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Global Economics | North America

Global Trade Monitor: Persistent Softness

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We expect global trade to remain soft for the rest of 2023 as DM aggregate demand slows, while global supply chains continue to ease. Lower than expected growth in China is likely to have global spillovers, which we examine in detail.

- We expect global growth to be only 2.9%Y in 2023 and 2.8%Y in 2024, down from 3.5%Y in 2022.
- In Jul-23, the most recent data available, global goods exports declined 2.5%YoY in volume terms, and 5.6% in value terms, the latter a bigger decline because of easing inflationary pressures.
- Global services exports declined in July for the first time in over a year, as the recovery in travel softened . After being a key driver of services exports since 2021, transportation exports contracted for two consecutive quarters.
- Steep voluntary production cuts by Saudi Arabia and Russia caused oil prices to increase by 20 USD/ BBL to 95 USD/ BBL over the past quarter. These cuts are likely to last at least until the end of the year.
- A weaker Chinese recovery is likely to have implications for exports from the rest of the world, with Asia and Latin America being the most exposed regions.
- The Morgan Stanley Supply Chain Index (MSSCI) continued to decline in August, while Global demand PMIs improved slowly. Our index incorporating demand factors (MSSCISD) ticked downwards again, and is now at pre-pandemic levels.

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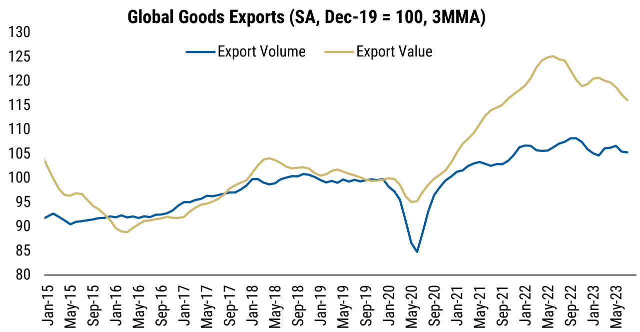
Weaker global trade expected going forward

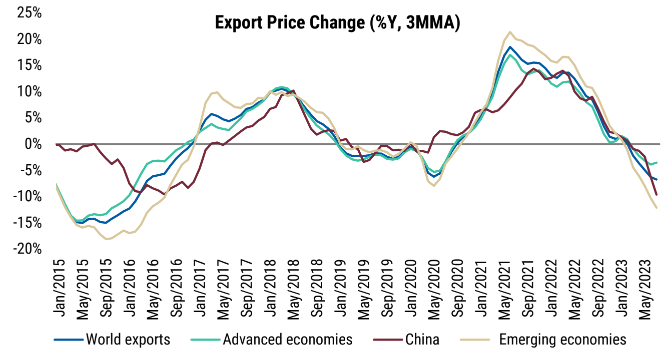
The global economy is expected to step down to 2.9% in 2023 from 3.4%Y in 2022. Overall, EM are expected to expand 4.1%, outperforming DM, which are expected to grow 1.4%. Asian economies (4.8%Y) continue to drive EM growth.

Exhibit 1: Growth in global exports has been slowing, and contracted sharply in value terms...



Source: Haver, Morgan Stanley Research

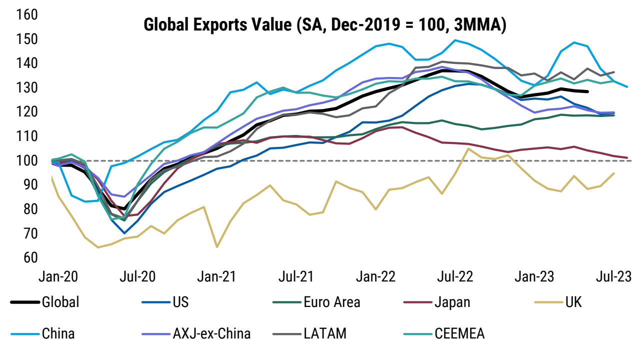
Exhibit 2: ...as inflationary pressures eased and export prices entered deflationary territory



Source: CPB, Haver, Morgan Stanley Research

In Jul-23, the most recent data available, global goods exports declined 2.5%YoY in volume terms, and 5.6% in value terms (Exhibit 1), reflecting easing inflationary pressures (Exhibit 2). 3MMA Global export prices have been in deflationary territory from March to July, leading to a larger contraction in value terms. Chinese exports in value terms have declined sharply, in line with the sharp drop in export prices, while AxJ-ex-China exports remained flat (Exhibit 3).

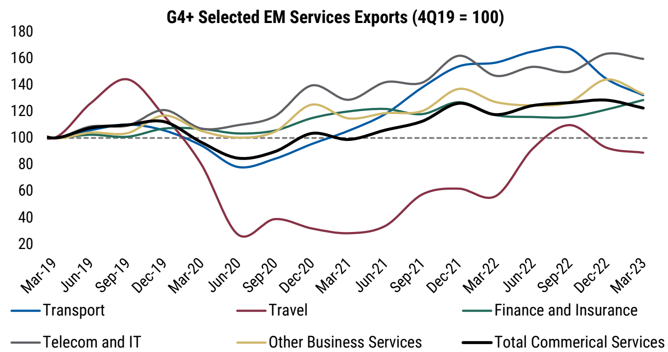
Exhibit 3:
Global Export values remained weak amidst subdued demand and receding import prices



Source: Haver, Morgan Stanley Research

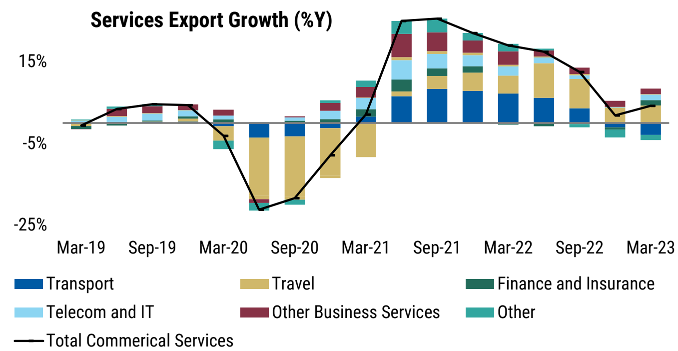
Services Exports declined 4.6%QoQ following a year of gradual growth (Exhibit 4). With the exception of financial and insurance services, all major categories of services exports declined from 4Q22 to 1Q23 (latest data available). After a strong recovery from 1Q22 to 3Q22, travel services returned to pre-Covid levels in nominal terms, but have declined for two successive quarters since. Transportation followed a similar trajectory, expanding from 2Q-20 to 3Q-22, but has contracted sharply since then. This sequential decline is likely to manifest in a substantial drag on YoY Services Exports growth in coming quarters owing to a large base effect (Exhibit 5). After staying flat for several quarters exports of Finance and Insurance services increased by 9.7%YoY in 1Q-23.

Exhibit 4: Services exports declined for the first time in a year...



Source: WTO, Morgan Stanley Research

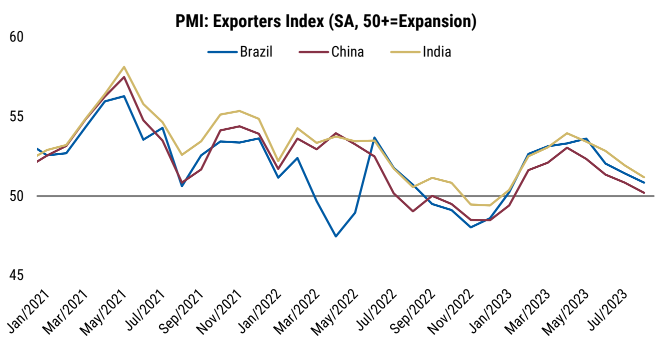
Exhibit 5: ...as growth contributions from Travel and Transportation moderated



Source: WTO, Morgan Stanley Research

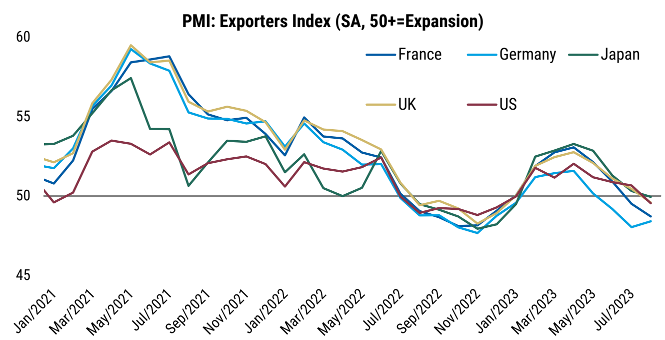
A glance at the PMI: Exporters Index suggests a clear divergence between DM and EM- The three key EM, China, India and Brazil, all have PMIs in expansionary territory (Exhibit 6); while the US, UK, Japan, and the key Euro Area economies- Germany, France, Italy and Spain are all in contractionary territory (Exhibit 7). Global Demand PMIs for New Orders and Purchases have also below been 50 since mid-2022.

Exhibit 6: PMI: Exporter's Index is over 50 for key EM with Indian PMIs higher than the rest...



Source: S&P Global, Haver, Morgan Stanley Research

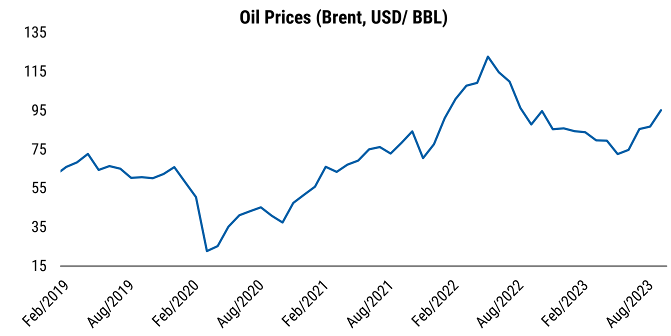
Exhibit 7: ...while DM PMIs are below 50, with German PMIs lagging behind the other DM



Source: S&P Global, Haver, Morgan Stanley Research

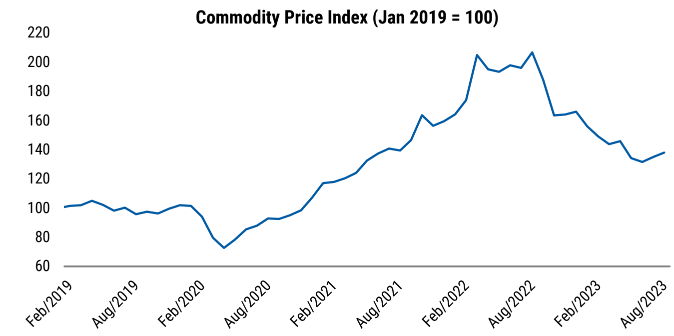
Oil prices have increased by 20 USD/ BBL to 95 USD/ BBL since July (Exhibit 8), boosted by voluntary cuts from Saudi Arabia and Russia, which are expected to last at least until year end. With these cuts, higher prices appear to be well-supported with robust demand growth and falling observable inventories. Prices are expected to remain in the mid-$90s as long as OPEC production cuts continue, and prices to be meaningfully higher would require outright demand destruction to balance the market. The Commodity Price index (Exhibit 9) tends to closely follow oil prices, and has started to tick up as well.

Exhibit 8: Oil prices have risen sharply following cuts from Saudi Arabia and Russia...



Source: Bloomberg, Morgan Stanley Research

Exhibit 9: ...and the Commodity Price Index is starting to tick up as well



Source: Bloomberg, Morgan Stanley Research

In the **US**, trade added 4bp (%Q, SAAR) to growth in 2Q23, a large step down from the +58bp contribution in 1Q23. Trade volumes were down, with goods exports down 16%, and goods imports down 8%.

In the **Euro Area** exports have considerably weakened (0.2%Y in 2Q23), in sync with weak global trade, and contribution to a particularly weak outlook in the manufacturing sector. Going forward, our Euro Area team sees expects a progressive pick-up from 0.4%Y in 2023 to 1.7%Y in 2024, still well below their average of 4%Y over 2011-19.

China's August trade data improved and slightly beat expectations. Owing to stronger commodities, imports rebounded sequentially for the first time in five months, likely suggesting upcoming stabilization in infrastructure investment. Exports also came in steady MoM, as softer exports to DM were offset by resilient regional supply chain trade (Exhibit 11).

Imports of iron ore, coal, crude oil and copper rose MoM in both price and quantity (Exhibit 12), possibly reflecting robust mobility and stabilization in infrastructure investment, although imports of mechanical and electrical products continued to edge lower. Seasonally adjusted dollar exports came in flat at 0%M after consecutive contraction in Apr-Jul, and a low base pushed YoY higher to -8.8% from -14.5% in July. Shipments to western DM (dominated by finished goods) moderated further, while exports to regional economies (where supply chain trade in intermediate goods is more common) improved. Full year growth of Chinese exports may reach ~-5%, and stands at -5.5% YTD.

In the **UK**, goods exports, adjusted for the trade in erratics, are deeply subdued relative to pre-2020 levels- as of 2Q23, they are 6.2% down on 1Q20. However, trade openness has evolved largely as expected on the back of strong services exports, especially those of travel and other business services. Compared to 2019, in 2022 exports of travel and other business services were 12% and 32% higher, respectively.

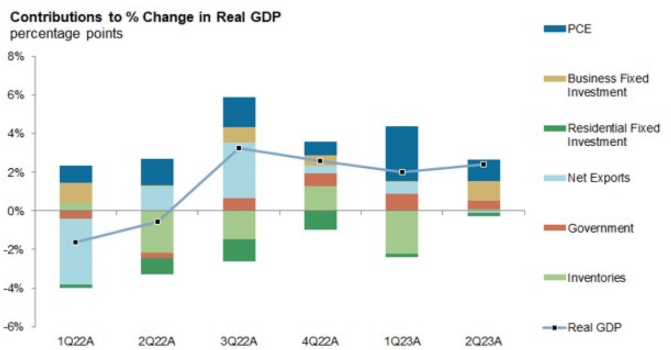
In **Japan**, net exports grew by 7.1% (SAAR), with exports growing 3%Y and imports shrinking by 1.7%Y, which contributed to an above-consensus 2Q23 growth print. August real trade estimates suggested a sharp MoM drop of 6% in exports, with exports to Asia (-9%MoM) and EU (-12%MoM) registering large contractions despite a weaker yen. Real Imports declined by 3.2%MoM, and are on track for a third consecutive quarter of QoQ decline.

In **India**, the trade balance widened to its highest since Nov-22, as both exports (-6.9%YoY) and imports (-5.2%YoY) contracted on a YoY basis, even as exports rose 8%MoM on an SA basis. A slight growth in exports of electronics, textiles and ceramics exports partially offset sharp declines in oil exports, while oil imports devlines 23.7%YoY. Services exports declined 0.4%%YoY driven by base effect, but on a sequential basis, services trade balance rose marginally.

Korean exports improved more than expected for the second consecutive month (-4.4% YoY vs -8.4% in Aug), and semiconductor exports recorded their highest monthly exports value in 12 months. Strong demand from the US and Europe continued to support non-tech goods demand across autos and general machinery while demand from ASEAN and China improves gradually.

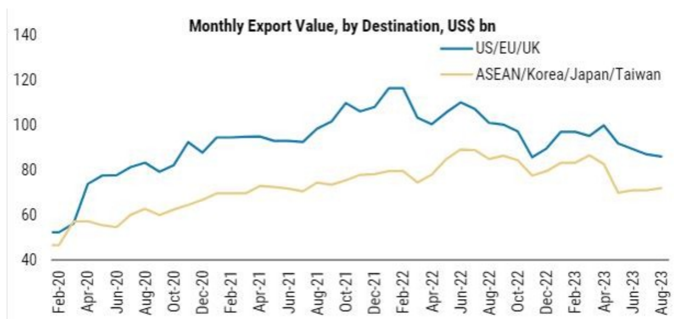
Strong domestic demand in **Mexico** saw imports grow 2.2% QoQ in 2Q23, while exports contracted by 3.1% QoQ, likely due to early signs of a slowdown in the US. In **Brazil**, exports grew 2.9% QoQ, and resilient exports contributed to a materially above consensus GDP print.

Exhibit 10: In the US, Net Exports were a drag on growth



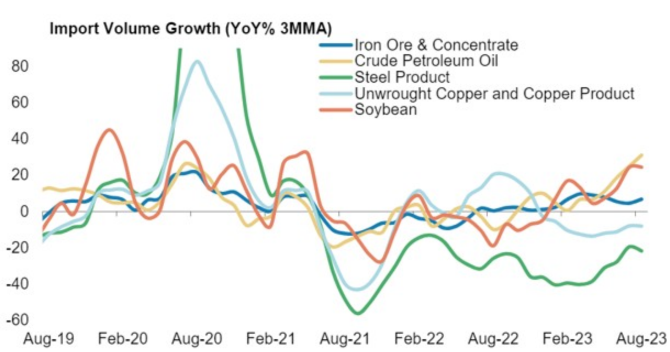
Source: Bureau of Economic Analysis, Morgan Stanley Research

Exhibit 11: Chinese exports to Asian economies are faring better than exports to DM...



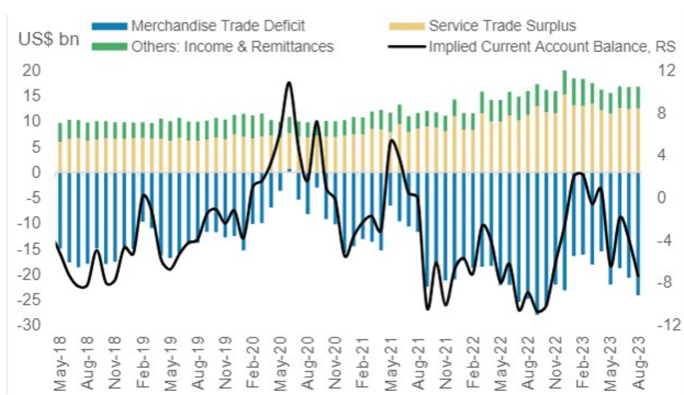
Source: China Customs, CEIC, Morgan Stanley Research

Exhibit 12: Chinese imports of iron ore, crude oil and copper rose, possibly indicating robust mobility and infrastructure investment



Source: General Administration of Customs, Morgan Stanley Research

Exhibit 13: India's trade deficit widened to its highest since Nov-22



Source: CEIC, Haver Analytics, Morgan Stanley Research

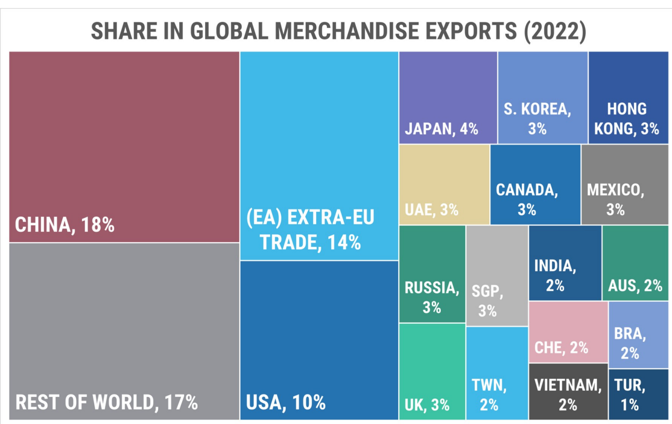
Revisiting Trade Spillovers from China

Our China team has written extensively about the 3D challenges that China faces- debt, demographics and deflation, which coupled with geopolitical tension have slowed China's potential growth.

China is currently the world's largest goods exporter(Exhibit 14) and the third-largest goods importer. It accounts for between 43% and 63% of global demand for the key commodities of steel, aluminium, copper and coal, and 15% of global oil demand- the second-largest importer (Exhibit 15). As such, China's weaker recovery has repercussions for global trade, commodity prices and inflation.

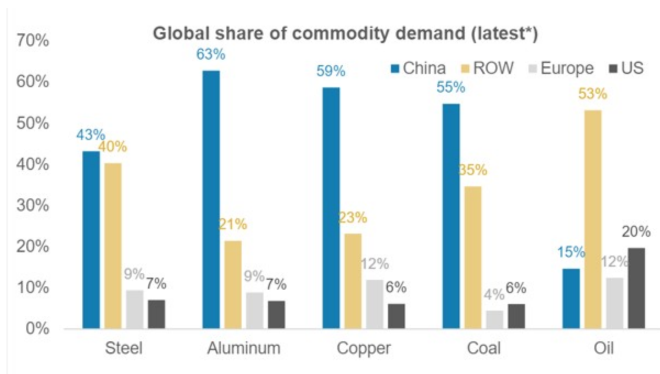
Further, if China were to slip into a debt-deflation loop, it could act as disinflationary force for the rest of the world via trade, commodity prices, and currency movements. China's exports of manufactured goods, especially if accompanied by a significant currency depreciation, would spread disinflation globally.

Exhibit 14: China is the world's largest exporter of goods...



Source: WTO, Morgan Stanley Research

Exhibit 15: ..and one of the largest importers of commodities



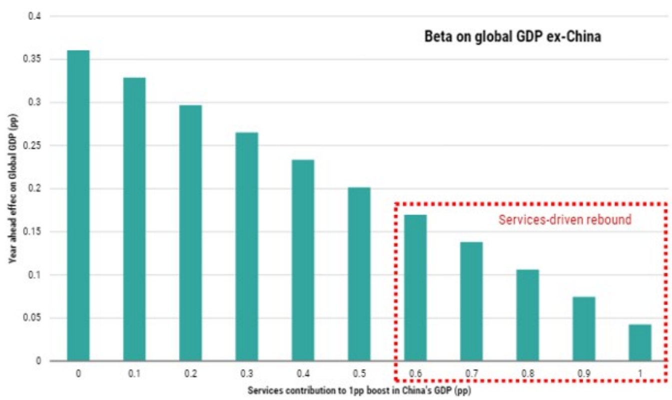
Source: World Bureau of Metal Statistics, BP Statistical Review of World Energy, Morgan Stanley Research; Note: *2023 data as of 2Q23

In our work at a global level one year ago, we argued that even if China were to rebound, the 'growth impulse' for the global economy would be lower because the next Chinese cycle is likely to be consumer led and not investment led (Exhibit 16). In contrast, the slump in China has spread to the manufacturing sector, implying more of a spillover than the first quarter surge.

Over the past two decades, China has also moved up the value chain towards products like electronics and machinery, and away from agricultural products and textiles. As China shifts away from raw materials and towards higher value added products and services, the nature of Chinese spillovers are likely to be different across regions, depending on the nature of their value chains relative to China.

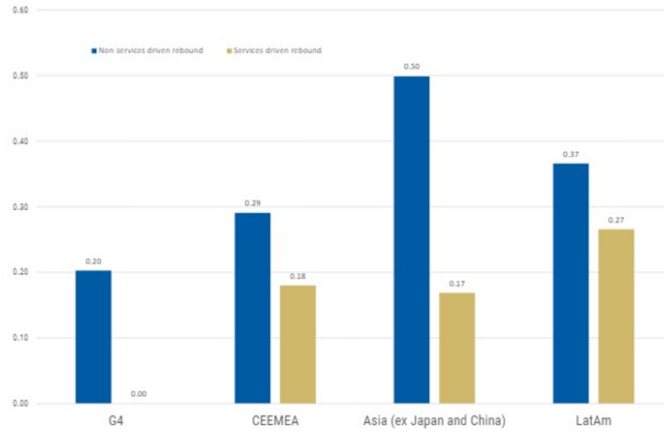
In our previous analysis, we observed that Asia and LatAm had the highest sensitivity to China (Exhibit 17), but the sensitivity in Latin America was less dependent on the type of recovery in China. We examine these spillovers in detail for Asia, LatAm and Euro Area in subsequent sections.

Exhibit 16: Beta on global ex-China GDP could be lower in case of a consumer-led recovery



Source: Morgan Stanley Research, Bloomberg, Haver

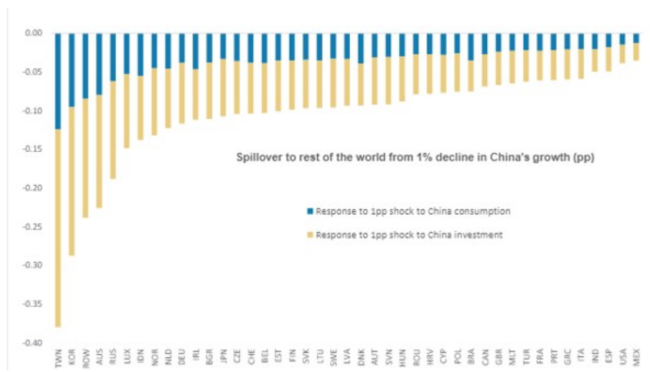
Exhibit 17: Effect of a Non-Services rebound (Blue) is higher than that of a Services-driven rebound (Gold)



Source: Morgan Stanley Research, Bloomberg, Haver

Trade Spillovers to Asia

Exhibit 18: How a 1ppt decline in China's consumption and investment affects growth in the rest of the world

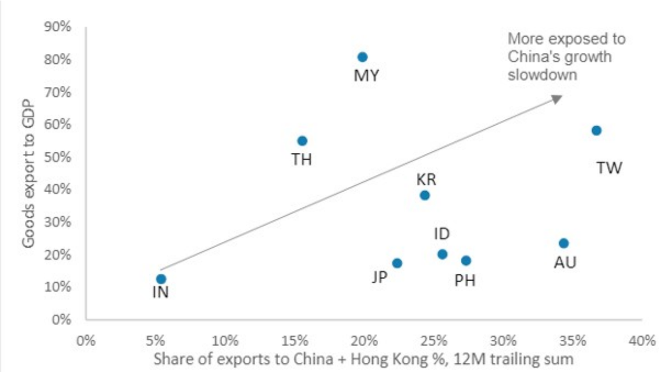


Source: World input-output table; Note: For more details on World input-output table analysis methodology, kindly refer to: Global Economics: Global Supply Chain Impact: Who's Most Exposed?

Given its geographical proximity and stronger trade linkages developed over the past two decades, Asia bears the highest exposure to a Chinese slowdown, even more so when it comes to a investment or manufacturing led slowdown. Our China team estimates that each 1ppt decline in China's growth rate would reduce growth in other Asian economies by 15bps. However, the nature of the slowdown carries a great deal of importance. If the slowdown were to be driven more by investment and manufacturing, the beta would be 10bps, which is 80% higher than if the slowdown were to be driven by weaker consumption (Exhibit 18).

The linkages of Asian economies to China are not restricted to just trade- weaker Chinese growth can also be transmitted through commodity and non-commodity goods prices, MNC operations and broader financial conditions.

Exhibit 19: India has lower exposure to a slowdown in China from a trade perspective, while Korea and Taiwan have higher exposure...



Source: Haver, Morgan Stanley Research

Exhibit 20: ..since Taiwan, Singapore and Australia run sizeable trade surpluses with China while India runs a large trade deficit

Source: Haver, Morgan Stanley Research

Except for India and the Philippines, China is the number one trade partner for all Asian economies under our coverage. **Korea, Singapore, and Taiwan** are the most exposed to a Chinese slowdown, given these are trade-oriented economies that run large trade surpluses with China (Exhibit 19 , Exhibit 20).

As such, a slowdown in China affects demand for these commodities, and net exporters like **Australia** (iron ore, coal and gas), **Indonesia** (coal, palm oil, nickel) and **Malaysia** (palm oil, gas) are likely to face downside risks. In particular, demand construction related materials exported by Australia (long steel, iron ore and cement) could face more downward pressures. However, given most countries in Asia are net importers of commodities, weaker Chinese demand is likely to result in better terms of trade and contribute to disinflation.

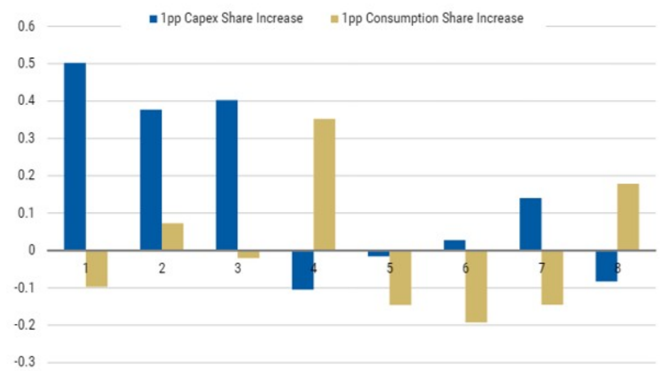
India is least exposed to China through the trade channel, given its trade deficit with China, low share of exports to China and structural uptrend. It is also a significant commodity importer, and can benefit from weaker commodity prices.

Spillovers to Latin America

Within LatAm, the natural resource-led economies of Brazil and Chile have the highest export dependence on China, while the manufacturing driven economy of Mexico is oriented more towards the US, as is Colombia.

While the beta of LatAm to Chinese growth is consistent across investment-led versus consumer-led cycles relative to other regions (Exhibit 21), the timing of the spillover of Chinese growth is only explicit when it is an investment-led cycle. A 1pp increase in the share of investment spending in China leads to a 50bp increase in LatAm exports to China, an effect that persists for three quarters.

Exhibit 21: Sensitivity to 1pp change in Chinese share of GDP growth for Latin American exports to China

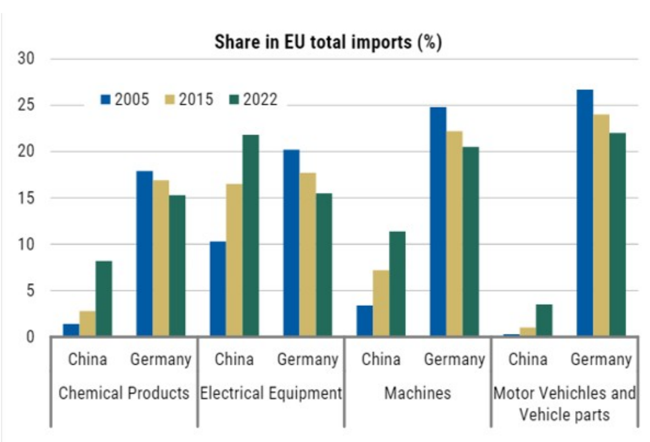


Source: Haver Analytics, IMF Direction of Trade, Morgan Stanley Research; Note: The above results are based on a structural VAR model. Quarterly data for 2010-19 were used for the following variables: total level of exports from Brazil, Chile, Mexico and Colombia to China in US dollars, the shares of gross capital formation and final consumption expenditures in the real GDP growth of China and HP-detrended series of China's real GDP. The AIC/Schwarz criterion was used to determine the number of lags in the VAR, and the Cholesky decomposition was used to generate impulse response functions. This is similar to the strategy used in IMF (2004), where the link between Mexican exports and different economies was examined.

A large share of Brazil's exports of iron ore, crude petroleum and soybeans, and Chile's exports of copper (refined and ore) are directed to China. Unsurprisingly, this has led to Brazil and Chile having above-average sensitivity to Chinese growth. Following 1pp of investment-led growth in China, Brazil's exports show a persistent rise in exports to China of around 25bp, lasting across three quarters, while Chile's exports seem to rise by 70bp quickly before fading.

Spillovers to Euro Area

Exhibit 22: While not conventionally a close trade partner of the Euro Area, China's market share has been markedly increasing across a number of key sectors with time



Source: IW, Morgan Stanley Research

The effect of weaker Chinese growth on the Euro Area is likely to be limited when compared to Asia and Latin America. Although China's weight as a destination for European goods has increased steadily over the past few years to 1.5% of EA GDP, it remains well below that of the US, at 3% of EA GDP. Consequently, it would take a very large shock to Chinese demand for the direct trade channel to affect the macroeconomic outlook in Europe. Recent scenario analysis by the ECB concludes that if GDP in China falls 140pp below current expectations in 2024, it would reduce growth in Europe by 20bp and inflation by 10bp. On the other hand, China's integration in European supply chains is much higher, especially in sectors like electrical equipment, where it accounts for 24% of EU imports, or motor vehicles, where it has an increasingly large share.

MSSCI: Another Improvement

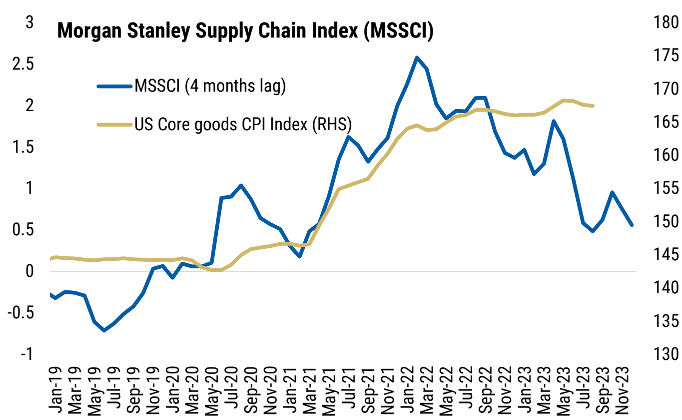
The Morgan Stanley Supply Chain Index (MSSCI) continued to decline in August. Global demand PMIs also improved slowly, while our index incorporating demand factors (MSSCISD) ticked downwards again, marking its 16th consecutive month of declines

Another Improvement: The Morgan Stanley Supply Chain Index (MSSCI) contracted by 0.19pts in August, similar to the decline of 0.20pts in the prior month. Containership rates continued to decline sharply m-o-m in August, like they did in July. While containership rates have shrunk to a quarter of what they were one year ago, they remain 60-140% above pre-Covid levels. Shipping rates ticked up after declining for two straight months, while import air freight costs from Asia declined 18% m-o-m. Global backlogs PMIs ticked up slightly, while global delivery times PMIs declined by 1pt , led by a 3pt contraction in Euro Area Manufacturing Suppliers' Delivery Time PMI. The index remains below pre-Covid levels, reflecting still-elevated containership and air freight rates.

"MSSCI supply and demand" (MSSCISD) returning to pre-Covid levels. The "MSSCI supply and demand" (MSSCISD) continued its gradual downward trajectory, with an improvement in global demand. Global Manufacturing New Orders and Manufacturing Quantity of Purchases PMIs increased by 0.41 and 0.46 to 46.5 and 45.6, respectively . This was driven by a recovery in Chinese PMIs, and partially offset by a sharp contraction in UK PMIs. US and Korean new order and purchases PMIs also declined. The “MSSCI supply and demand” is now at -0.28, which is comparable to pre-Covid levels, such as the 2019 average of -0.24.

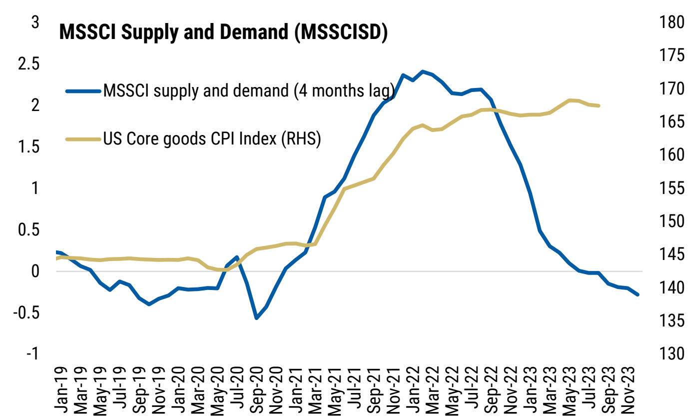
MSSCI is on Bloomberg. Our index is on Bloomberg. Type "MSSCI Index <GO>" or "MSSCISD Index <GO>" on your terminal to get our latest prints.

Exhibit 23: MSSCI contracted for the second consecutive month



Source: Morgan Stanley Research, Haver Analytics, Clarkson Research

Exhibit 24: MSSCISD continued its gradual decline



Source: Morgan Stanley Research, Haver Analytics, Clarkson Research

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