summer onwards. The normalization of mobility in China means that industrial activity there should also recover, in particular in the automotive, electronics, computers & telecom, household equipment and machinery & equipment sectors. Indeed, our detailed sectoral analysis of cities that saw full lockdowns for at least 20 days since March suggests that these industries were the most affected. Once production comes back to normal, however, the impact on other countries that rely on Chinese goods also depends on China's port activity. **Based on the temporary port closures seen in 2021,** it could take between two to three months for port congestion to normalize (see Figure 5). This would imply a surge in goods trade around August or September, which are traditionally critical months as many sectors are preparing production and pilling up inventories ahead of the festive season. In other words, China's reopening could come right on time to save Christmas.

[3] *At the time of writing, Beijing and Erenhot (in Inner Mongolia) are seeing increases in new infections. The former is seeing localized lockdowns of residential compounds and the latter represents a negligible share of national GDP. As long as extended full lockdowns of large cities can be avoided, we should stay close to our central scenario.*

[4] *Indeed, some cities that have gone through partial or full lockdowns this year are already seeing normalized mobility, while others (including Shanghai) could wait until mid-June if we apply the average period of 50 days from-trough-to-normal for mobility observed in cities that underwent full lockdowns in 2020.*

Figure 5: Volume of container vessels anchored outside ports in China, difference with normal* (as % of annual throughput)

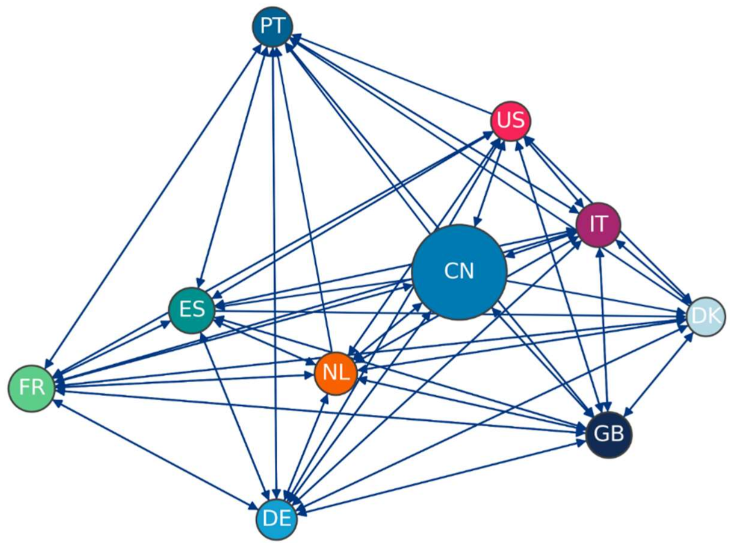


** average of corresponding days in 2017, 2018 and 2019.*
Sources: Refinitiv, Allianz Research

Some sectors and countries will benefit more than others.

Our proprietary data reveals that the agrifood, pharma and software & IT Services sectors are set to benefit the most from the reopening boost. Using our proprietary data on over 3,700 firms involved in trade with China and over 6,000 commercial relations, we can map out the way global supply chains are linked with Chinese companies (see Figure 6 for cross-country links). Although our database can seem rather small compared to the number of firms doing business with China, we find that the links between firms, between countries and between sectors are rather close to the sectoral and country breakdown of Chinese exports. We only note one significant discrepancy: We have a relatively low number of links originating from the computer and telecom sector in China, though it accounts for a sizeable share of Chinese exports. In other words, our estimations could be underestimated when it comes to that particular sector.

Figure 6: Export links originating from China



Source: Allianz Research

By first focusing on the larger cities that went into at least 20 days of partial or full lockdowns, we look at the drop in mobility in these cities in the two months prior to the end of lockdowns (i.e. in March-April or April-May) and we assume that this drop is reversed in in the second half of the year. Such a reversal would translate into a boost in economic activity by +4.6% y/y at the national level. We distribute this boost across sectors based on firms' demographics in the concerned cities. For instance, cities that were impacted by lockdowns were not involved in metals activity. As a result, the estimated boost to activity in this sector is less than half a percentage point while the boost for the electronics sector is above 5%. In the final step, we propagate the relevant boosts along exporting sectors and come up with potential boosts in activity/production in "end" sectors and countries. Overall, we find that the global agrifood sector and Emerging Europe countries would see the largest boost from the reopening of China. The US and the UK would benefit from boosts of around 5% while Germany would see a boost of 4.7%. However, if we translate that into a potential GDP boost by considering, all else being equal, that the activity boost fully materializes in additional output through consumption or inventory, Germany's real GDP could grow by up to an extra 0.5% in 2022. In contrast, the UK and France would only grow by up to 0.3%.

Table 1: Top five sectors and countries to benefit from Chinese reopening

Global sector	Activity boost
Agrifood	5.5%
Pharmaceuticals	5.3%
Software & IT services	5.3%
Computers & Telecom	5.3%
Textiles	5.3%

Country	Activity boost	Maximum boost to 2022 GDP
USA	5.1%	+0.28%
UK	5.1%	+0.28%
Germany	4.7%	+0.50%
France	4.9%	+0.26%
Italy	5.0%	+0.41%

Source: Allianz Research

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