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Trade in Transition 2023

Global Report

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DP WORLD FORWARD

Making Trade flow – and the world move



**Sultan Ahmed
Bin Sulayem**
Group Chairman
and CEO, DP World

One thing has become clear over past centuries and decades, without logistics the world stops.

To keep it moving, businesses around the world must adapt when faced with major challenges. We have seen supply chains emerging from the pandemic impacted by geopolitical tensions and wrestle with policies potentially detrimental to the globalised world we have become accustomed to.

New trends in regionalisation and reshoring are further changing the logistics landscape. Like most other industries, logistics is undergoing its own transformation. Emerging technologies, the drive to digitalise, new market entrants, growing customer expectations, consolidation and new business models have shaped the need for collaboration, diversification and innovation.

That's why I am delighted to welcome the third edition of "**Trade in Transition**". This Economist Impact-led annual global survey of over 3,000 trade and supply-chain managers monitors and assesses these trends. Tracking sentiments and recording current issues provides valuable insights into what is being done, and needs to be done, to make trade flow—for the benefit of all.

Returning manufacturing to markets closer to home is one highlight of **Trade in Transition** this year. The survey found that twice as many companies as in 2021 are shifting manufacturing and suppliers from far-flung locations to their home markets. Continued inflationary pressures and being agile enough to expand into stable and transparent markets are other key highlights.

I said earlier that trade benefits all and I am always encouraged by its capacity to resolve the issues that we face in our lives. Trade is an engine that creates jobs, reduces poverty and increases economic prosperity. Indeed, over one billion people have moved out of poverty because of economic growth underpinned by global trade since 1990. Facilitating trade at borders, within borders and beyond them is one of the solutions that we should all pursue.

As we move through 2023, real-time visibility, port-centric capabilities and sustainable supply chains will ensure companies can continue to find new efficiencies in an increasingly challenging environment. Today, and in the years to come, companies increasingly need simplicity with single distribution platforms covering all elements of the supply chain to make their lives easier in an increasingly noisy, fragmented and complicated world.

Without rapid transformation to keep pace with evolving demands for end-to-end services, logistics runs the risk of being disrupted by new competitors. Adapting to change and offering new capabilities are massive opportunities that will create greater supply-chain efficiencies, wider market access and prosperity for the sector at large as well as prosperity for the greater good.

I hope you find **Trade In Transition 3** both thought provoking, insightful and of interest and I wish you all the best in 2023.

About this research

Trade in Transition 2023 is an Economist Impact research programme, supported by DP World, which captures private-sector sentiment on international trade. In the inaugural programme, launched in 2021, we explored the impact of covid-19 on companies' trade operations. In 2022, the second year of the programme, we explored how companies are navigating the ups and downs of the global economic recovery against the backdrop of an ongoing pandemic.

In this third edition we explore private-sector sentiment on the trading environment shaped by global shocks, particularly geopolitical shocks such as the war in Ukraine, but also the sporadic covid-19 lockdown policies that persist in key markets. This year's research is also based on a global survey of senior executives involved in their firms' day-to-day international trade decisions and transactions. The survey of 3,000 respondents was conducted between September and November 2022, capturing the perspectives of executives across six regions (North America, South America, Europe, Middle East, Africa and Asia-Pacific).

As a further addition to our research we used quantitative techniques to assess the macroeconomic impact of three key global scenarios, including 1) sustained inflation rates and consequently higher than expected monetary tightening; 2) the significant deterioration in US, Taiwan and China tensions; and 3) the increasing use of technology in trade operations. Our economic modelling exercise uses the standard Global Trade Analysis Project (GTAP) model to estimate the

impacts of these likely global events in terms of GDP, exports / imports and employment outcomes over the next 12 months.

The GTAP model is a multiregional, multisectoral and computable general equilibrium model that assesses the macroeconomic impacts of policy shocks. The model's baseline, the GTAP 10 Data Base, contains information on 65 commodities and 141 global regions. These sectors and regions were aggregated into six geographical regions and seven broad sectors (see Appendix) for our modelling purposes. We derived inputs/shocks for the model through our global survey and secured responses from private-sector executives on the extent of changes to exports and imports under each scenario (see question in the Appendix). The outputs of the model are obtained as a percentage, which is the impact compared to a baseline. We then use the GDP data for 2022 derived from the data hub of The Economist Intelligence Unit (EIU) to quantify the impact in monetary terms.¹

The survey findings were supplemented by in-depth interviews with trade experts and senior executives across regions and sectors. We would like to thank the following experts for their time and insight (listed alphabetically):

- **Deborah Elms**, executive director, Asian Trade Centre
- **Stuart Harbinson**, independent trade policy adviser and former senior official at the World Trade Organisation
- **Abel Kamau**, trade policy manager, Kenya Association of Manufacturers

¹ <http://data.eiu.com/default.aspx>

- **Lalit Kumar Bhagat**, director, material planning and logistics, International Markets Group (IMG), Ford Motor Company
- **David Lawrence**, research fellow, Chatham House
- **Angus MacNeil**, chair, UK Trade Select Committee, House of Commons, UK
- **Anderson Martins**, head of supply chain and procurement, Nestlé Philippines
- **Rob Merrylees**, policy manager (safety and nautical) and analyst, UK Chamber of Shipping
- **Fabrizio Operti**, manager, integration and trade sector, Inter-American Development Bank (IDB)
- **Sulaiman Pallak**, regional manager of global purchasing and supply chain, General Motors
- **William Alan Reinsch**, senior adviser and Scholl Chair in international business, Centre for Strategic and International Studies (CSIS)
- **Oliver Stuenkel**, associate professor, Fundação Getulio Vargas (FGV), School of International Relations, São Paulo, Brazil
- **Nangula Nelulu Uaandja**, chief executive officer, Namibia Investment Promotion and Development Board
- **Rick White**, president and CEO, Canadian Canola Growers Association

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Executive summary

Against the backdrop of the covid-19 pandemic geopolitical events, such as the war in Ukraine and US-China tensions, have created great uncertainty for businesses. In response to the resulting supply disruptions, and in anticipation of a slowdown in trading activity in 2023, businesses are focused on enhancing their resilience for the longer term with the aim of insulating themselves from future shocks.

Through changes to their trade operations companies are endeavouring to take advantage of small pockets of growth. The World Trade Organisation (WTO) expects the volume of world merchandise trade (an average of goods imports and exports) to grow by one percentage point in 2023, compared with 3.5% in 2022. So, amid all the disruption, there are still opportunities for growth, but businesses need to uncover where such opportunities lie.

In this report corporate perspectives are also shared about how businesses are building further resilience into their strategies, responding not only to today's shocks and their associated implications but also to those that are likely to come hereafter.

The key findings of this report are:

1. **Businesses are still prioritising growth through market expansion.** The top drivers of export growth in 2023 are expected to be growing demand in key markets (cited by 25% of executives surveyed) and the expansion of operations into new markets (20%).
2. **Inflation will be a persistent threat for businesses.** Inflation is cited as the top

reason for pessimism about global trade over the next 24 months by the executives surveyed. According to The Economist Intelligence Unit (EIU), average global inflation in 2023 is forecast at 6.9%, compared with 9.9% in 2022 and 6.8% in 2021. The impact both on the demand side (reducing the purchasing power of consumers) and the supply side (increasing input costs for businesses) will reduce the profitability of businesses severely.

3. **Diversification is still the primary approach to supply-chain reconfiguration, but there is a shift towards regionalisation and reshoring.** The trend to bring supply chains closer to "home" through nearshoring/ regionalising or reshoring has increased since our last Trade in Transition report. Nearshoring/ regionalisation has increased by 8 percentage points and reshoring by 10 percentage points since our 2021 survey. There are multiple reasons for this shift, from reducing the impact of higher transport costs to taking advantage of government financial incentives. Yet diversification is still the primary strategy for overall cost reduction and increased resilience (cited by 47% of executives surveyed).
4. **While economics is driving supply-chain reconfiguration, geopolitics is also a critical factor.** In general, cost

reduction is the top driver of corporate supply-chain reconfiguration efforts, followed closely by reduced risk of disruption. However, 96% of executives surveyed confirm that they are making changes to their supply chains in response to geopolitical events.

5. **Resilience is being prioritised over short-term profitability.** Businesses are thinking long term as they are sacrificing profitability in the immediate term for increased resilience. On the demand side, businesses say that exporting to new markets and launching new products in existing markets are the most effective ways to increase demand-side resilience. The adoption of digital tools for inventory management and increasing co-ordination with suppliers are the two most effective supply-side resilience strategies.
6. **Just-in-time is still dormant.** Just-in-time is the prevailing trend among many businesses. Companies are increasing their inventory buffers: on average, companies held 10.1 weeks of inventories in 2022, compared with 8.9 weeks in 2021. Although increasing

inventories does push up costs, it appears to offset potentially greater losses incurred through failure to hold sufficient inventory. With higher interest rates in some of the largest economies, the cost of working capital (including the opportunity cost of holding inventories) is much greater.

7. **The adoption of technology and increased digitisation go hand in hand with the desire to achieve greater resilience.** Across technologies, about 35% executives on average say that in addition to just using digital tools for inventory management they have started using advanced technologies in their value chain, compared with 31% in 2021, and 29% of companies say they are planning to adopt these technologies, compared with 23% last year. Furthermore, the share of respondents who felt that advanced technologies were “not applicable” fell from 12% on average to 2%. With resilience being a central theme in this year’s survey, executives are using technologies to increase their agility to respond to new challenges.

Global trade: trends and expectations

The robust recovery the world anticipated in 2022 never materialised. The shocks that plagued global trade in 2020 with the onset of the covid-19 pandemic persist even today—through old and new avenues. In China, the world's largest export market,² the legacy of pandemic-related lockdowns continues to blight the country through rising infections, derailing regional and global supply chains. In addition, Russia's invasion of Ukraine has resulted in surging energy prices, supply disruptions and protectionist policies, reminiscent of the early days of the pandemic.

Despite these shocks, global trade remained resilient in the first half of 2022.³ The World Trade Organisation (WTO) estimates average year-on-year growth of 4.3% in global trade in real terms in the first five months of 2022.⁴ In line with this, more than 70% of respondents in our annual Trade in Transition survey reported an expansion of their international sales in the first half of 2022.

For the full year the WTO estimates trade growth of 3.5% (according to figures released in October 2022), lower than the 4% initially forecast for the year.⁵ But with an economic slowdown looming in key markets—The Economist Intelligence Unit (EIU) forecasts

a contraction in the euro area of 0.3% and anaemic growth of 0.2% in the US in 2023—the outlook for global trade is bleak. Economists at the WTO predict only 1% growth in global trade volumes in 2023.⁶



² https://ec.europa.eu/eurostat/statistics-explained/index.php?title=China-EU_-_international_trade_in_goods_statistics#EU_and_China_in_world_trade_in_goods

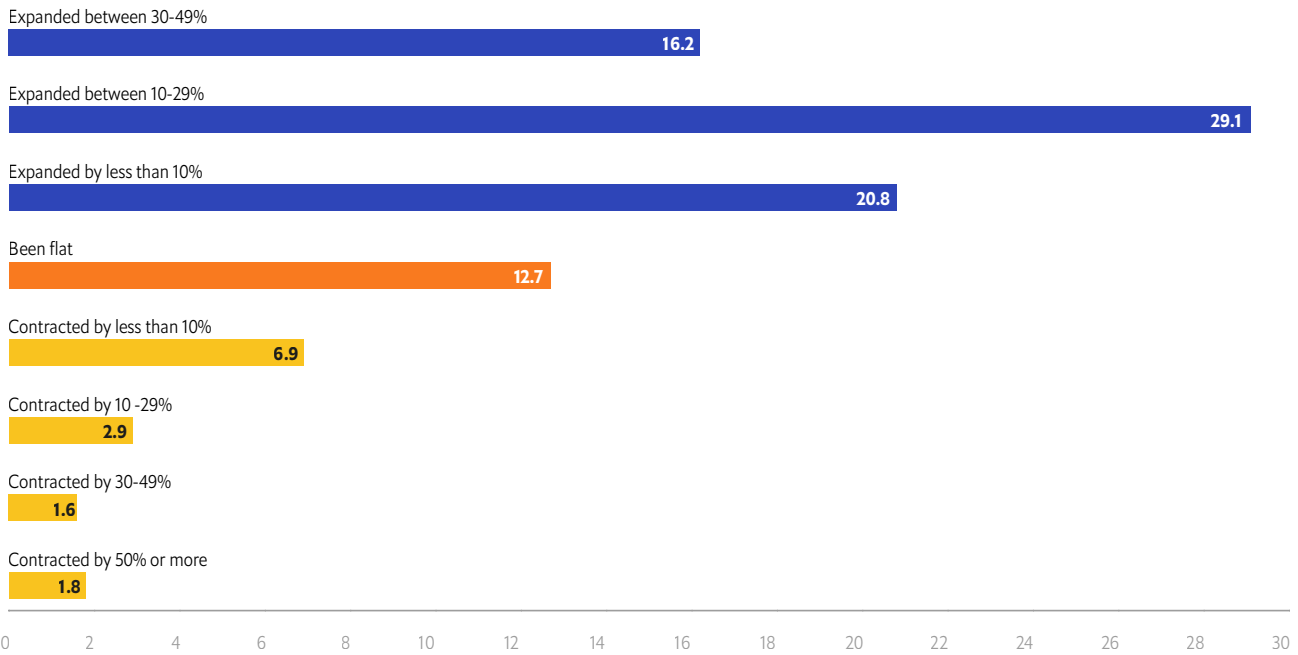
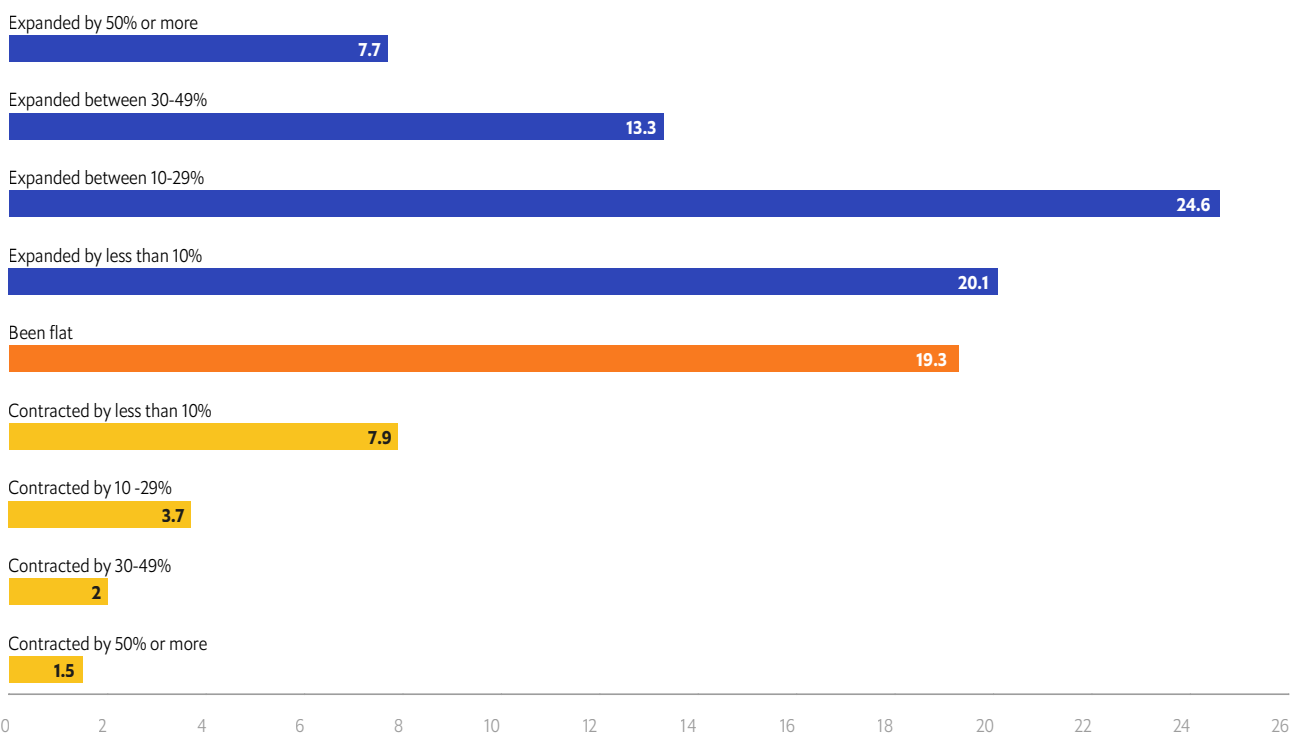
³ https://unctad.org/system/files/official-document/tdr2022_en.pdf

⁴ https://unctad.org/system/files/official-document/tdr2022_en.pdf

⁵ United Nations Conference on Trade and Development, "Global merchandise trade exceeds pre-COVID-19 level, but services recovery falls short", December 9th 2021. <https://unctad.org/news/global-merchandise-trade-exceeds-pre-covid-19-level-services-recovery-falls-short>

⁶ https://www.wto.org/english/news_e/pres22_e/pr909_e.htm#:~:text=The%20new%20WTO%20forecast%20estimates,than%20what%20was%20previously%20projected.

Figure 1: Changes to exports and imports in the first half of 2022 (compared with H1 2021)

Exports*Imports*

Source: Economist Impact Trade in Transition survey, conducted September-November 2022.

Drivers of growth

The subdued growth in exports next year is expected to be driven by three main factors, according to the executives we surveyed. These include “growing demand in key markets”, cited by 25% of respondents, followed closely by “expansion of operations into new markets” (22%) and “efficiency gains through digitisation of supply chains” (19%). The former points to uneven growth expectations in different parts of the world, where some countries are expected to record robust economic growth in 2022 and 2023 (particularly the oil-exporting countries of the Gulf Co-operation Council on the back of higher oil prices, and potentially China if it manages to rein in covid-19 cases). The Asia-Pacific region is expected to be the outlier in terms of trade growth because of higher consumption levels expected in the more self-reliant economies of India, Indonesia and the Philippines.⁷ However, foreign-exchange stress is threatening this positive growth, particularly in some African and South American countries, of which businesses need to be mindful.

There will also be pockets of healthier growth in certain sectors in 2023. While the automotive sector is only expected to see growth of 1%, 14 percentage points below 2019 levels, sales of electric vehicles are expected to increase by 25%.⁸ Energy companies will be among the biggest winners as a result of increased demand from Asia. Demand for renewable energy alone is expected to increase by 11%.⁹ Healthcare spending will also increase in nominal US dollar terms, given the ongoing effects of covid-19 and attention on the sector because of other viruses such as monkeypox.¹⁰ There will be many opportunities in the infrastructure sector. Investment the world over will continue, driven by legislative changes and initiatives,

from the US Infrastructure Bill to China’s One Belt One Road initiative to the rebuilding of Ukrainian infrastructure.¹¹ Information technology is yet another sector that will see growth as companies use these technologies to predict demand and track supply.¹²

On the import side, 25% of executives expect that rising production levels due to growing demand will be a key driver in 2023. Businesses are also confident about the impact that technology will have on import growth, with executives citing this as the top reason for optimism about global trade in general. Over one-quarter of executives believe that import growth will be driven by an increase in production levels led by technological upgrades. Around one-fifth of respondents also expect that efficiency gains through supply-chain digitisation will drive their imports in 2023. These responses reflect the fact that firms are still investing in improving efficiency as a way to recoup some of the costs incurred as a result of lower growth rates (see chapter on “Resilience matters” for more analysis of technology adoption).

Inflationary pressures

Corporate success will rely on how well businesses are able to navigate the host of challenges facing them as they engage in global trade. Consistent with last year’s survey, higher transport costs were cited as one of the major impediments to export growth (cited by 23%) and import growth (25%). On the export side, supply shortages of key inputs have also disrupted production levels, and ultimately exports, for about 20% of executives.

Together, these challenges are contributing to the highly inflationary environment in which businesses are operating today. Additionally,

⁷ <https://www.spglobal.com/ratings/en/research/articles/221128-economic-research-global-slowdown-will-hit-not-halt-asia-pacific-growth-12573068>

⁸ <https://www.economist.com/the-world-ahead/2022/11/21/ten-business-trends-for-2023-and-forecasts-for-15-industries>

⁹ Ibid.

¹⁰ Ibid.

¹¹ Ibid.

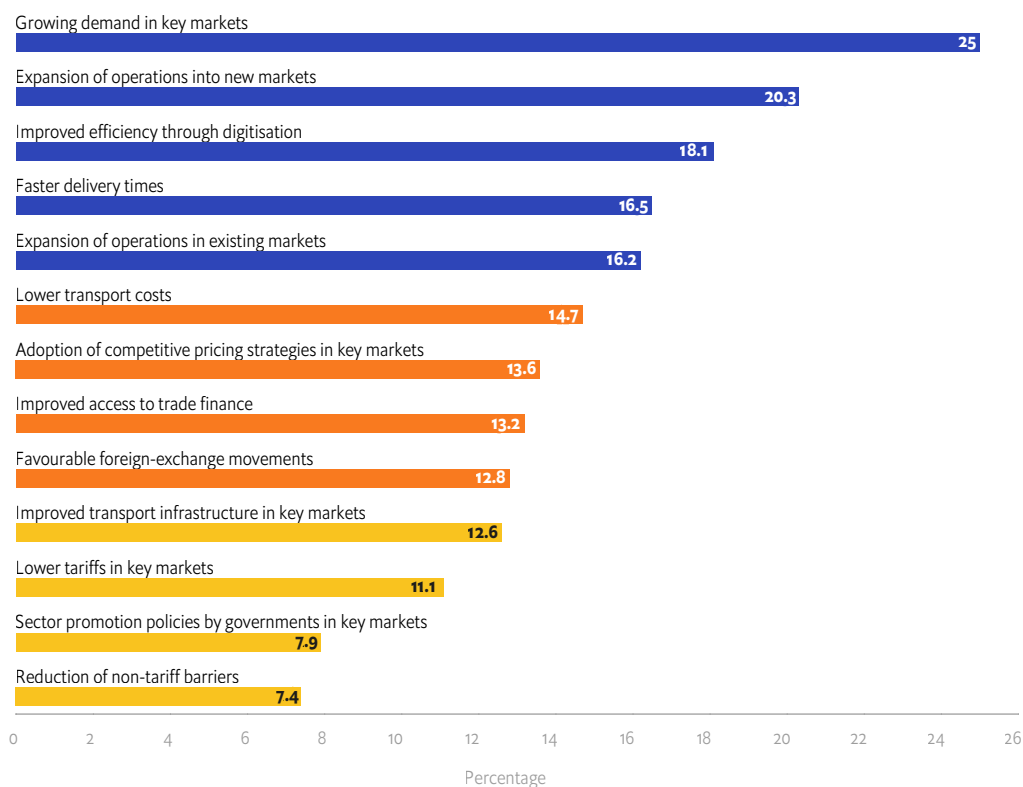
¹² Ibid.

geopolitical shocks, the resulting supply-chain disruptions and pent-up demand following the pandemic have also been driving inflation in 2022. Average commodity prices are projected to grow by 10% in 2022, which is a 26-year high.¹³ Overall, The EIU expects inflation to reach 6.9% in 2023, compared with a rate of 9.9% in 2022. Inflation is expected to ease slightly as the ongoing monetary tightening slows down economic growth and consumer demand. Inflationary pressures are not expected to subside even if China continues to loosen its zero-covid policy (which is currently

creating supply-chain bottlenecks and driving up prices). The supply disruption will only be replaced by a surge in demand for several commodities as production ramps up, sustaining high prices on average.¹⁴

Ultimately, higher costs mean reduced profitability for businesses, which is a real and persistent threat for them as inflation is expected to be sticky. As such, rising inflation is the top reason for pessimism about global trade over the next two years, cited by 30% of executives—significantly higher than the 20% who cited the economic recession.

Figure 2: Drivers of export and import growth in 2023



Source: Economist Impact Trade in Transition survey, conducted September–November 2022.

¹³ https://pages.eiu.com/rs/753-RIQ-438/images/global-economic-outlook-q4.pdf?mkt_tok=NzUzLVJJUSooMzgAAAGIY2yj7x8eVsLJM-fAaojabO8pwlvC-tU_VtpGoi2cQ8S3iQVURvjjlHyLWGsjsxwVEGMUAFWohR2ZgsctrEaYzgZoowQr5PmRSJCKd7lDu3OGFQXg

¹⁴ <https://www.project-syndicate.org/onpoint/age-of-megathreats-war-climate-debt-inflation-technology-by-nouriel-roubini-2022-11>

Quantifying the impact of inflationary pressures

The isolated impacts of inflation on businesses and consumers at the regional level have been quantified using the GTAP model (see “About this research” for more details). The impacts are modelled based on the input shocks, which are the changes to exports and imports expected over the next 12 months if inflation and monetary tightening persist (obtained from the global survey of private-sector executives).

There are interesting regional differences worth noting. Europe seems to be taking the greatest hit. Our modelling suggests that in the event of persistent inflation and monetary tightening in 2023 Europe's GDP would be 0.2% lower than it would be in a business-as-usual scenario. However, in terms of exports and imports by region the picture is mixed. In this scenario of continued inflation and monetary tightening private-sector executives in Europe, North America and Asia-Pacific expect exports to be 1% lower than they would have been if inflation were to ease as expected in 2023, reflecting decelerated production levels in North America and Europe and a fall in consumer demand reducing intra-regional exports.

For Asia-Pacific there are two reasons for expecting a decline in exports under this scenario. Falling demand in North America and Europe, which are key export markets for Asia-Pacific countries, particularly China, will reduce exports. In addition, lower production levels driven by monetary tightening measures in response to inflation exceeding central bank targets in most Asian economies will subsequently drive down exports.¹⁵ This is particularly true in the case of consumer-facing exports, a study from S&P Global finds.¹⁶

Exports in the Middle East and South America are expected to be hit the hardest by rising inflation and monetary tightening. Exports from these regions in 2023 are expected to decline by 3.5% and 2.7%, respectively, compared with 2022. As a trade and travel hub, the countries of the Middle East may see exports decline on the back of a slowdown expected in other markets due to high inflation and monetary tightening. As for South America, monetary tightening policies by major central banks would render financing scarce, resulting in a subsequent deceleration in activity.¹⁷

In this scenario impacts in Africa are negligible, with real exports expected to increase by 0.3%, compared with a contraction in other regions. Although the situation will be challenging for resource-intensive economies and key commodity exports in the region, the outlook is not as grim. Higher export prices and intense competition for Africa's resources would still avert a contraction of their exports.¹⁸

While the model's findings are consistent with the global discourse, the long-run impacts of these developments are yet to be seen.

¹⁵ <https://www.imf.org/en/Blogs/Articles/2022/10/13/asia-sails-into-headwinds-from-rate-hikes-war-and-china-slowdown>

¹⁶ <https://www.spglobal.com/ratings/en/research/articles/220926-economic-outlook-latin-america-q4-2022-a-period-of-below-trend-growth-ahead-12509793>

¹⁷ <https://www.imf.org/en/Blogs/Articles/2022/10/13/latin-america-faces-a-third-shock-as-global-financial-conditions-tighten>

¹⁸ <https://country.eiu.com/article.aspx?articleid=1952522378&Country=Nigeria&topic=Economy&subtopic=Outlook&subsubtopic=Overview#:~:text=African%20exporters%20will%20face%20a,markets%20in%20the%20year%20ahead.>

Geopolitical shocks

Beyond inflation and the bleak economic outlook, geopolitical undercurrents are influencing global trade. “There has been a general shift in international trade more towards being about geopolitics rather than being about economics and economic growth,” states David Lawrence, a research fellow at Chatham House, a London think-tank.

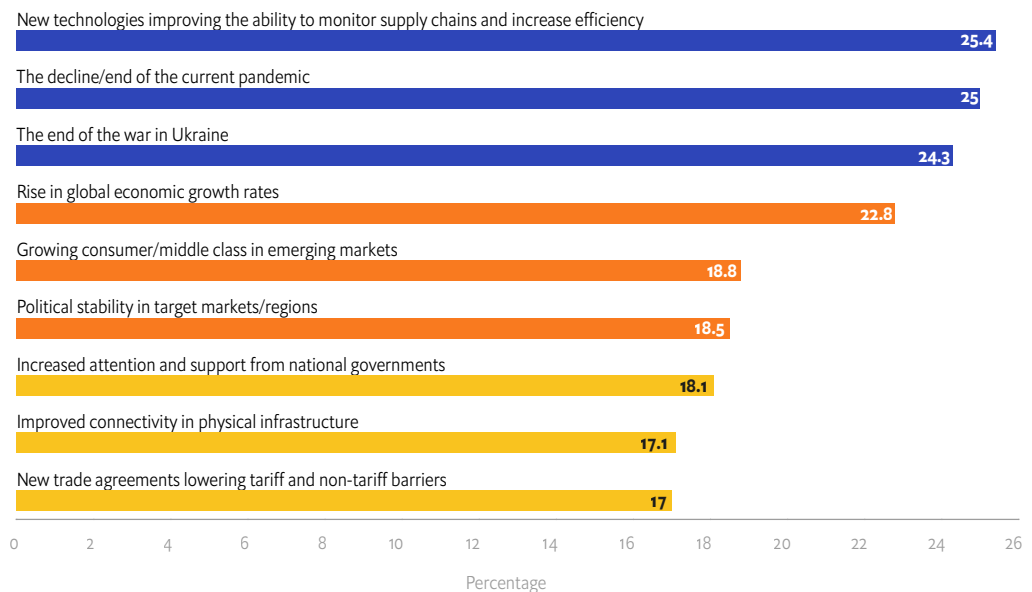
The war in Ukraine is the most recent example of this. Not only has it resulted in supply shortages of natural gas, ammonia and wheat from Russia and Ukraine, but it has also forced companies to reorganise supply chains, motivated either by the imposition of sanctions or for more altruistic reasons.

Similarly, ongoing trade tensions between China and the US, as the two economic giants compete for supremacy, are causing companies to create two streams of operations: maintaining Chinese operations to serve the local market and creating new production bases in Asia to serve the rest of the world. For instance, Samsung stopped manufacturing smartphones, TVs and PCs in China in 2019 and 2020 and shifted its global production base to Vietnam. Similarly, Apple has been moving

“There has been a general shift in international trade more towards being about geopolitics rather than being about economics and economic growth.”

David Lawrence, research fellow, Chatham House

Figure 3: Reasons for optimism about global trade in 2023 and 2024

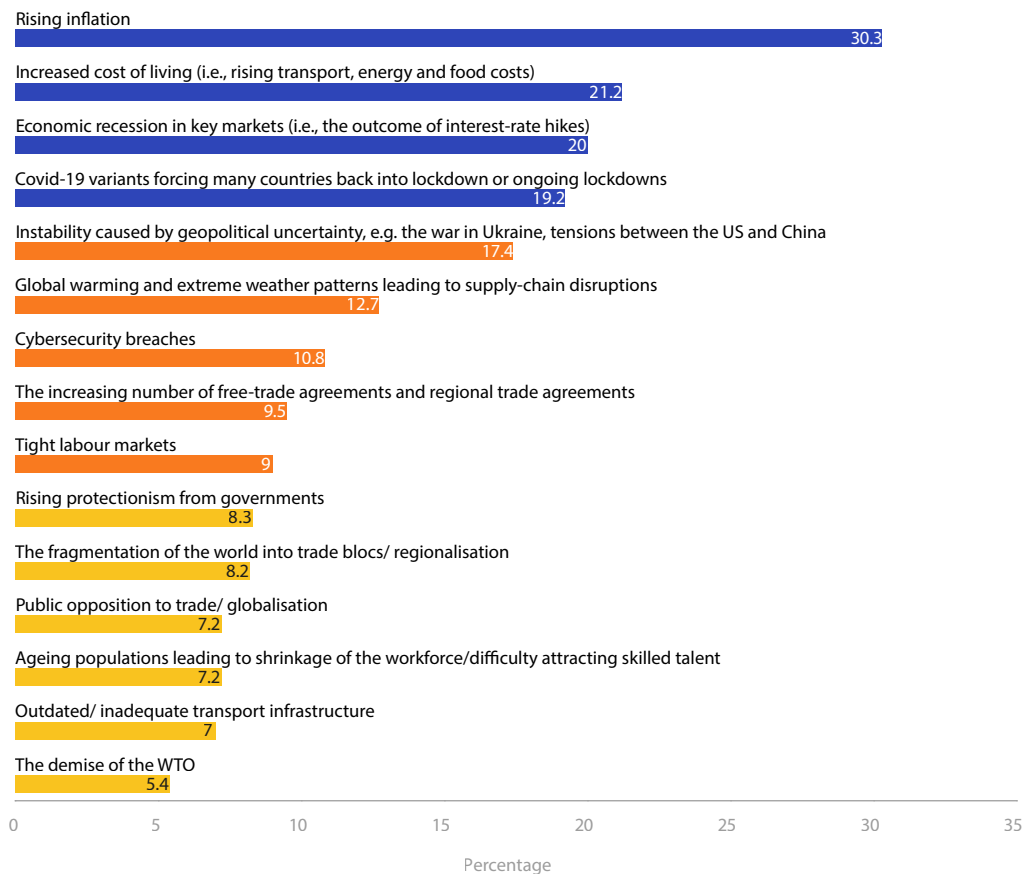


Source: Economist Impact Trade in Transition survey, conducted September-November 2022.

parts of its iPhone production lines to India and some assembly lines to the US. For its AirPods Apple has chosen Vietnam as the primary production hub.¹⁹ In 2022, 5% of Apple products were made outside China,

but JPMorgan Chase, a bank, predicts that this will rise to 25% in 2025 (still leaving a sizable portion manufactured in China).²⁰ As such, geopolitical tensions are another source of supply-chain shifts.

Figure 4: Reasons for pessimism about global trade in 2023 and 2024



Source: Economist Impact Trade in Transition survey, conducted September-November 2022.

¹⁹ <https://www.asiaperspective.com/move-manufacturing-china-to-southeast-asia/>

²⁰ <https://www.economist.com/business/2022/10/24/the-end-of-apples-affair-with-china>

Quantifying the impact of geopolitical shocks

On aggregate, a significant deterioration in US-China tensions (as opposed to continuing as they are currently) is expected to have a negative impact on global trade and GDP. As per our GTAP model (see "About this research" for more details), GDP losses under this scenario are fairly low and are consistent for all geographical regions. The losses range from 0.01% to 0.07% negative growth, except for the Middle East, where we observe a 0.31% reduction in GDP in 2023. However, the largest hit will be taken by Europe and North America, with a 0.07% decline in GDP growth in 2023, which roughly translates into US\$17.4bn and US\$16.1bn, respectively.

Interestingly, Asia-Pacific suffers the smallest decline in GDP under this scenario, with a reduction of just 0.01%. Protectionist tariff increases have already been implemented, and businesses in China have adjusted to these accordingly. Any future tensions are unlikely to increase tariffs significantly. Moreover, bilateral trade agreements between the US and other Asian countries, such as Japan, South Korea and Vietnam, would absorb the impact of a US-China tension shock through diverting trade to these geographies.

Some countries in Asia Pacific, such as India and Vietnam, even stand to gain from worsening trade and geopolitical tensions, if companies move facilities out of China into these markets.

The way forward for businesses

The uncertainties caused by global shocks are pushing companies towards optimising their trade operations for resilience and growth. Navigating these turbulent and uncertain waters is no easy feat, particularly with lower prospects for growth in 2023. Times are tough, and tough decisions will have to be made. That raises the question: how are companies worldwide strategising their next move? "Companies are

more responsive now," says Mr Lawrence from Chatham House. "They are responsive to where they think things are going, they are responsive to consumers, they are responsive to regulations, and so some companies will benefit from this. A massive risk assessment and fragmentation are under way." No matter what, the responses from companies are essentially geared towards building resilience, be it in terms of reconfiguring supply chains or finding new sources of demand. This will be explored in-depth in the next chapter.

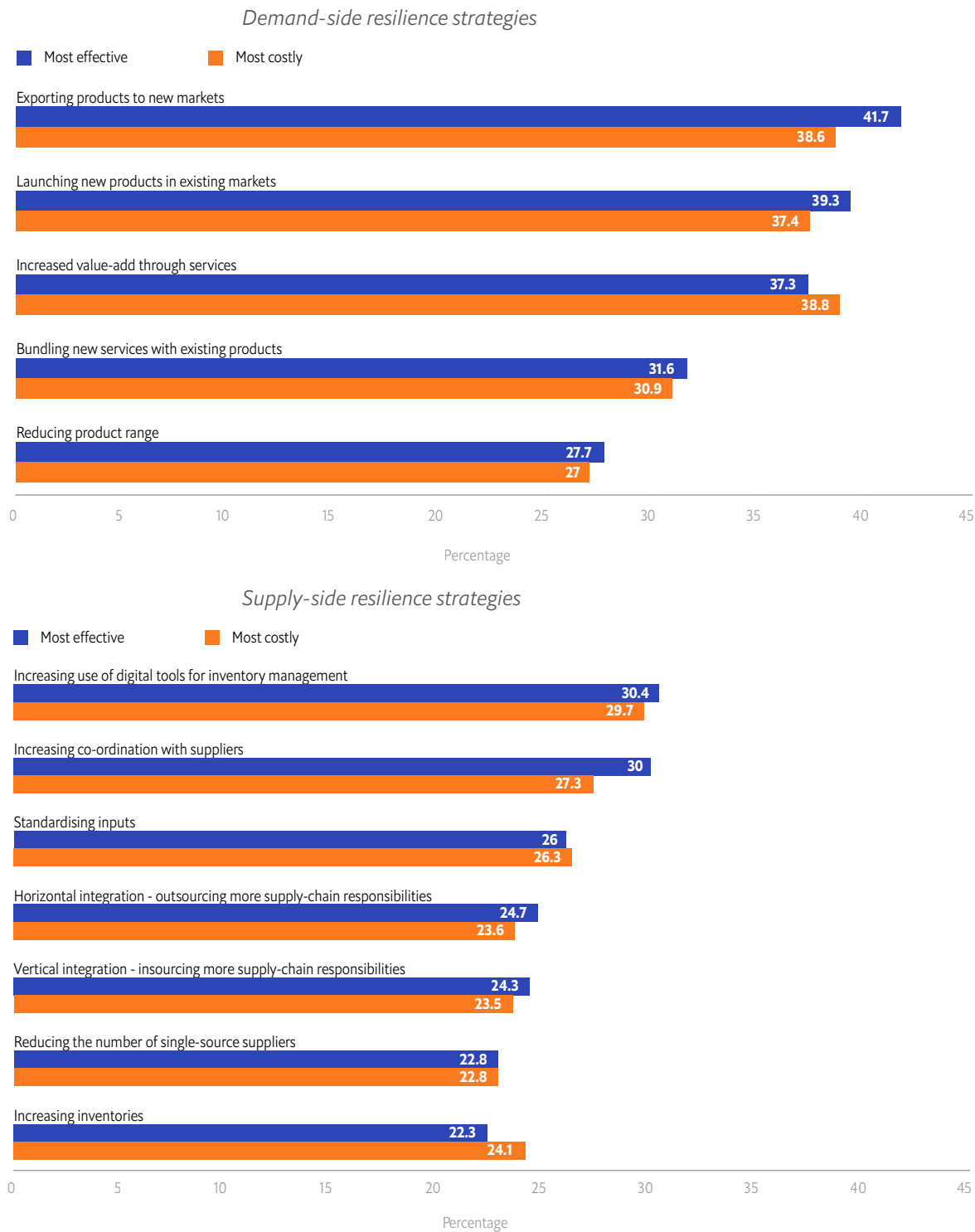
Resilience matters

In a fractured trading environment characterised by geopolitical tensions, inflationary pressures and supply disruptions, among others, businesses worldwide are united in one goal: the need to increase resilience in their trade operations. Businesses are thinking long term as they sacrifice profitability in the immediate term, continuing their search for efficiencies in other parts of the value chain. Indeed, a crucial finding in this year's edition of Trade in Transition

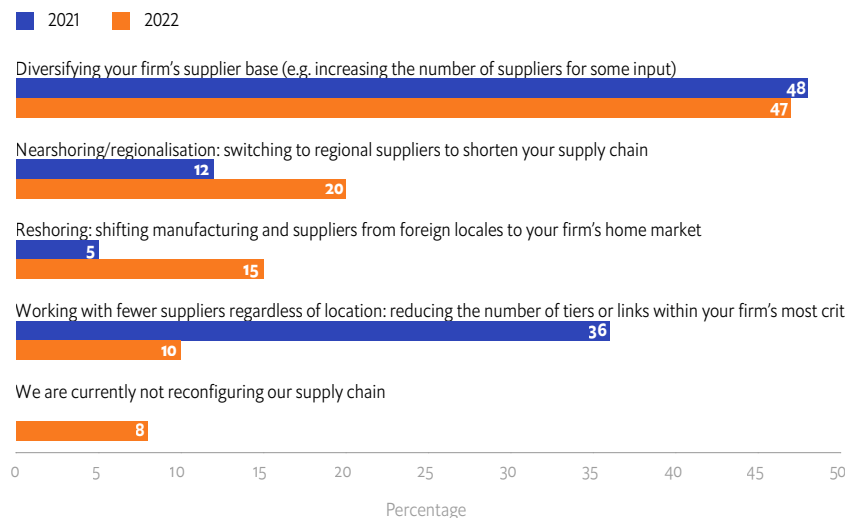
is that the most effective demand-side and supply-side resilience strategies adopted by businesses are also the costliest (see Figure 5).

But it is still economics that underpins their approach to supply-chain reconfiguration and choice of strategies for resilience, as we explore in this chapter. We discuss the shifting direction of trade, the driving forces behind these shifts, and the resilience strategies that are yielding results.



Figure 5: The most effective demand- and supply-side strategies for resilience are also the costliest

Source: Economist Impact Trade in Transition survey, conducted September-November 2022.

Figure 6: Companies' primary approach to reconfiguration and their motivations

Source: Economist Impact Trade in Transition survey, conducted September-November 2022.

A new chapter for globalisation

Diversification continues to be the dominant approach to reconfiguring trade operations, cited by 47% of the 3,000 executives surveyed around the world, almost exactly the same as last year (48%). But reducing the length of supply chains, either through regionalisation or reshoring, has risen sharply since the 2021 survey (see Figure 6). About 20% of executives are pursuing regionalisation as their primary approach to reconfiguration (versus 12% in 2021), and 15% are pursuing reshoring (versus just 5% in 2021).

Diversification as a strategy has clear economic benefits, according to the International Monetary Fund (IMF). In a paper published in 2022 the IMF found that higher diversification of suppliers reduces the loss in GDP through a supply shock by almost 50%.²¹ This is the aggregate of corporate-level impacts, where having multiple suppliers in different regions or even different countries within a region can reduce exposure to and losses from a supply disruption. "As much as possible, our strategy is to deal with multiple suppliers that we can leverage," says Sulaiman Pallak, regional manager of global purchasing and supply chain at General Motors.

Diversifying the supplier base is complemented by efforts to standardise inputs, designed to increase substitutability in sourcing and production. This strategy is among the top three most effective strategies (see Figure 5) cited by just over one-quarter of executives surveyed (26%). For example, General Motors has reduced the number of semiconductor chip types it is using in its cars from 60 to three unique types of microcontrollers, such that one chip has multiple uses in a car.²² In this way, companies can move away from a few specialised suppliers and source from multiple generic distributors.

“You rarely have two or three suppliers for an input that are identical. Usually, one of them is significantly more effective, efficient, faster, and that’s your preferred supplier.”

Deborah Elms, executive director, Asian Trade Centre

²¹ <https://www.imf.org/en/Blogs/Articles/2022/04/12/blog041222-sm2022-weo-ch4>

²² <https://www.imf.org/en/Blogs/Articles/2022/04/12/blog041222-sm2022-weo-ch4>

But putting this theory into practice is easier said than done. “You rarely have two or three suppliers for an input that are identical,” states Deborah Elms, executive director at the Asian Trade Centre. “Usually, one of them is significantly more effective, efficient, faster, and that’s your preferred supplier.”

For critical inputs with a limited number of suppliers companies are setting up long-term agreements. At General Motors, for example, Mr Pallak explains their strategy: “For battery raw materials that are in high demand there are very few suppliers, so we have structured five- or ten-year agreements with them.” This allows companies to secure supplies on a priority basis and deepen co-ordination with these suppliers to gain more visibility on inventory levels. A recent study of Indian firms showed that companies investing in closer relationships with suppliers were more resilient.²³ However, this strategy requires the heft of a multinational with a large production base, leaving smaller firms at a clear disadvantage.

Diversification matters on the demand side too. Exporting products to new markets and launching new products in existing markets are the two most effective demand-side resilience strategies cited by 42% and 39% of executives, respectively (see Figure 5). One study found that adding one export destination can reduce the impact of tariff shocks by 0.031 standard deviations.²⁴ So, taking a diversification approach can help to insulate companies from global shocks and contribute to securing the long-term health of their business.

The ‘R’ words

Beyond diversification, the shift to regionalisation and reshoring has been sharp but unsurprising. Protectionism and diversification of the global trading system has only increased since the start of the covid-19 pandemic. Among the most prominent examples of this are the US-China trade tensions over semiconductors.

Recently the US signed into law the Creating Helpful Incentives to Produce Semiconductors and Science Act of 2022 (CHIPS Act).²⁵ This law entails a US\$52.7bn subsidy in total to support chip manufacturing, earmarked primarily for the construction of “fabs”, or semiconductor fabrication plants, over the next five years. However, the act prohibits funding for companies that expand semiconductor manufacturing in China and other countries regarded as threats to national security.²⁶

But although reshoring promises more control over inputs in the short run, it leaves businesses exposed to regional shocks that could significantly debilitate operations. For example, as the US increases its production of semiconductors, it will increase its reliance on suppliers of mineral raw materials, such as Chile. At present US companies are at risk of facing higher tax rates in Chile because of an unratified treaty between the two countries. As a result, companies may have to pay rates of 44%, compared with the 35% its competitors pay in other countries where the treaty is in force, such as China, Japan, Canada, Australia and the UK.²⁷

²³ https://www.richmondfed.org/publications/research/economic_brief/2022/eb_22-46#:~:text=We%20look%20at%20the%20COVID,-maintaining%20relationships%20with%20their%20suppliers

²⁴ <https://www.sciencedirect.com/science/article/pii/S002219962200040X>

²⁵ <https://www.mckinsey.com/industries/public-and-social-sector/our-insights/the-chips-and-science-act-heres-whats-in-it>

²⁶ <https://www.pwc.com/us/en/library/forward-now-accounting-business-news/chips-act.html>

²⁷ <https://mineralsmakelife.org/blog/how-the-u-s-chile-tax-treaty-protects-mineral-supply-chains/>

Grappling with geopolitics

“An enemy now might not be an enemy in ten years’ time,” says Angus MacNeil, chair of the UK Trade Select Committee at the House of Commons. The uncertainty surrounding most geopolitical crises, especially those that even the most experienced experts deem unlikely to materialise (read: Russia invading Ukraine), is one of the greatest threats facing companies’ trade operations. Almost all executives surveyed (96%) report that they were making changes in response to geopolitical events, ranging from the war in Ukraine to US-China trade tensions.

The war in Ukraine has involved cyber-attacks which could escalate into full-scale, state-on-state cyber-attacks, further impacting business operations. For instance, the shutdown of a national grid, likely to be targeted by such attacks, would severely disrupt business operations. Moreover, a further deterioration of the US-China relationship, specifically as a result of tensions over Taiwan, would force some markets and companies to pick sides and operate two supply chains.²⁸

Companies are relying on a range of strategies to respond to geopolitical events (see Figure 7). These include expanding into more stable and transparent markets (cited by 33% of executives), increasing the length of supply chains to hedge against risks (30%) and undertaking more due diligence (29%).

In particular, the need to undertake more due diligence places an unnecessary burden on companies already saddled with high transport and inventory costs. “I just feel all of this is just complicating the system more for businesses,” says Deborah Elms, executive director of the Asian Trade Centre. Policymakers and multilateral organisations such as the World Trade Organisation have an obligation to resolve trade-restrictive issues and create stable, predictable environments in which businesses, both local and international, can operate and thrive (research shows that a one percentage point increase in uncertainty can lead to a decrease in global trade of 0.02 percentage points).²⁹ As such, current geopolitical issues deserve urgent attention. The global economic outlook depends on it.

Figure 7: Corporate changes to geopolitical events



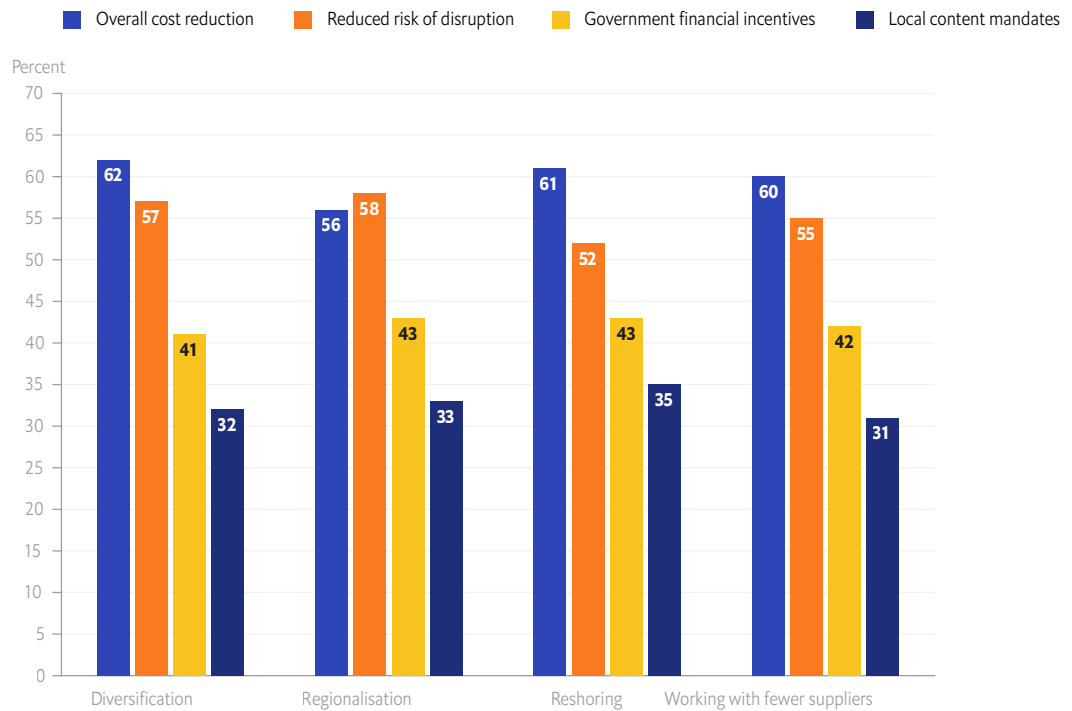
Source: Economist Impact Trade in Transition survey, conducted September-November 2022.

²⁸ https://pages.eiu.com/rs/753-RIQ-438/images/EIU_Risk%20outlook%202023.pdf?mkt_tok=NzUzLVJJUS00MzgAAAGlaEkuYgAAsZY-wEtqgKkWtSefU_Zxq9xMbAalFT5RogHvYsueoOHFMrTBFK55iwLovifglWFeM7SOWxT5VkmCISmylk3e2owoHTJX1c1Lek19A

²⁹ <https://blogs.worldbank.org/trade/how-policy-uncertainty-hurt-world-trade-2019#:~:text=The%20results%2C%20which%20are%20robust,and%20services%20trade%20volume%20growth.>

Figure 8: Top motivations for companies' primary approach to supply-chain reconfiguration

(Executives ranked up to two top drivers)



Source: Economist Impact Trade in Transition survey, conducted September-November 2022.

But while geopolitical considerations and local incentives or mandates are certainly playing a role in nearshoring, the primary driver is still economics, according to the executives we surveyed (see Figure 8). Although “local mandates” were a driver of reshoring for a slightly higher percentage of executives (35% vs 32% for diversification), “overall cost reduction” was the top driver (cited by about 60% of executives on average), followed closely by “reduced risk of disruption of critical inputs” (56%). “Economics is always going to win out against politics,” summarises William Reinsch, senior adviser and Scholl Chair in international business at the Centre for Strategic and International Studies (CSIS), an American think-tank.

The prevailing sentiment behind some of these resilience strategies, particularly on the supply side, is to prepare for the worst, just in case. As Stuart Harbinson, an independent trade policy

adviser and former senior official of the World Trade Organisation, explains: “Companies are looking at their supply chains and considering what alternatives, what fallbacks they have if things go really pear-shaped.” Indeed, the shift in supply-chain philosophy from “just in time”—that is, operating with less than a two-week inventory buffer—to “just in case” since the start of the covid-19 pandemic has only become more entrenched. Companies have increased their inventory buffers and were holding 10.1 weeks of inventories on average in 2022, compared with 8.9 weeks in 2021.

“The just-in-time concept was introduced to make sure that we have the lowest cost of manufacturing a product,” says Lalit Kumar Bhagat, director for material planning and logistics at the International Markets Group (IMG) of the Ford Motor Company. “With the current situation [with less predictability],

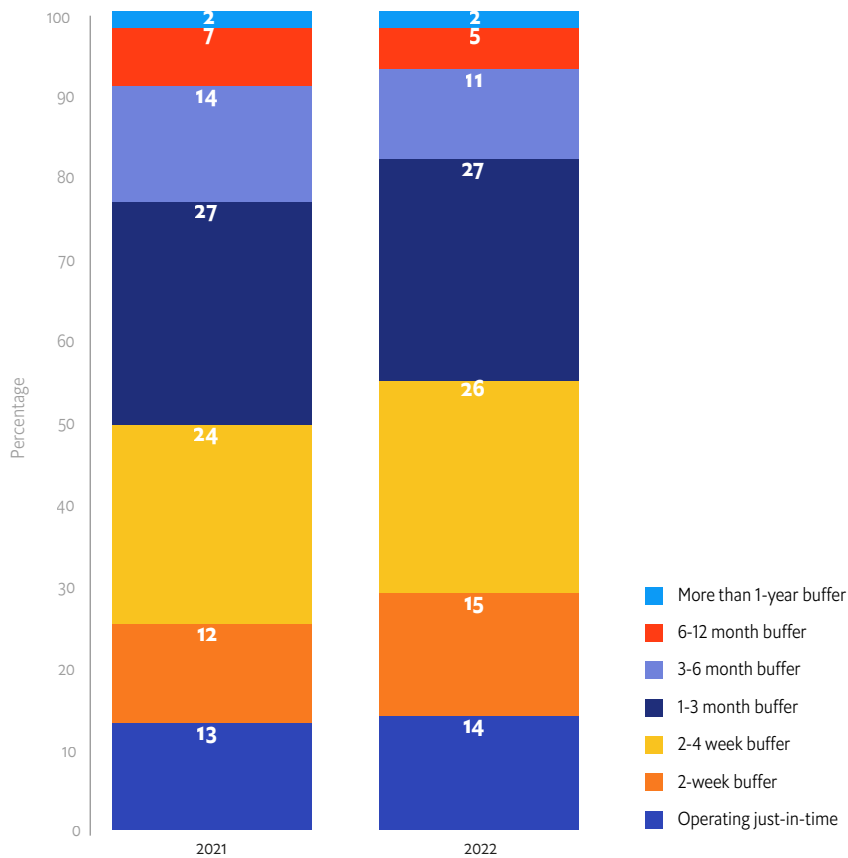
you are losing more money by keeping less inventory.” When critical input supplies are disrupted, companies without sufficient buffers have to pause production, which reduces output and ultimately sales.

But global supply-chain managers are at a crossroads. Against the backdrop of increasing interest rates, the opportunity cost of working capital (i.e. cash locked in inventories) is high. In addition, an impending deceleration in global demand may ease inflationary pressures, leaving corporations holding inventories purchased at

peak prices. Companies are using price derivatives as a way to manage price risks, with Procter & Gamble and Nestlé reportedly doing so to manage price risks for primary commodities.^{30,31}

This explains some mixed feelings about holding inventory buffers and serves as a rationale for a surprising finding. In our survey, “increasing inventories” was considered the least effective resilience strategy, cited by 22% of executives, compared with 30% who cited the increasing use of digital tools in inventory management.

Figure 9: Average inventory held by companies, 2022 vs 2021



Source: Economist Source: Economist Impact Trade in Transition survey, conducted September-November 2022 and September-December 2021.

³⁰ https://s1.q4cdn.com/695946674/files/doc_financials/2022/ar/2022_annual_report.pdf

³¹ <https://www.nestle.com/sites/default/files/2022-07/2022-half-year-report-en.pdf>

Digitalisation for resilience

As stated above, increasing the use of digital tools for inventory management is the most effective supply-side resilience strategy, according to 30% executives surveyed (see Figure 5). Digital platforms to engage with customers and suppliers were still the most widely adopted technology in 2022 (cited by 51% of executives), as in 2021. This is vital for co-ordinating with suppliers, the

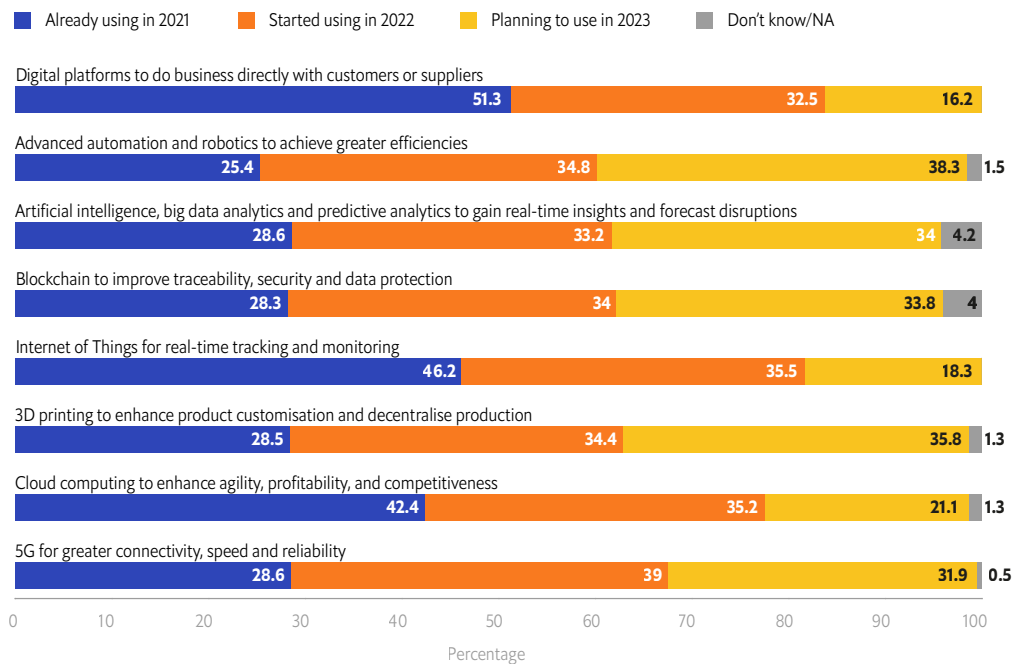
second-most effective supply-side resilience strategy (also cited by 30% of executives), ultimately offering executives more visibility of inventory levels and distribution networks.

The highest share of companies also started using 5G technologies (39%) and the Internet of Things (36%) in 2022, offering valuable real-time insights. But these tools go beyond just cargo tracking. “It’s not just about dashboards and reporting, but on the demand side, how we can be better in predicting demand,” explains Anderson Martins, head of supply chain and procurement at Nestlé Philippines. Above all, it is clear that companies around the world are embracing the use of technology for their supply-chain management. The most powerful indicator of this may be the share of executives who stated that advanced technologies were “not applicable”—just 2% on average in 2022, compared with 12% in 2021.

“Companies are looking at their supply chains and considering what alternatives, what fallbacks they have if things go really pear-shaped.”

Stuart Harbinson, independent trade policy adviser and former senior official at the World Trade Organisation

Figure 10: Adoption levels of advanced technologies in supply chains



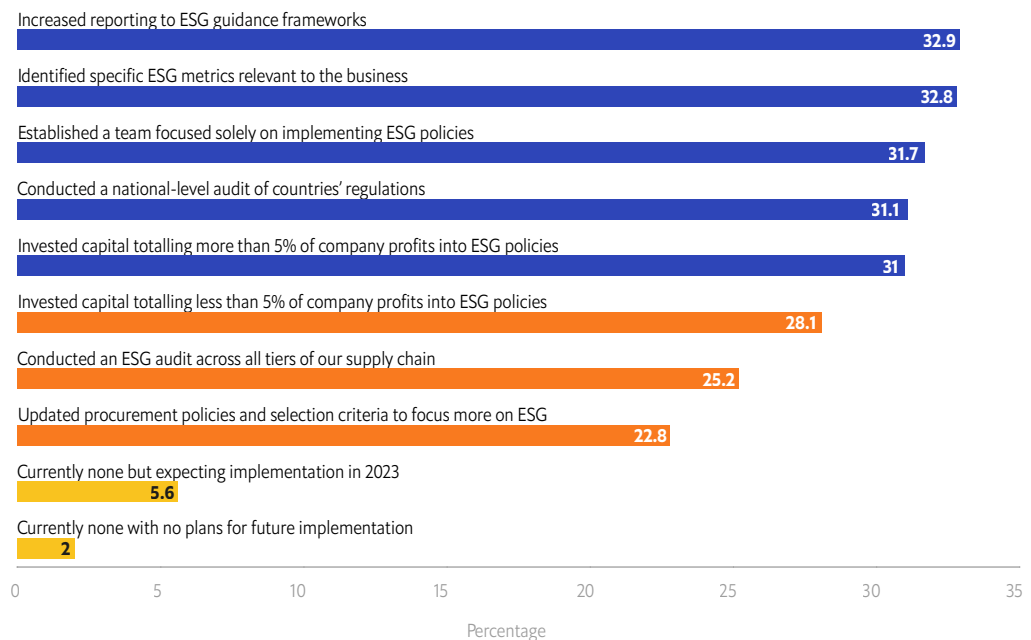
Source: Economist Impact Trade in Transition survey, conducted September-November 2022.

ESG for competitiveness

Environmental, Social and Governance (ESG) considerations within a supply chain range from the carbon emissions of the distributors of a company’s products to labour rights at a supplier’s facility. Such factors are important to consider, as more than 80% of consumer companies’ greenhouse gas emissions come from their supply chains.³² Importantly, the International Labour Organisation (ILO) estimates that over 17m people are exploited in private-sector business operations and supply chains.³³ More than just curbing these damaging practices, investing in supply-chain ESG initiatives can enhance companies’ competitive advantage and is also linked to a quicker recovery post-crisis.³⁴ Therefore, having a focus on ESG can reduce both harm to the environment and business costs significantly.³⁵

From our survey it is evident that companies are taking a range of actions to achieve their ESG goals. The top two among these are “aligning reporting to ESG frameworks such as the Sustainable Accounting Standards Boards” and “identifying specific ESG metrics relevant to the business”, each cited by about 33% of executives (see Figure 11). But many other actions, including investing more than 5% of their company’s profits, are being implemented by a similar share of companies (31%). This shows that companies are moving beyond the initial stages of just aligning with frameworks and developing monitoring systems to actually dedicating significant financial resources to meeting their goals. With environmental supply-chain risks alone estimated to cost companies US\$120bn by 2026, businesses need to ensure that their investments prevent or reduce such costs sufficiently.³⁶

Figure 11: ESG initiatives adopted by companies



Source: Economist Impact Trade in Transition survey, conducted September-November 2022.

³² <https://www.mckinsey.com/capabilities/sustainability/our-insights/starting-at-the-source-sustainability-in-supply-chains>
³³ https://www.ilo.org/wcmsp5/groups/public/---ed_norm/---ipec/documents/publication/wcms_854733.pdf
³⁴ <https://corpgov.law.harvard.edu/2020/08/14/the-other-s-in-esg-building-a-sustainable-and-resilient-supply-chain/>
³⁵ <https://www.mckinsey.com/capabilities/sustainability/our-insights/starting-at-the-source-sustainability-in-supply-chains>
³⁶ <https://www.cdp.net/en/research/global-reports/transparency-to-transformation>

Sector deep dives

Industrial (automotives)

With around 30,000 inputs going into the production of a car,³⁷ supply chains are critical to this sector. According to Mr Kumar Bhagat at the Ford Motor Company, the three biggest risks to his industry in the last two years have been covid-19, the war in Ukraine and semiconductor shortages. All have inflicted significant disruptions to supply chains. With such disruptions, single sourcing is very risk prone. Diversification is therefore still the number one supply-chain strategy for this sector, with 46.8% of respondents citing this as their primary policy. According to Mr Kumar Bhagat, automotive companies may still have “a global player, but they will have to have a backup player who can supplement inputs if shocks arise”.

Rising inflation—and therefore higher input costs—is the main reason for pessimism regarding global trade in this sector, cited by over one-quarter of all executives surveyed. To mitigate against increased costs, executives have had to alter supply chains to get the best price. A single approach to supply-chain management does not suffice for this sector: the promotion of inputs which can be regionalised or localised is also necessary. This will provide businesses with greater control over parts of their supply chains, which is reflected in our survey, where the vertical integration of supply chains is rated more highly in the industrial sector than in

the other sectors. However, the key is not to regionalise or localise everything, rather just a “few critical commodities”, notes Mr Kumar Bhagat. Greater control of the supply chain also comes with reducing suppliers for critical inputs, specifically semiconductors. Mr Pallak of General Motors says that his company has consolidated its imports of semiconductors to a handful of suppliers to maintain greater control.

Not only is a supply-chain strategy important, but so is also the need to maintain visibility and build trust, which is a central component in order to maintain consistency of supply. Increasing co-ordination with suppliers is cited as the second-most important factor for supply-chain strategies in our survey. The first is the use of digital tools, which is also critical for supply-chain visibility. However, this is a longer-term strategy, as companies need time to test different technologies and suppliers. As such, the real benefits are likely to materialise one to two years after implementation.

That said, efficiency gains through the further adoption and development of technology do not negate the need for just-in-case supply chains. As the world is less and less predictable, there is still a need to rely on a just-in-case supply-chain model. Most executives (49%) are maintaining inventories of between two weeks and three months, as holding inventory to insulate the company is critical.

³⁷ Kevin Quinn, director of additive design and manufacturing, General Motors (<https://www.autodesk.com/customer-stories/gener-al-motors-generative-design>)

Figure 12: Approaches to geographical reconfiguration of supply chain adopted by industries (automotive)



Source: Economist Impact Trade in Transition survey, conducted September-November 2022.

Technology is not just important for supply-chain management in this sector. Using technology for production is increasingly important. In our 2022 Trade in Transition report General Motors stated that they were planning to use 3D printing for automotive production. The adoption of this technology will impact global sourcing patterns, as it will allow more manufacturers to produce intermediate and final goods closer to their end use. Plans for 3D adoption are progressing and are on track, with Mr Pallak stating that they are making good progress on this front. Once fully rolled out and operational in the coming two years, supply chains are likely to undergo significant changes by having more component parts produced near the location of final assembly.

As an industry that is considered strategically important in many manufacturing countries, the automotive sector is often at the whim of government mandates or strategies. While companies are able to adapt to certain changes, barring inputs from certain regions or mandating domestic production will significantly impede them. William Reinsch, School Chair and senior adviser at the Centre for Strategic and International Studies states that “the flat out

prohibition, starting in 2024, of using Chinese minerals in US produced EV batteries will slow down the transition to EVs in the US and lead to a less globally competitive US auto industry.”

Governments need to be more targeted with their policies so as not to cause businesses unnecessary harm and disruption, adopting a more consultative approach to policy development. Moreover, governments need to ensure that they are consistent with changes and open with their communication to businesses, as it is not the added regulation that necessarily inhibits businesses but rather the uncertainty.

Consumer goods

Despite a bleak economic outlook, sales in the consumer goods sector are expected to increase by nearly 6% in 2023.³⁸ This is consistent with our survey results, where the majority of respondents in the sector expect both exports and imports to increase by between 10% and 30% in 2023 compared with 2022. However, in subsequent years this demand is expected to cool slightly because of higher household debt and borrowing costs.

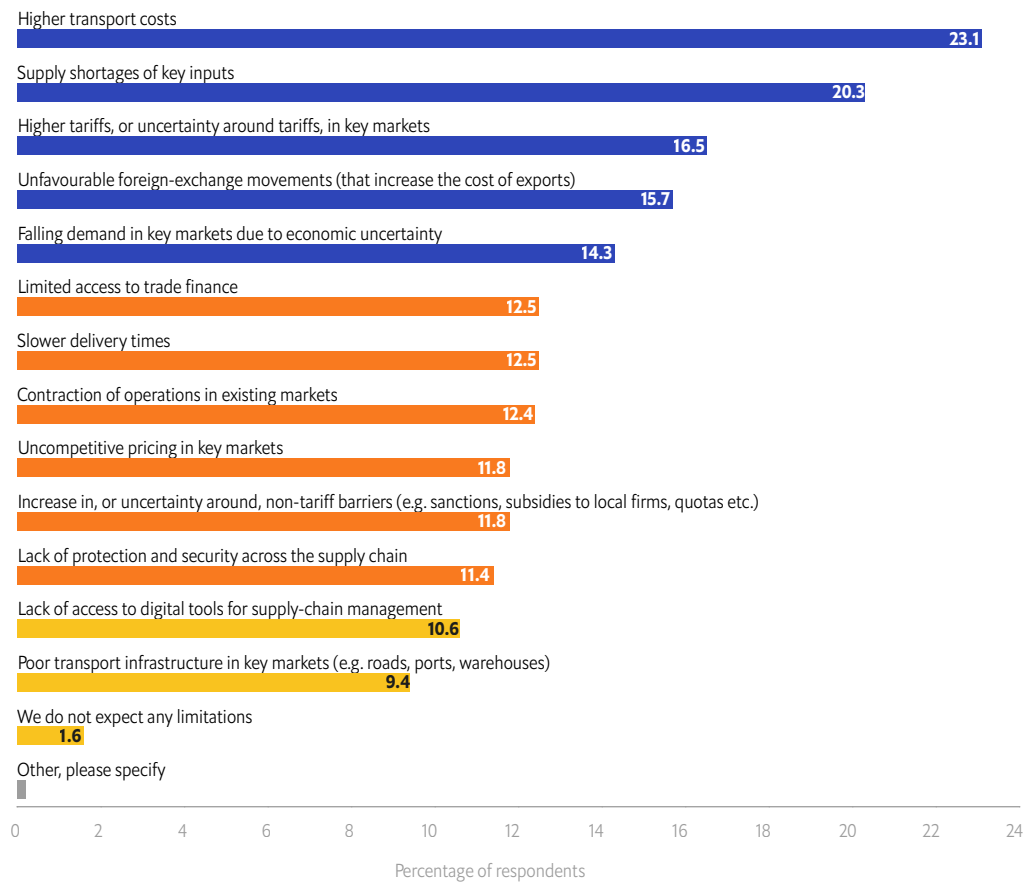
³⁸ EIU, *Consumer goods and retail report: Non-food products*, October 2022.

While demand will remain for 2023, the survey highlights that supply-side issues will dampen the growth of the sector, with supply shortages ranked as the second-highest limitation to export growth in 2023. In response, consumer goods companies are undertaking risk mitigation measures to reduce the impact of supply-side disruptions. For example, over half of the executives we surveyed are maintaining inventory buffers ranging from two weeks to three months.

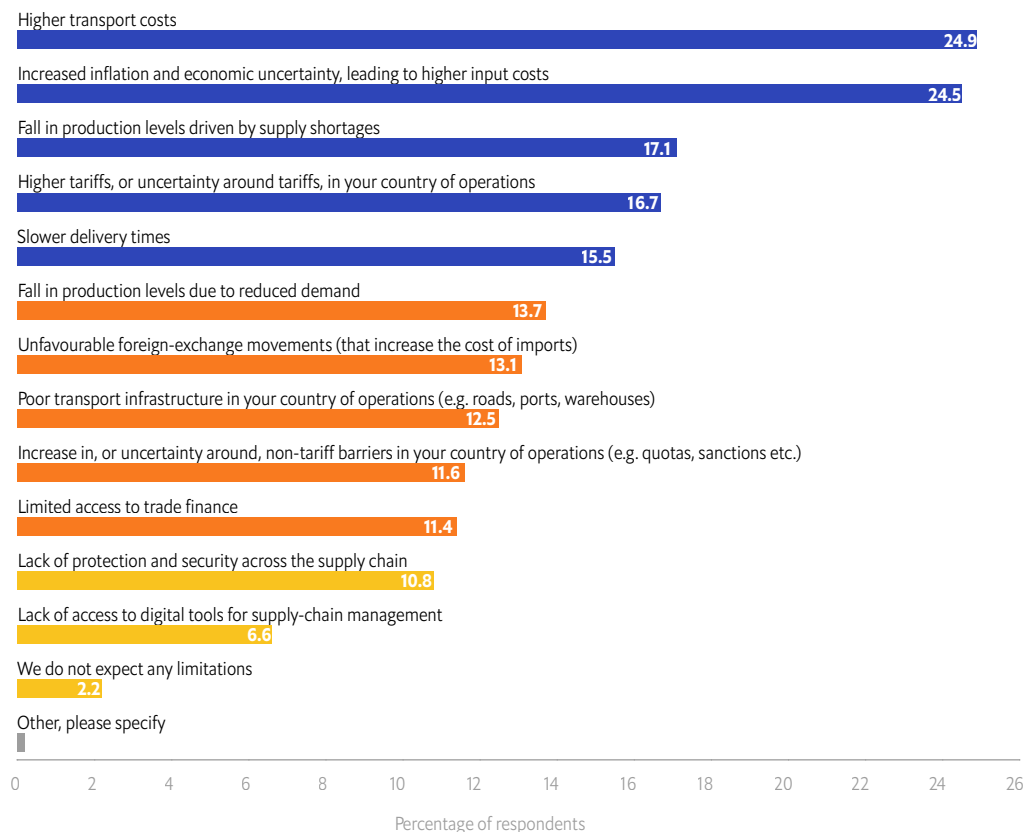
Higher transport costs remain the top limitation for companies wanting to increase exports and imports in 2023. This is consistent with previous years. But contrary to this finding, lower transport costs were rated as the primary growth drivers by 15.1% and 18.5% of respondents, respectively, for exports and

imports in 2023. According to Mr Martins, “the global shipping crisis is much better than before. It’s a matter of balancing supply and demand. We’ve seen some new ships coming to industry, while on the demand side there is a deceleration in the US and China.” When disaggregating consumer goods companies to only those involved in the raw material stage of the value chain, higher transport costs are ranked as an export limitation by just 12.5% of companies, down by over 10% when compared with companies involved in the entire supply chain. A decline is also apparent for imports. Therefore it matters which area of consumer goods a business is in, and at what stage of the value chain it finds itself. A one-size-fits-all approach cannot be taken in this sector because of the diversity apparent within it.

Figure 13: Limitations with increasing exports of consumer goods in 2023



Source: Economist Impact Trade in Transition survey, conducted September-November 2022.

Figure 14: Limitations with increasing imports of consumer goods in 2023

Source: Economist Impact Trade in Transition survey, conducted September-November 2022.

The decline of the pandemic is rated as the number one reason why the sector is optimistic about global trade. This is again linked to the supply-side issues that dampened growth significantly. But the biggest reason for pessimism is the increase in inflation, as higher costs of essential goods mean that there will be less disposable income to spend on non-essential goods. Furthermore, because of the higher cost of living consumer goods companies cannot pass significant costs on to consumers. Companies “need to try as much as we can to find efficiencies to protect [the consumer]. Otherwise, the profitability will be impacted. One that is important is a

short-term view to protect the long term. Because if we just go and increase prices, we might lose competitiveness. That’s what we don’t want to do,” comments Mr Martins.

Second-hand goods traders stand to benefit as consumers will opt to buy goods that eat up a smaller proportion of their budgets.³⁹ To take advantage of this trend, companies could look at introducing new aspects to their business models, such as refurbishment. Lululemon has done this with its “Like New” initiative⁴⁰. These initiatives also meet different ESG requirements, which is an important consideration for the sector.

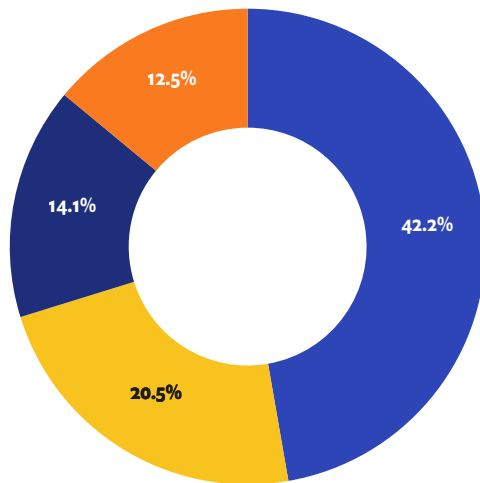
³⁹ EIU, High inflation bodes well for second hand goods consumption, April 2022

⁴⁰ <https://edition.cnn.com/2022/04/22/cnn-underscored/reviews/lululemon-like-new-launch>

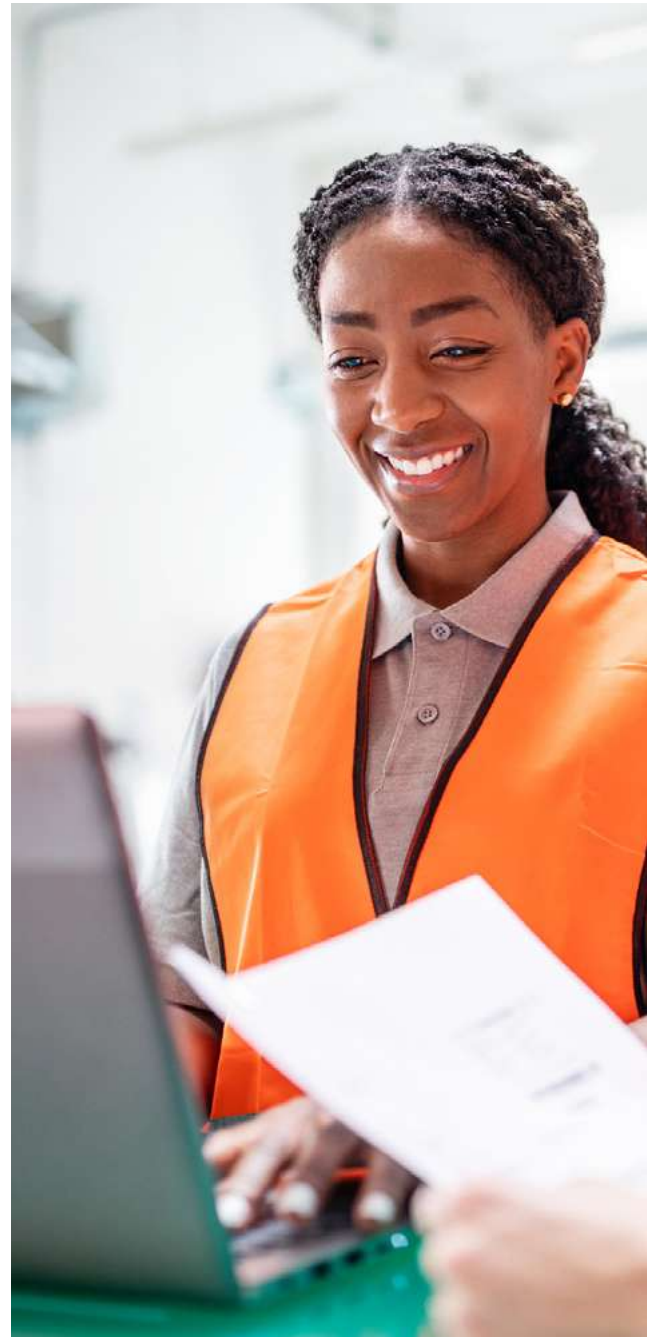
As was the case in 2021, consumer goods companies are continuing to diversify their supply bases regardless of location, cited by over 40% of executives. However, working with fewer suppliers is a bigger trend in this sector than in the other sectors surveyed. Strengthening relationships with suppliers has been found to make supply chains more resilient.⁴¹ The supply chains of firms that maintained fewer but more important suppliers were less likely to break down following covid-19 lockdowns.⁴² This increased resilience can explain why more businesses in this sector are prioritising this approach to supply-chain configuration.

Figure 15: Approaches to geographical reconfiguration of supply-chain adopted by consumer goods companies

- Diversifying your firm's supplier base
- Nearshoring/regionalisation
- Reshoring
- Working with fewer suppliers regardless of location



Source: Economist Impact Trade in Transition survey, conducted September–November 2022.



⁴¹ https://www.richmondfed.org/publications/research/economic_brief/2022/eb_22-46#:~:text=We%20look%20at%20the%20COVID,-maintaining%20relationships%20with%20their%20suppliers.

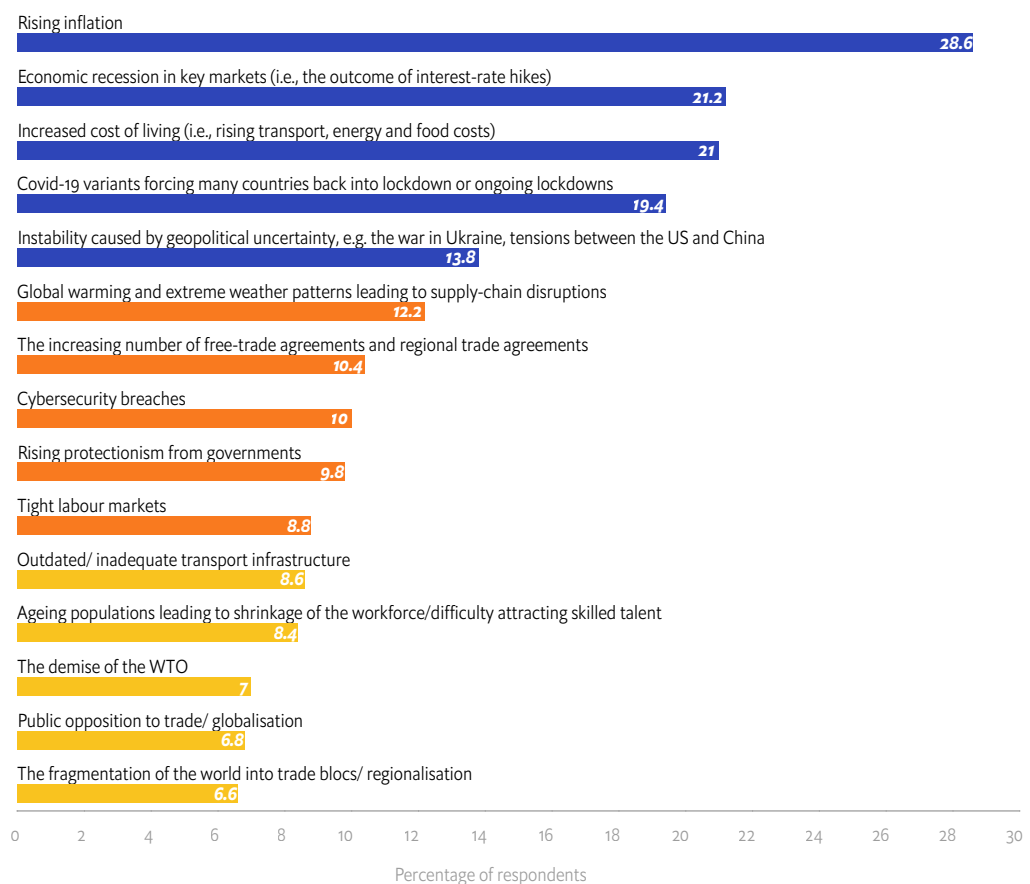
⁴² Ibid.

Food and beverages

In 2022 the food and beverage sector was characterised by significant shortages. Disruptions to operations from absences as employees were forced to quarantine or recovering from covid-19 was cited as the predominant reason for this. Since then, shortages and uncertainty of supply have only been exacerbated by the war in Ukraine. Certain countries have imposed export restrictions on key food groups, such

as India announcing a restriction on exports of wheat flour in July 2022 as a result of “global supply disruptions”.⁴³ Restrictions on the supply of key food groups have also been announced by many other countries.⁴⁴ Such shortages and uncertainties are likely to persist as “restrictions of key inputs” is rated by nearly 20% of executives as the second-biggest limitation to increasing exports in 2023, followed by uncertainty around tariffs in key markets.

Figure 16: Reasons for pessimism on global trade expansion for food and beverage industry, 2022-2024



Source: Economist Impact Trade in Transition survey, conducted September-November 2022.

⁴³ <https://www.globaltradealert.org/intervention/104408/export-licensing-requirement/india-restriction-on-exports-of-wheat-flour>

⁴⁴ <https://www.fao.org/newsroom/detail/joint-statement-by-the-heads-of-the-food-and-agriculture-organization-international-mone-tary-fund-world-bank-group-world-food-programme-and-world-trade-organization-on-the-global-food-security-crisis/en>

Rising inflation and the cost of living are weighing on the minds of executives, who cite them as the top two reasons for being pessimistic about global trade over the coming two years. Mr Martins at Nestlé confirms this, stating that “the biggest issue we have now across the board is very high inflation commodity-wise”. Such issues mean that the risk premiums are high in this sector, and business leaders should be mindful of this.

To mitigate against risk, executives in the food and beverage sector are embracing technological upgrades. Adopting new technologies to monitor supply chains is ranked as the primary reason to be optimistic about trade over the next two years. Nestlé’s CEO, Mark Schneider, has previously stated that innovation and embracing digital opportunities are key ways in which the company can accelerate organic sales.⁴⁵ Over half of executives in this sector have already widely embraced using digital direct-to-consumer platforms.

Technological adaptation is not only about growing sales but also increasing efficiency. At a time of higher costs, which cannot easily be passed on to the consumer in this sector, food and beverage companies need to “try as much as possible to find efficiencies to protect consumers”, comments Mr Martins. Survey results indicate that many executives are also likely to start embracing advanced automation and robotics to achieve greater efficiencies, while also adopting artificial intelligence and data analytics to get real-time forecasts. By driving efficiency, investing in technology will then help to absorb some of the inefficiencies generated through higher inflation.

Diversification remains the central supply-chain reconfiguration strategy for this sector. The main purpose of this is to reduce overall costs. Again, as inflation is going to be a

significant factor for this sector, reducing costs in other ways is going to be imperative if businesses are to remain profitable. But respondents are also pursuing diversification strategies to reduce the risk of disruption to critical inputs. Rick White, president and CEO of the Canadian Canola Growers Association, believes that “diversified supply chains, long ones, short ones and local ones, all need to work together to provide the resiliency when bad things happen to the environment or geopolitical shocks cause disruption.”

Severe weather events are able to disrupt this sector more than others due to the nature of how food and beverages are produced. But having a credible ESG approach is tough for this sector. Two main reasons stand out, the first one being that there is no common base or common understanding around an ESG framework. This then leads to demands being placed on businesses to meet different ESG requirements either at the country or the business supplier level, which increases costs. The second reason is that the technologies allowing businesses to significantly reduce their carbon footprint have not yet been developed. According to Mr White, “it’s going to take seed technology, biological technologies to come along, so that plants could be more efficient in the use and uptake of their fertiliser and requiring the need for less fertiliser, yet increasing yields.” So the industry needs to focus on developing sector-specific technologies in order to increase efficiency and reduce environmental harm.

On ESG, one area where the sector is making inroads is waste management, and specifically targeting plastic neutrality. Consumer goods companies, which include the food and beverage sector, are at the heart of the plastics problem, accounting for more than 50% of global plastic consumption.⁴⁶ Plastic neutrality is where companies aim to take back the same amount of plastic as that used in their

⁴⁵ <https://www.just-food.com/analysis/nestle-2017-investor-day-5-things-to-learn-from-ceo-mark-schneiders-vision-for-food-giant/>

⁴⁶ EIU data, The plastics problem facing consumer companies, July 2022.

products, thereby having no impact on the environment. Nestlé have just celebrated their second year of doing this.⁴⁷ It is an important issue for both consumers and businesses, and as Mr Martins says, by having these initiatives “we can guarantee that we are taking back, we work with partners to process those used plastics without having the risk to the ocean”. However, this is just one area where businesses in this sector are having an impact. Many more initiatives will be needed to ensure a sustainable future for subsequent generations.

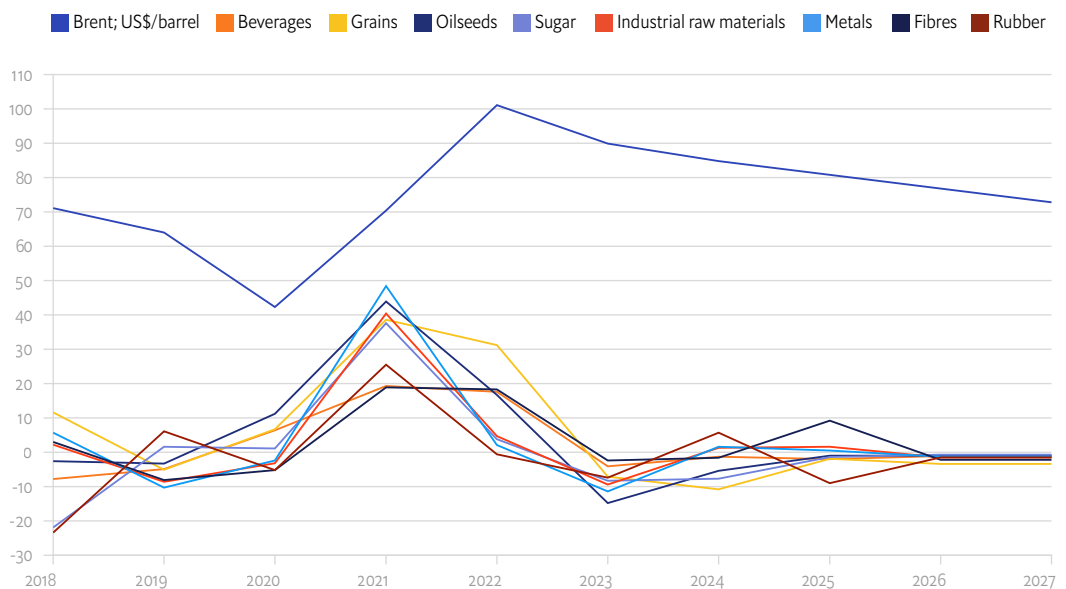
Energy and natural resources

Amid the current geopolitical volatility, such as the war in Ukraine and the US-China tensions, the energy and natural resources sector, particularly oil and gas, has been severely disrupted. Fewer than 5% of the companies we surveyed say that current geopolitical events are not shaping their trade and supply-chain strategies. In response, a

vast majority of companies in the sector are shifting their supply-chain operations.

One-third of respondents are increasing the length of their supply chains to hedge against future shocks. A further third are opting to expand into more stable and transparent markets. Interestingly, 30% of respondents stated that they were decreasing the length of their supply chains. However, this was due to reducing costs rather than hedging against risk. Rob Merrylees, policy manager and analyst at the UK Chamber of Shipping, offers a reason for this: “The range of supply-chain issues coming off the back of covid-19 but also congestion, worker shortages and pent-up demand with lack of supply has meant the LNG market now is becoming very tight, with day rates that are 10 or 15 times what they have been in previous years.” LNG shipping rates can now fetch around US\$400,000 per day, with rates expected to go even higher than this.⁴⁸

Figure 17: Commodity price, forecast up to 2027

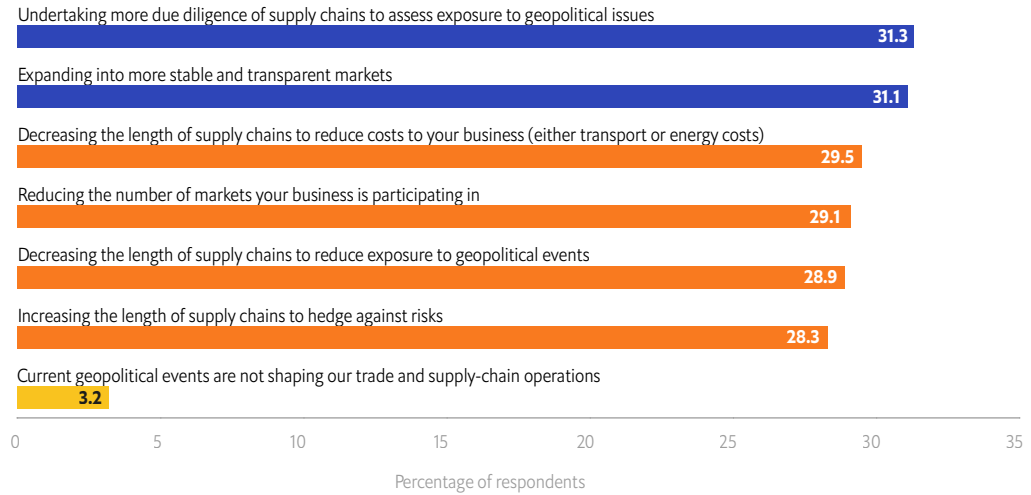


Source: Economist Intelligence (EIU), 2022.

⁴⁷ Economist Impact interview, Anderson Martins, November 2022.

⁴⁸ <https://www.freightwaves.com/news/lng-shipping-rates-shooting-for-the-stars-at-500000-per-day>

Figure 18: Effect of geopolitical events on energy and natural resources sector

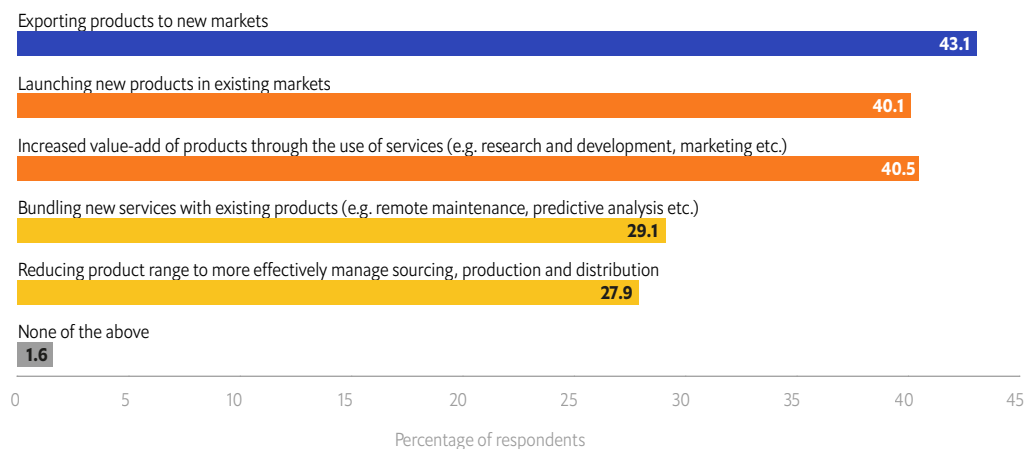


Source: Economist Impact Trade in Transition survey, conducted September-November 2022.

To insulate themselves from further geopolitical shocks, businesses in this sector are maintaining larger inventories than other sectors, with 44% holding buffers ranging from four weeks to six months. This applies predominantly to the West, as these countries try to wean themselves off Russian oil and gas. US sanctions extend to Russia’s oil and gas sector, and the UK and EU are working to reduce their reliance on Russian hydrocarbons.⁴⁹ While there is less security of supply, increasing inventories is an appropriate measure to insure against any shortage.

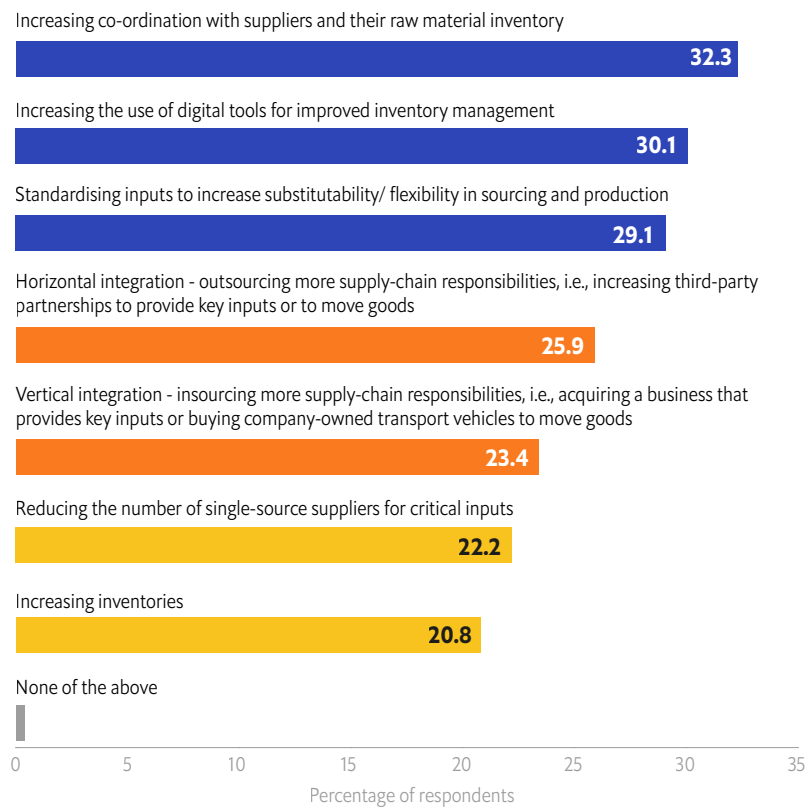
To bolster resilience further, companies are adopting a wide variety of both demand- and supply-side strategies within this sector. On the demand side, executives surveyed say the most effective strategies include exporting products to new markets (43%), followed by increasing the value added of products (37%). The most effective supply-side strategies include increasing co-ordination with suppliers (32%), followed by increasing the use of digital tools for better inventory management (30.1%).

Figure 19: Demand-side strategies for resilience in energy and natural resources sector



Source: Economist Impact Trade in Transition survey, conducted September-November 2022

⁴⁹ EIU report, Europe aims to divert its gas supplies from Russia, March 2022.

Figure 20: Supply-side strategies for resilience in energy and natural resources sector

Source: Economist Impact Trade in Transition survey, conducted September-November 2022.

Just as important as making the sector more resilient to geopolitical shocks is making it more attuned to ESG policies. The sector is investing in ESG initiatives with varied resources. One-third of executives state that they are investing capital totalling more than 5% of company profits in an effort to achieve their ESG goals. Moreover, growth in renewable energy will remain strong in the coming years. According to estimates from The EIU, solar and wind consumption will surge by more than 11% in 2023 and will continue to grow at an annual rate of 10% over the next ten years.⁵⁰ Policies to restrict capital expenditure on oil and gas, including the exploration of new oil and gas fields, will fuel the growth in clean energy sources in the coming

years. But in the process the lack of capital expenditure on hydrocarbons will create supply tightness, leading to further price increases.⁵¹

The growing middle class in many developing countries will mean that energy consumption will increase substantially. This is the third-most cited reason why energy firms are optimistic about future trade in the next two years. As the middle class grows and its consumption increases, coupled with the rise in cleaner forms of energy like electric vehicles, the demand for natural resources, such as lithium and cobalt, will become even greater. So, investment in critical mineral mining and exploration is likely to expand even further.

⁵⁰ EIU report, Things to watch in energy in 2023, November 2022.

⁵¹ <https://www.goldmansachs.com/insights/pages/from-briefings-20-january-2022.html>

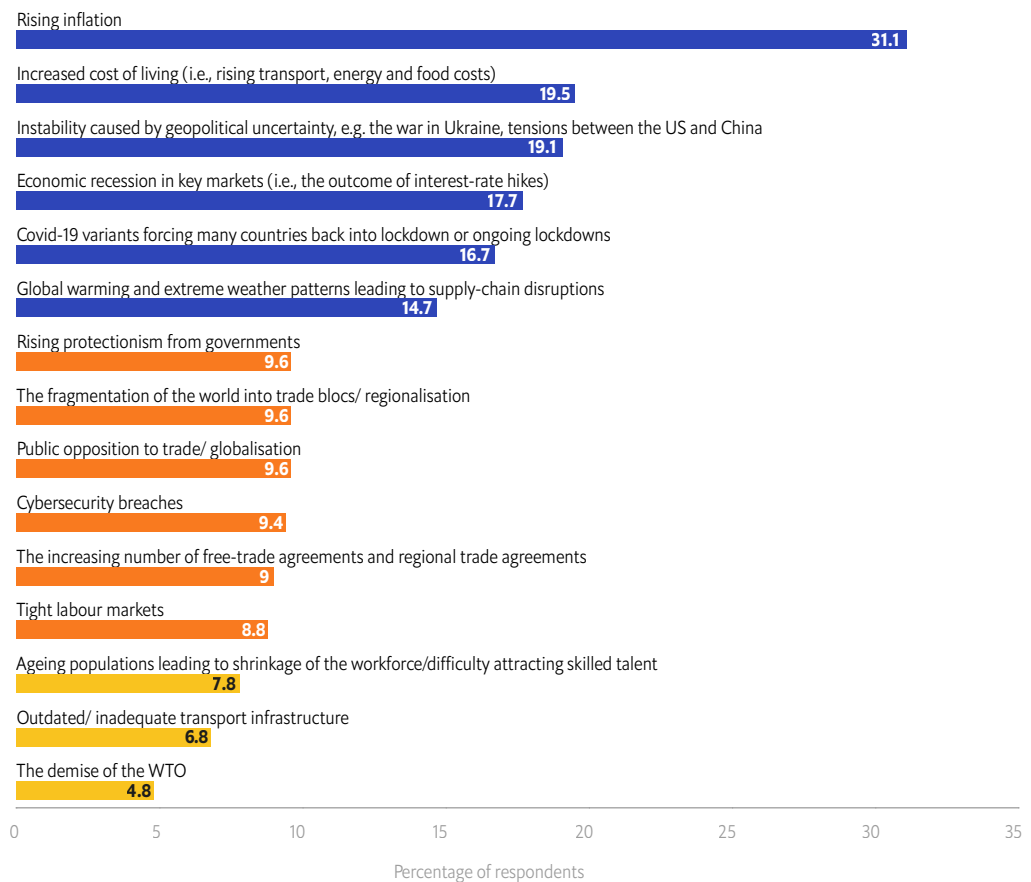
Health and pharmaceuticals

Our findings from last year's Trade in Transition survey have proved correct. Executives in this sector anticipated that growing demand would bolster exports and imports. It is now expected that households and governments will continue to prioritise healthcare spending despite uncertain finances,⁵² with public and private spending expected to increase by 4.9% in 2023.⁵³ Over one-quarter (26%) of executives surveyed also say that growing demand in key markets will be the primary growth driver of exports in 2023, followed by expansion into new markets (21%). In the aftermath of the covid-19 pandemic the importance placed on healthcare

and pharmaceuticals is the primary reason why healthcare spending will remain elevated.

While the demand is there, there is still reason for executives to be cautious. Increased inflation is ranked as the number one reason for pessimism by almost one-third (29%) of executives in this sector. In particular, this is impacting smaller biotech companies, which have seen funding dry up after an unprecedented boom in 2020, as financiers are becoming more cautious with their investments.⁵⁴ Furthermore, a lot of the increase in spending allocated by these firms will go towards higher input costs, meaning that more funding for R&D will be curbed.

Figure 21: Reasons for pessimism on global trade expansion for health and pharmaceutical sector, 2022-2024

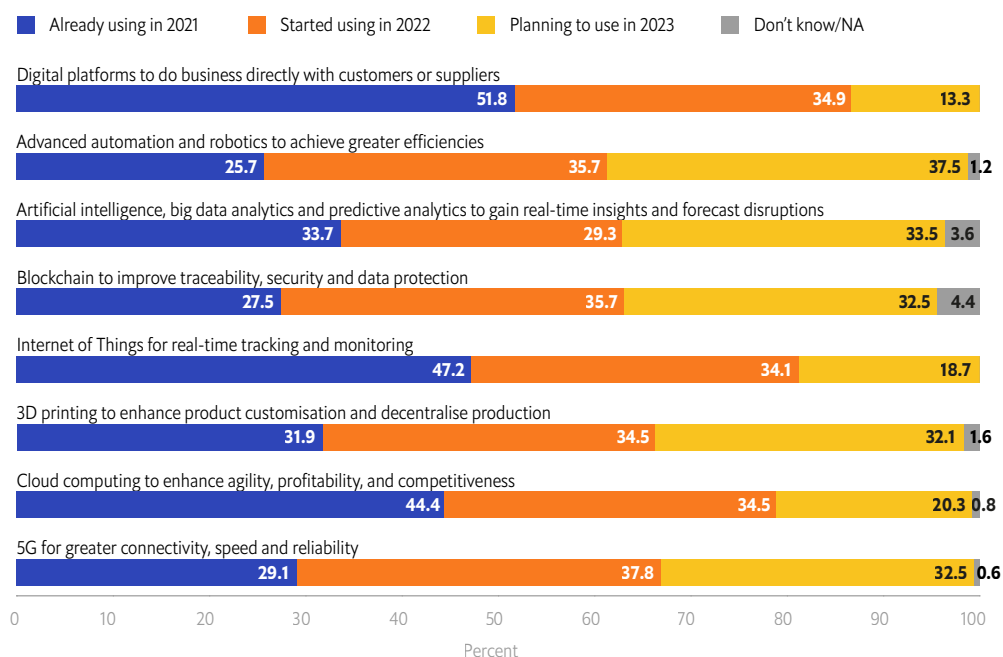


Source: Economist Impact Trade in Transition survey, conducted September-November 2022.

⁵² EIU report, The EIU view: Healthcare

⁵³ EIU report, Things to watch in healthcare in 2023, October 2022

⁵⁴ EIU report, Things to watch in healthcare in 2023, October 2022

Figure 22: Technologies that optimised trade in the health and pharmaceutical sector in 2022

Source: Economist Impact Trade in Transition survey, conducted September-November 2022.

But even with more caution the sector is still placing a lot of importance on innovation. This is made possible by technology. Medical technologies are helping to overcome a number of complex diseases by providing novel therapeutic devices, according to John Bowler, portfolio manager for the Schroder Global Healthcare Fund.⁵⁵ Digital innovations are also making health more accessible and efficient, thereby driving better patient outcomes.⁵⁶ Results from the survey also point to the importance of technology for the sector, as executives cite technological upgrades as the predominant factor to increasing imports in 2023. Furthermore, results indicate that this sector is more advanced than others where technological adoption is concerned. These technological innovations will help to drive returns across the sector and to combat the consequences of the rise in inflation.

Beyond the retained demand, other legacy factors from covid-19 are also affecting this sector. Higher tariffs or uncertainty around tariffs and non-tariff barriers are cited by over 30% of respondents as a top limitation for exports in 2023. During covid-19 there were significant changes introduced to trade rules, where countries looked to liberalise imports and limit exports of medical goods. These measures restricted the supply of these goods and increased the costs of trading medical goods by 60%.⁵⁷

Even though a large number of restrictive trade measures were introduced, not all were notified to the WTO.⁵⁸ Therefore, increased transparency from governments, in line with WTO principles, should be prioritised for this sector moving forward. This would help to reduce uncertainties and also barriers to trade through additional negotiations as a result of greater transparency.

⁵⁵ <https://www.schroders.com/en-gb/uk/individual/insights/how-tech-and-medical-advances-are-transforming-healthcare-investing/>

⁵⁶ Ibid.

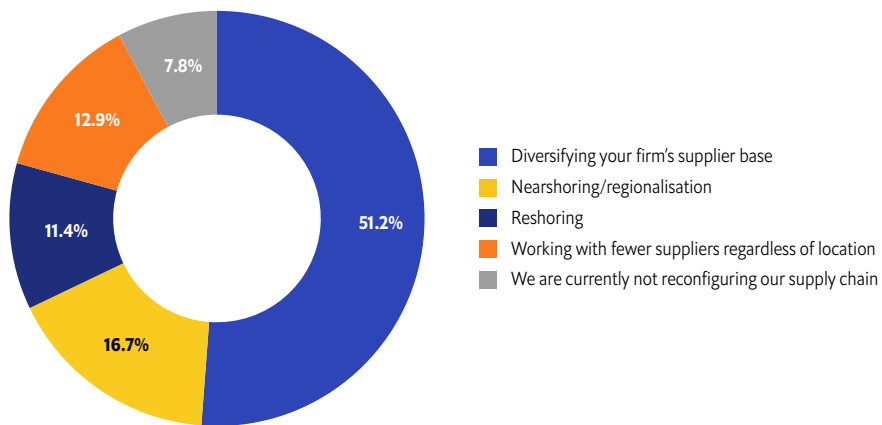
⁵⁷ <https://www.worldbank.org/en/topic/trade/publication/stronger-trade-systems-for-better-health>

⁵⁸ https://www.wto.org/english/news_e/news22_e/mark_05apr22_e.htm

As was the case in 2022, diversification is the leading supply-chain strategy for this sector, cited by more than one-half of executives surveyed. This aligns with the increase in trade restrictions from covid-19. Having more export and import destinations would help to strengthen the resilience of supply chains, ensuring

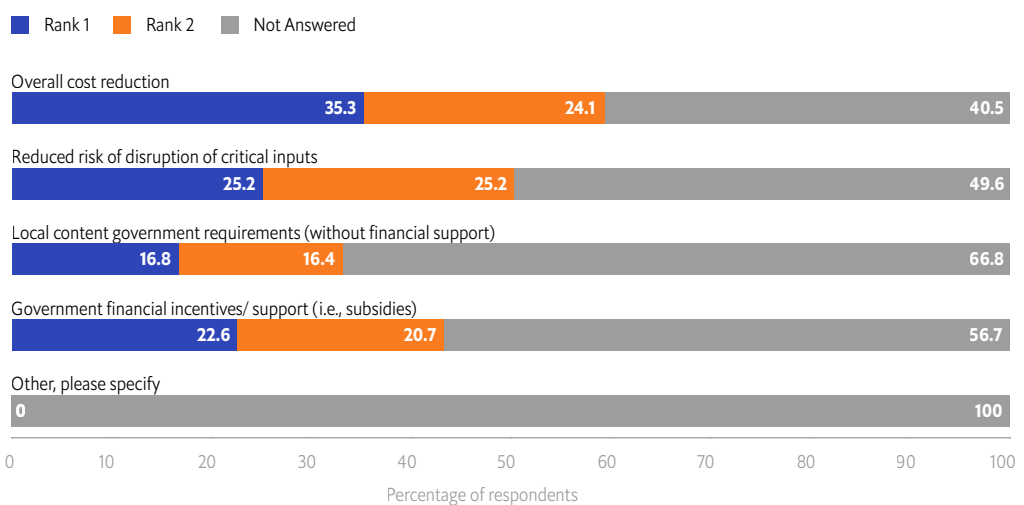
more consistent supply. Nearly one-third of respondents cite increased resilience as their second driver for the diversification strategy. Yet almost 40% of respondents name cost reduction as their primary driver for this supply-chain strategy, reflecting the cost increases that have arisen as a result of higher inflation.

Figure 23: Approaches to geographical reconfiguration of supply chain adopted by health and pharmaceutical companies in 2022



Source: Economist Impact Trade in Transition survey, conducted September-November 2022.

Figure 24: Drivers of geographical reconfiguration of supply chain adopted by health and pharmaceutical companies in 2022



Source: Economist Impact Trade in Transition survey, conducted September-November 2022.

Regional Insights

North America

The WTO predicts that the volume of North American exports will increase by 1.4% in 2023, with imports growing by 0.8% over the same period.⁵⁹ This is lower growth than in 2022. Sustained high inflation remains a risk to the economic outlook for North America, and in our survey it was the top reason for pessimism about global trade over the next two years among executives in North America, cited by 33% of respondents. The US and Canada have begun tightening monetary policy in response. As a result the US economy is expected to experience an economic downturn in 2023, with real GDP forecast to slow from 1.7% in 2022 to 0.1% in 2023.⁶⁰

Within the region, the political landscape has resulted in more stability for trade, particularly as US-Canada relations have become more predictable under the administration of the US president, Joe Biden, compared with his predecessor.⁶¹ Yet many China-centric trade policies enacted under the Trump administration have been retained or enhanced under the current administration.⁶² These trade policies are restrictive to the flow of trade. If they continue on their current trajectory or even worsen there will be significant economic consequences, as shown in the GTAP model (see “About this research” for more details). Exports from North America will decrease by 0.35%, equivalent

to US\$13bn. Imports into North America will also decline, by 0.29% or US\$14.7bn.

US trade policy is being used to retain a competitive advantage in key sectors (batteries, critical minerals, semiconductors, pharma and personal protective equipment), particularly with regard to China, which is deemed to be a threat to these industries and national security more generally. This is primarily in response to China’s military-civil fusion policy, which is using new technologies, developed by businesses, to increase their military capabilities.⁶³

Mr Reinsch of the CSIS explains the paradox with this policy, stating that “China is simultaneously the best customer and the biggest threat”. But there is a public-private divide. Businesses look at the monetary value of the Chinese market, whereas the US government looks at the threat through forced technology transfer.⁶⁴ US government policy is now more actively seeking to curb China’s military capabilities. “US government policy has traditionally been to keep China two steps behind by allowing US companies to export only old technology, thereby providing companies with the money for further R&D while depriving China of state-of-the-art technology,” comments Mr Reinsch. “Now their policy has moved on to actively degrading China’s military capabilities by expanding controls to cover things that have previously not been controlled.” Recent policy changes

⁵⁹ https://www.wto.org/english/news_e/pres22_e/pr909_e.htm#:~:text=The%20new%20WTO%20forecast%20estimates,than%20what%20was%20previously%20projected

⁶⁰ <https://viewpoint.eiu.com/analysis/geography/XB/reports/one-click-report>

⁶¹ <https://viewpoint.eiu.com/analysis/geography/XB/reports/one-click-report>

⁶² <https://foreignpolicy.com/2022/11/15/u-s-china-trade-war-wto-sanctions-xi-jinping-biden-trump/>

⁶³ <https://www.tandfonline.com/doi/abs/10.1080/03932729.2022.2080262?journalCode=rspe20>

⁶⁴ Economist Impact interview, William Reinsch, October 2022

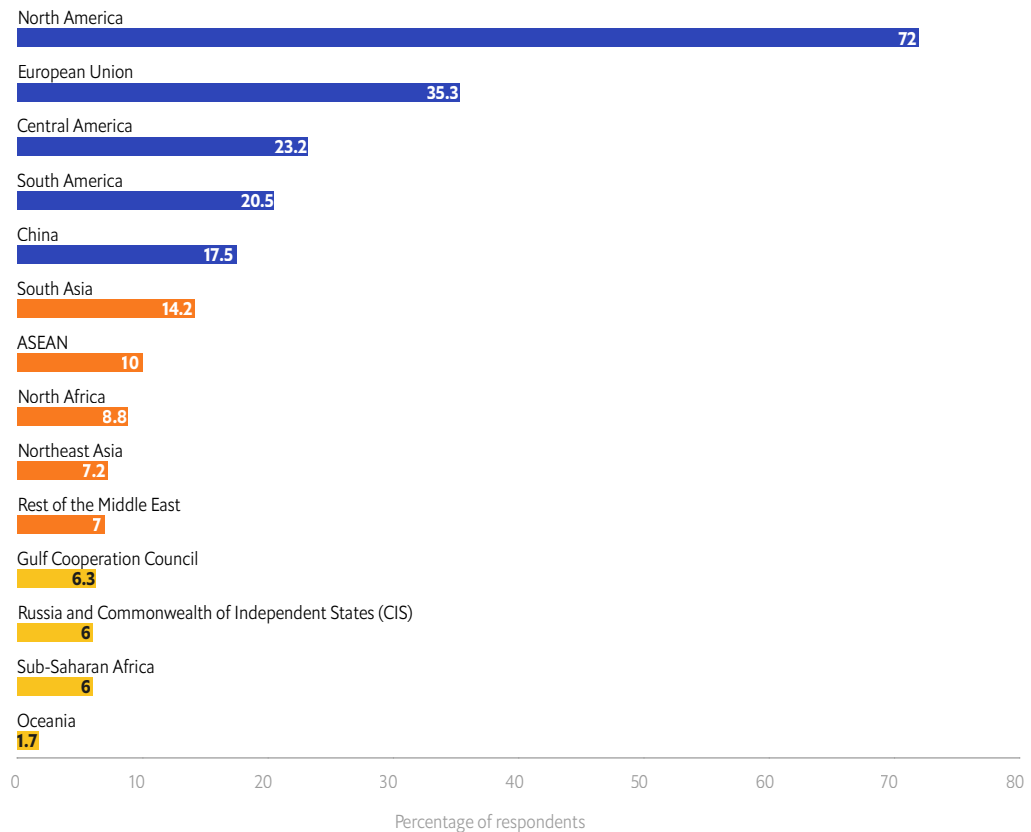
have led to many companies taking the ABC approach: Anywhere But China. Survey results also align with this trend as executives believe that North American sales revenue from exports to China will be lower than the global average.

Even so, Mr Reinsch believes the biggest risk for North American companies is that they stay in China too long. “It’s taken businesses 20 years to determine that they will never be treated fairly in China, and we can do the same to them in the US if we wish.” He adds: “But that would miss the point, which is whether we can compete with them in the rest of the world.” The worry is that North American companies will be captivated by China’s large market so they will stay there

longer than they should, meaning they will miss out on opportunities elsewhere.

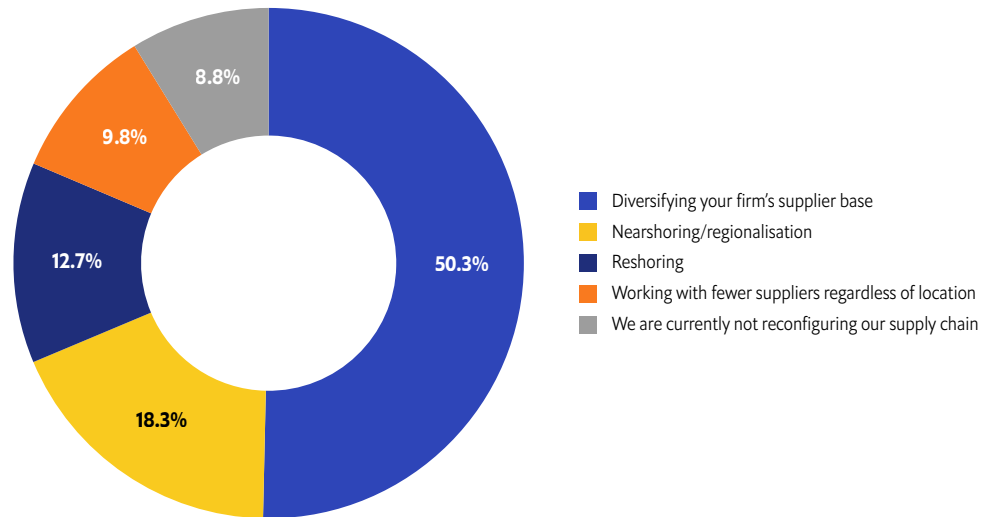
Changes in US policy, for example through the CHIPS and Science Act, are incentivising US companies to reshore production. Executive responses from our survey indicate that it is having an effect as the large number of respondents (31%) who opted to reshore their supply chains are doing so to take advantage of government local content requirements or to take advantage of government financial incentives. The share of respondents who say they are nearshoring increases to 35%. However, the primary goal for executives when reconfiguring their supply-chain strategies is overall cost reduction.

Figure 25: Expected North American export destinations in 2023



Source: Economist Impact Trade in Transition survey, conducted September-November 2022.

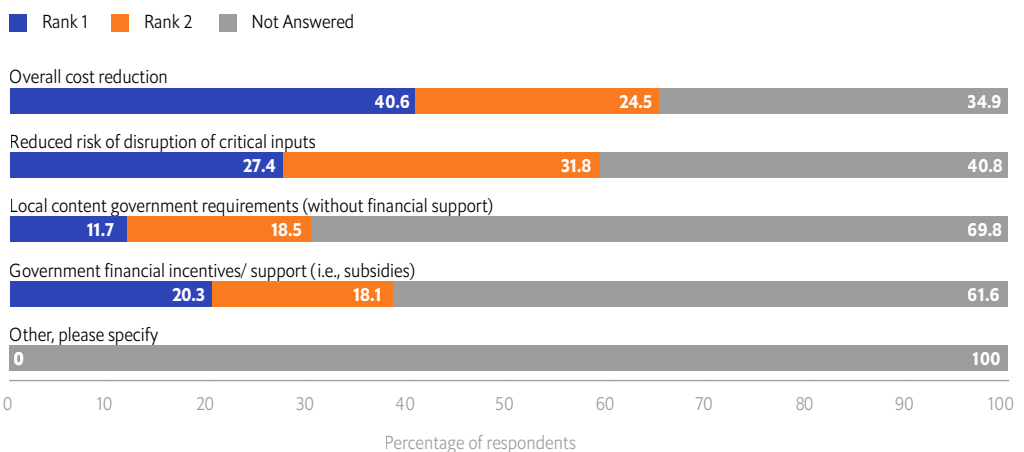
Figure 26: Approaches to geographical reconfiguration of supply chain adopted by companies in



North America in 2022

Source: Economist Impact Trade in Transition survey, conducted September-November 2022.

Figure 27: Drivers of geographical reconfiguration of supply chain adopted by companies in North America in 2022



Source: Economist Impact Trade in Transition survey, conducted September-November 2022.

The risk posed by these policies is that they will lead to the further demise of the multilateral trading system in which North America has long been a proactive participant. From a global

point of view, reducing free and fair competition through domestic incentives under the guise of national security is very harmful, comments Mr Harbinson. Massive subsidisation in the US

as a reaction to the state-sponsored subsidies that the government of China has pushed in the past decade will only degrade the multilateral trading system and further disadvantage the poorest nations, as they cannot afford the same level of subsidies. More engagement at the multilateral level, led by the US, needs to occur to maintain a level playing field for all.

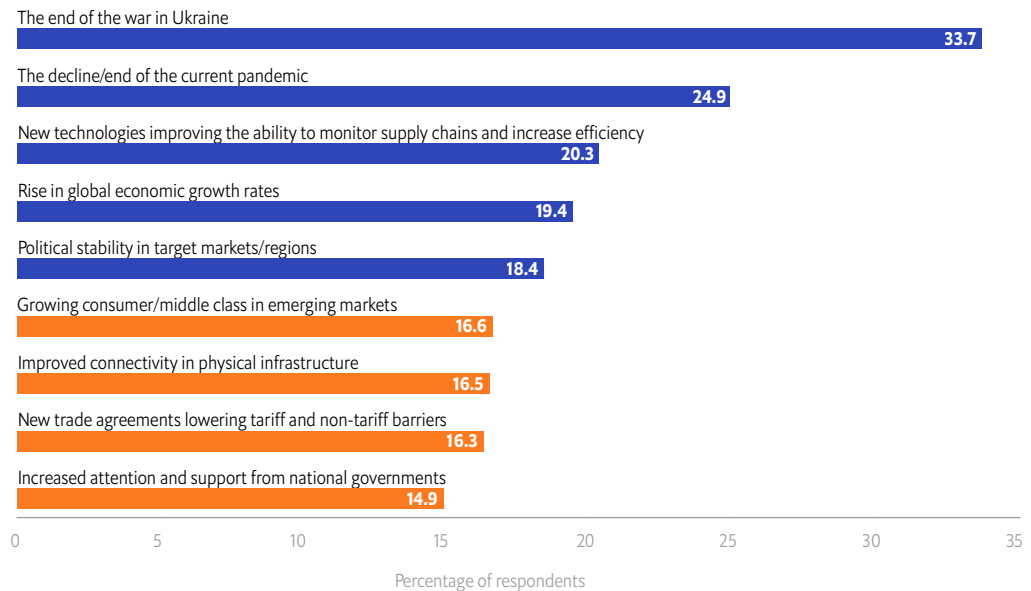
Europe

The economic recovery in Europe has stalled because of the war in Ukraine. Trade volume export growth is expected to be 0.8% in 2023, down one percentage point from 2022. Trade volumes for imports will decline, with the WTO predicting a 0.7% contraction.⁶⁵ Critically, disruptions in gas supplies from Russia will lead to an energy crisis this winter, with many

European countries forced to implement energy rationing. Inflation is also high, dampening consumer spending.⁶⁶ Combined, these factors will lead to a regional economic downturn in 2023. The recovery of trade will also be slower than in other regions,⁶⁷ with sluggish growth expected well into 2024.⁶⁸

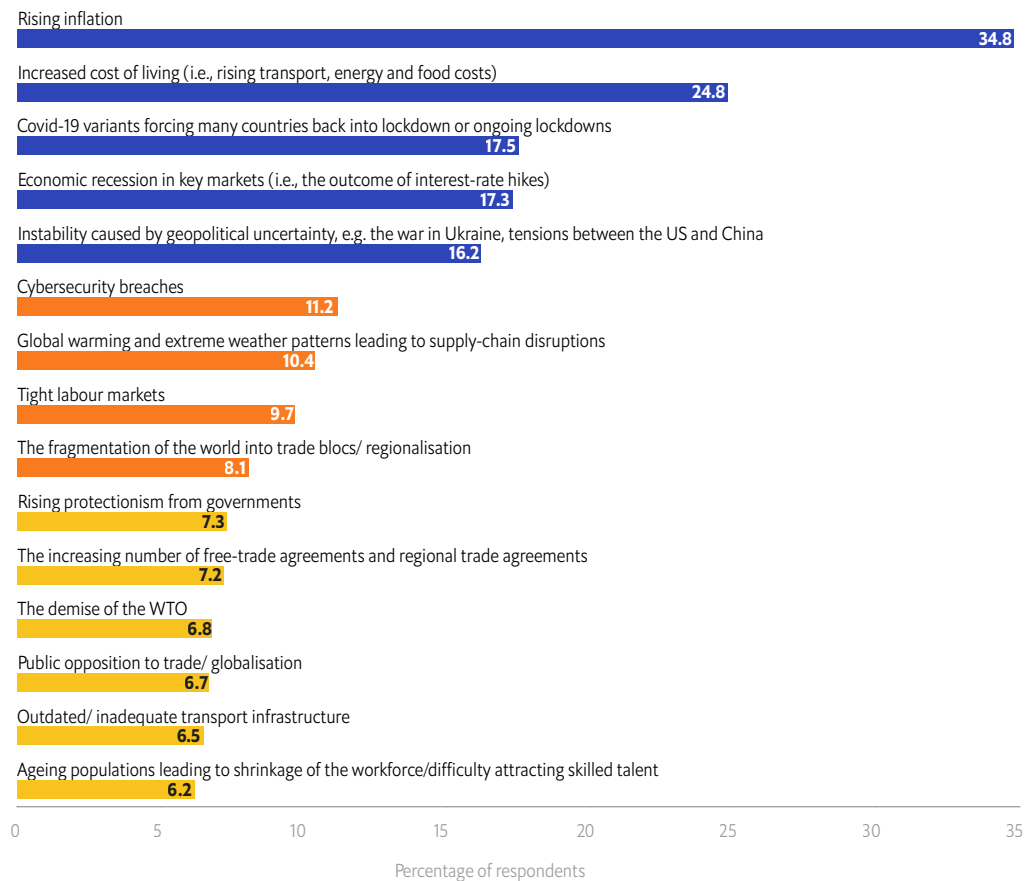
Rising inflation is the top reason for pessimism about global trade in the coming two years. Linked to this, significantly more European executives cite the end of the war in Ukraine as the top reason for optimism over the same time period (34%) than executives in other parts of the world (20.9%). So, while trade works as a global system, geographical proximity to shocks still matters greatly for trade and supply-chain health.

Figure 28: Reasons for optimism on global trade expansion for companies in Europe, 2022-24



Source: Economist Impact Trade in Transition survey, conducted September-November 2022.

⁶⁵ https://www.wto.org/english/news_e/pres22_e/pr909_e.htm#:~:text=The%20new%20WTO%20forecast%20estimates,than%20what%20was%20previously%20projected
⁶⁶ <https://viewpoint.eiu.com/analysis/geography/XG/reports/one-click-report>
⁶⁷ Question two of the survey (don't want to include the data though)
⁶⁸ <https://viewpoint.eiu.com/analysis/geography/XG/reports/one-click-report>

Figure 29: Reasons for pessimism on global trade expansion for companies in Europe, 2022-24

Source: Economist Impact Trade in Transition survey, conducted September-November 2022

Today trade is becoming less of an economic issue and more of a geopolitical one. Nations and businesses have to be wary about aligning themselves too closely with a unipolar supply-chain model. Mr Lawrence cautions that European countries are integrating their trade links, and by association their economic models, too closely with China. Over-reliance on one country reduces resilience and could hamper European trade and supply chains depending on future geopolitical shocks. Over-reliance on one nation is the reason why Europe, and particularly Germany and central and east European countries, are afflicted with

economic downturns as the majority of their energy needs used to be met by Russia.⁶⁹

Executives in Europe recognise the importance of diversification: a plurality (49%) say their primary approach to reconfiguration is diversifying their supplier base regardless of location. But diversifying is easier said than done. Mr MacNeil of the UK Trade Select Committee at the House of Commons explains: "Some economic lessons have been taken to their extreme. Adam Smith never really meant we should only have one pin maker on the planet. Instead, he was making an argument for specialisation. But in

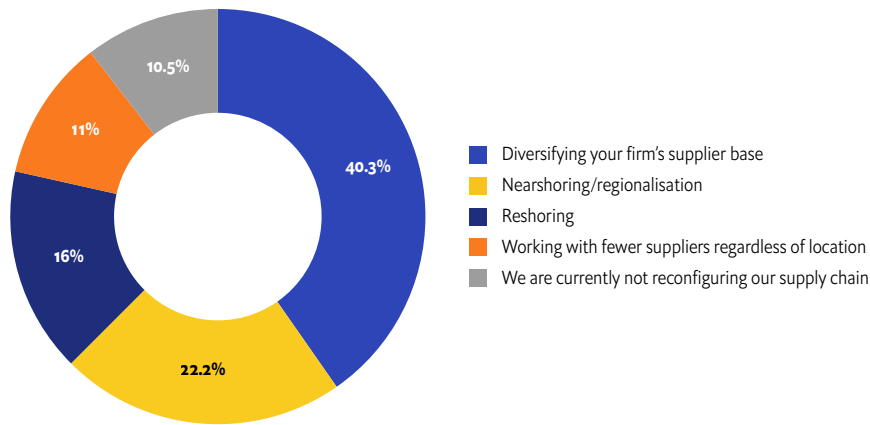
⁶⁹ <https://www.gjisreportsonline.com/r/german-gas-policy/>

some cases it's gone to such an extent that it's left businesses and countries vulnerable."

Overall cost reduction and increased resilience (by reducing the risk of disruption) were cited as the main reasons for diversification. This resonates with European policymakers, as in the aftermath of the initial shock of the war in Ukraine resilience was put at the heart of European policy efforts.

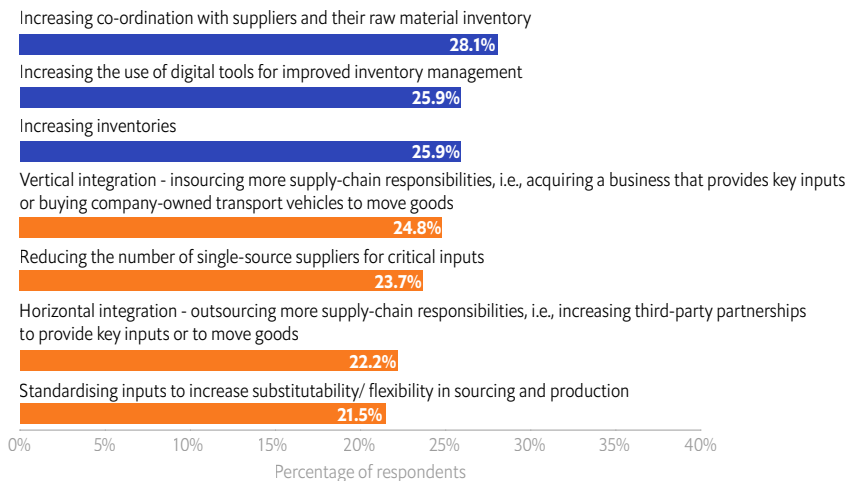
The extension of the EU's €750bn Recovery and Resilience Fund is key, as it will help to diversify energy sources and increase infrastructure development.⁷⁰ Beyond energy, fewer European executives are operating just-in-time supply chains (10%) than executives in other regions of the world (14%) to enhance resilience.

Figure 30: Approaches to geographical reconfiguration of supply chain adopted by companies in Europe in 2022



Source: Economist Impact Trade in Transition survey, conducted September-November 2022.

Figure 31: Supply-side strategies for resilience in Europe, compared with global average



Source: Economist Impact Trade in Transition survey, conducted September-November 2022.

⁷⁰ <https://viewpoint.eiu.com/analysis/geography/XG/reports/one-click-report>

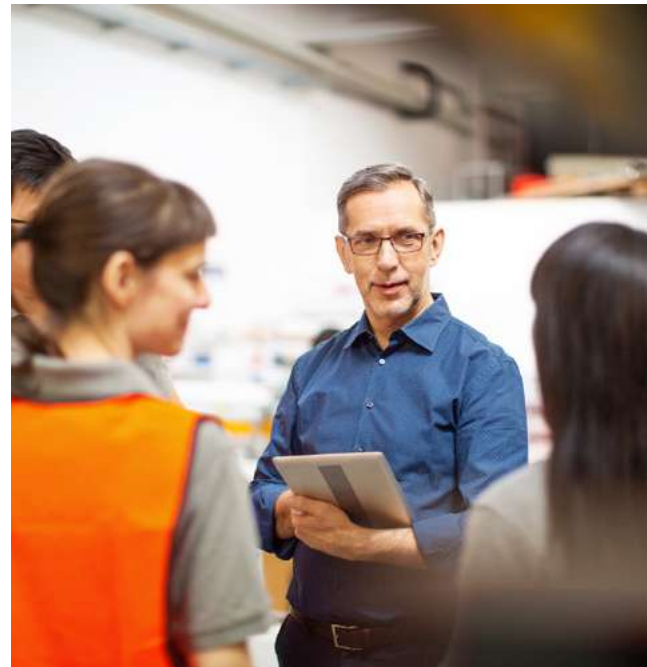
While current geopolitical events are throttling the region's growth prospects, predominantly through higher input costs, longer-term projections indicate that the EU's energy supply is expected to become greener and more resilient, and as a result so will the region's manufacturing capabilities. However, this will depend on imports of renewable technologies.⁷¹ Global supply chains will still be necessary to develop cost-effective energy sources and technologies, as production of the many critical components and essential resource extraction happen outside the region. So diversification is critical in order to hedge against future risk. This is yet another reason why over-reliance on the Chinese market, currently the EU's number one trading partner which produces many of these goods, would be an oversight.^{72,73}

Middle East

Economies in the Middle East, particularly the oil-exporting countries of the Gulf Co-operation Council (GCC), are set to experience a bump in GDP growth in 2022, driven by exports of oil at higher than average prices. This will trickle through the economy mainly via increased government spending. However, oil importing nations in the region must bear the brunt of rising inflation, as will the rest of the world.

According to our survey, in 2023 overall export growth in the Middle East (which includes only Saudi Arabia and the UAE) is expected to be driven by an expansion of operations into new and existing markets (cited by 22% of respondents). This aligns with the diversification strategy, which 49% of Middle Eastern executives want to adopt to reduce costs and increase resilience.

However, there has been a marked shift in regionalisation and reshoring, with 24% of respondents highlighting that they are regionalising in 2022 (compared with 13% in 2021), and 21% are reshoring (8% in 2021). There is a push for industrialisation in the UAE and Saudi Arabia in an attempt to diversify their economies away from oil, and regionalisation and reshoring would help to enable the development of nascent industries. For example, the government of Abu Dhabi's 2022 industrial strategy aims to double the size of the Emirate's manufacturing sector by 2031,⁷⁴ and it wants to transition towards a smart circular economy. Saudi Arabia also has plans to bolster its manufacturing sector by expanding 12 strategic industrial sectors as part of its National Industrial Strategy.⁷⁵



⁷¹ <https://viewpoint.eiu.com/analysis/article/472327430>

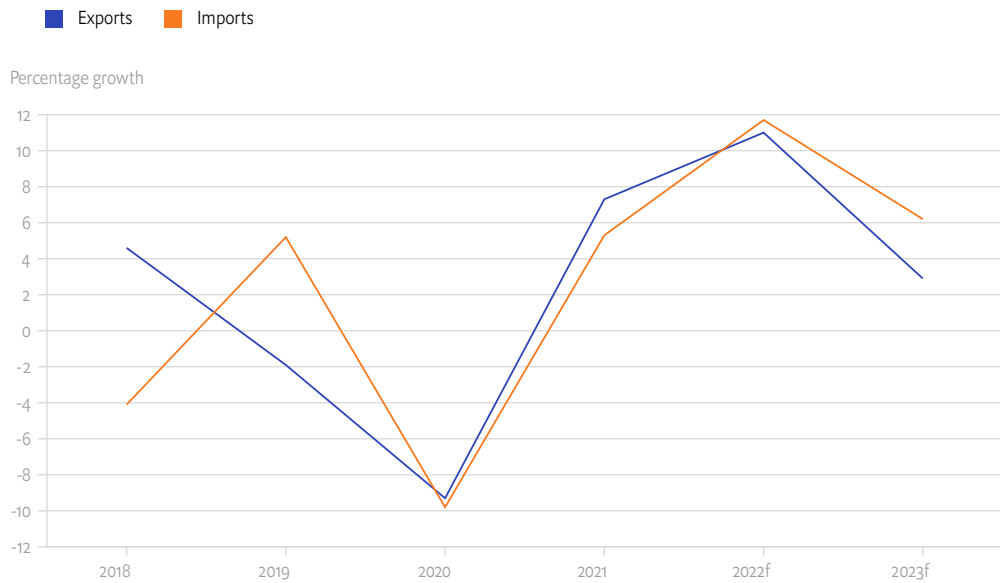
⁷² https://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_122530.pdf

⁷³ <https://www.csis.org/east-green-chinas-global-leadership-renewable-energy>

⁷⁴ <https://www.mediaoffice.abudhabi/en/economy/khaled-bin-mohamed-bin-zayed-launches-abu-dhabi-industrial-strategy-to-strengthen-the-emirates-position-as-the-regions-most-competitive-industrial-hub/>

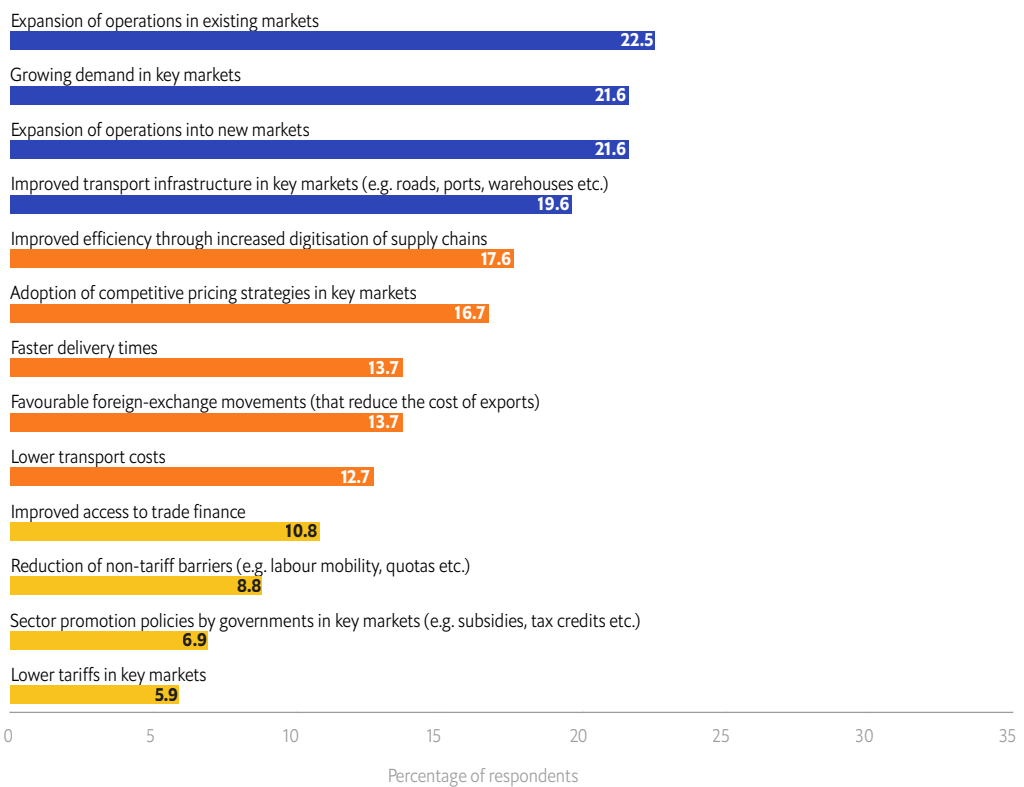
⁷⁵ <https://www.vision2030.gov.sa/v2030/vrps/nidlp/>

Figure 32: Annual percentage change in merchandise trade volumes in the Middle East

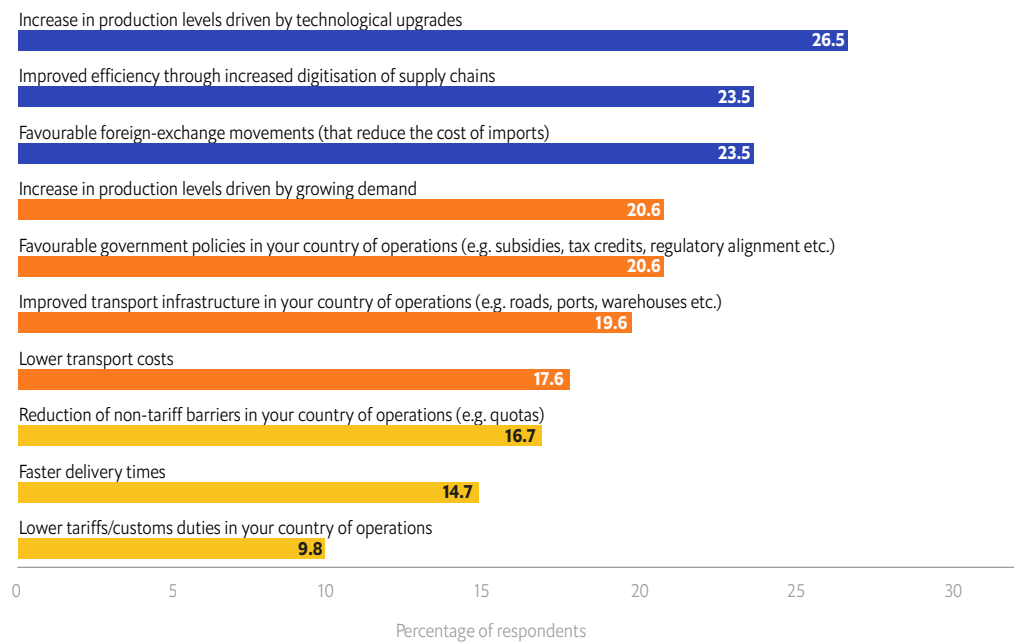


Source: WTO, 2022
 Projected data for 2022 and 2023

Figure 33: Drivers of export growth in the Middle East, 2023



Source: Economist Impact Trade in Transition survey, conducted September-November 2022.

Figure 34: Drivers of import growth in the Middle East, 2023

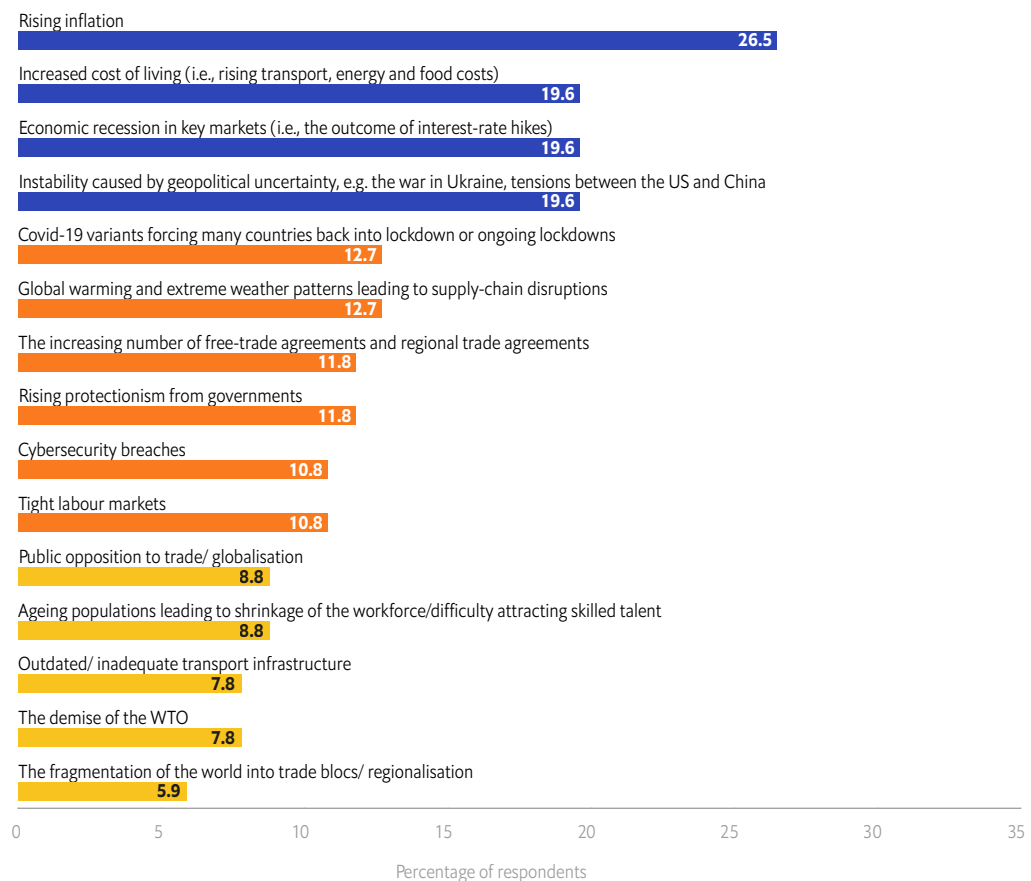
Source: Economist Impact Trade in Transition survey, conducted September-November 2022

When asked about limitations, the highest proportion of executives (21%) expect a falling level of demand in key markets as a result of higher inflation and high transport costs (20%) to be the top limitations to their export growth in 2023. The top export markets for Saudi Arabia and the UAE are China, India and Japan. An economic slowdown in China and India would therefore reduce exports from Saudi and UAE to these markets, inhibiting economic growth.

Globally, the uncertainties created by geopolitical events and elevated consumer prices will hit the Middle East in terms of import slowdowns as well. Executives in the region are most concerned about inflationary pressures when it comes to imports over the next

couple of years, similar to what we observed in last year's Trade in Transition study. Rising transport, energy and food costs, as well the presumption of economic recessions in key markets, are all a threat to Middle Eastern trade and therefore significant causes for concern.

Responding to higher inflation and therefore higher input costs, executives in the region are turning to technology. Executives state that the top two drivers of import growth in 2023 are expected to be an increase in production levels driven by technological upgrades (27%) and improved efficiency through the digitalisation of supply chains (24%). Both of these technologies would help to increase supply and also efficiency, offering more opportunity for further revenue.

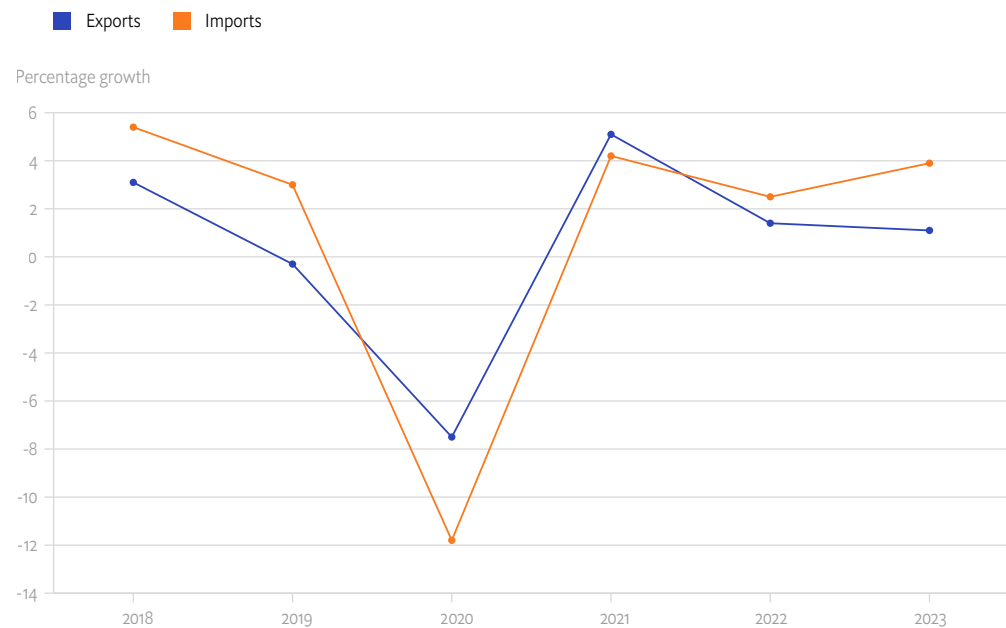
Figure 35: Reasons for pessimism about global trade over the next two years

Source: Economist Impact Trade in Transition survey, conducted September-November 2022.

Africa

Export growth in Africa is expected to shrink significantly in 2023. The WTO forecasts that African export volumes will fall by 1% in 2023, compared with 6% growth in 2022.⁷⁶ The trade environment is further hampered by rising inflation, which is predominantly caused by the war in Ukraine (as the continent is a significant export destination for Russian and Ukrainian food and energy), global monetary tightening and debt distress.

⁷⁶ <https://www.worldbank.org/en/region/afr/overview#:~:text=Economic%20growth%20in%20Sub%2DSaharan,rising%20risk%20of%20debt%20distress.>

Figure 36: Annual percentage change in merchandise trade volumes in Africa

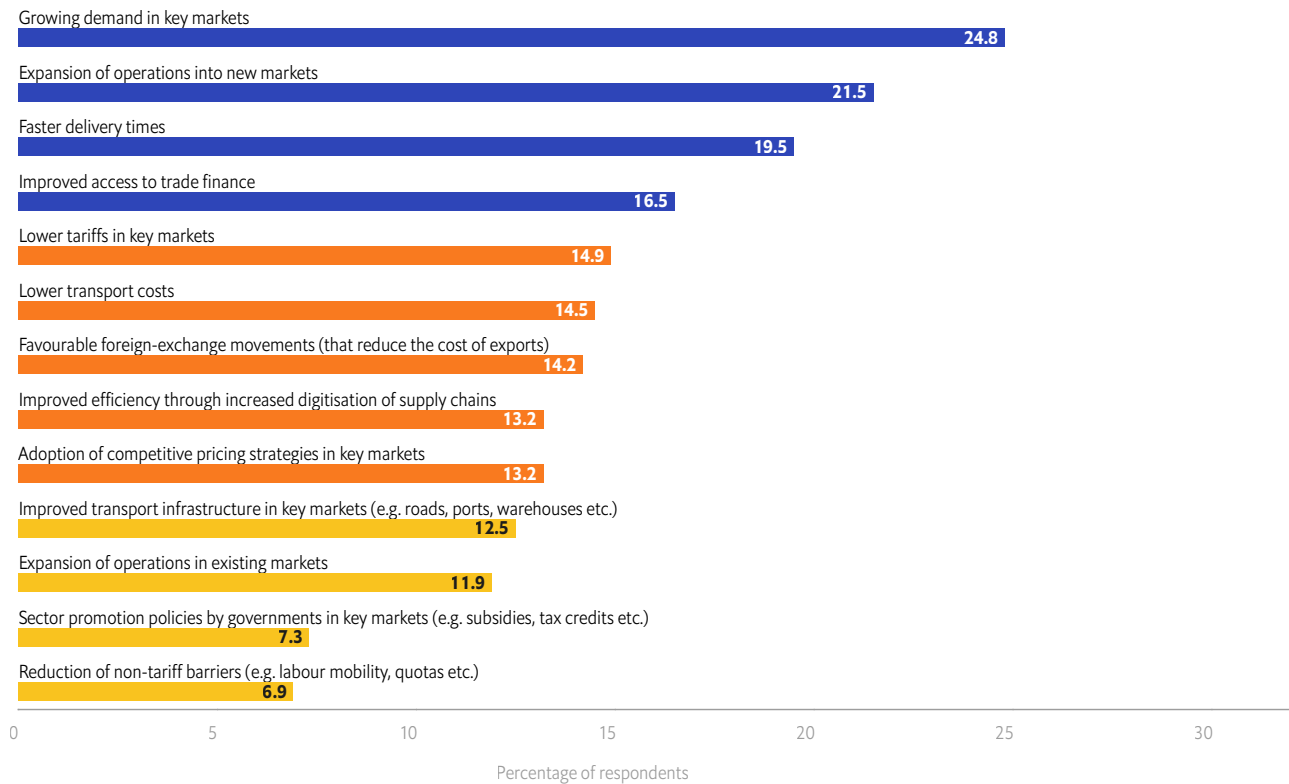
Source: WTO, 2022

Projected data for 2022 and 2023

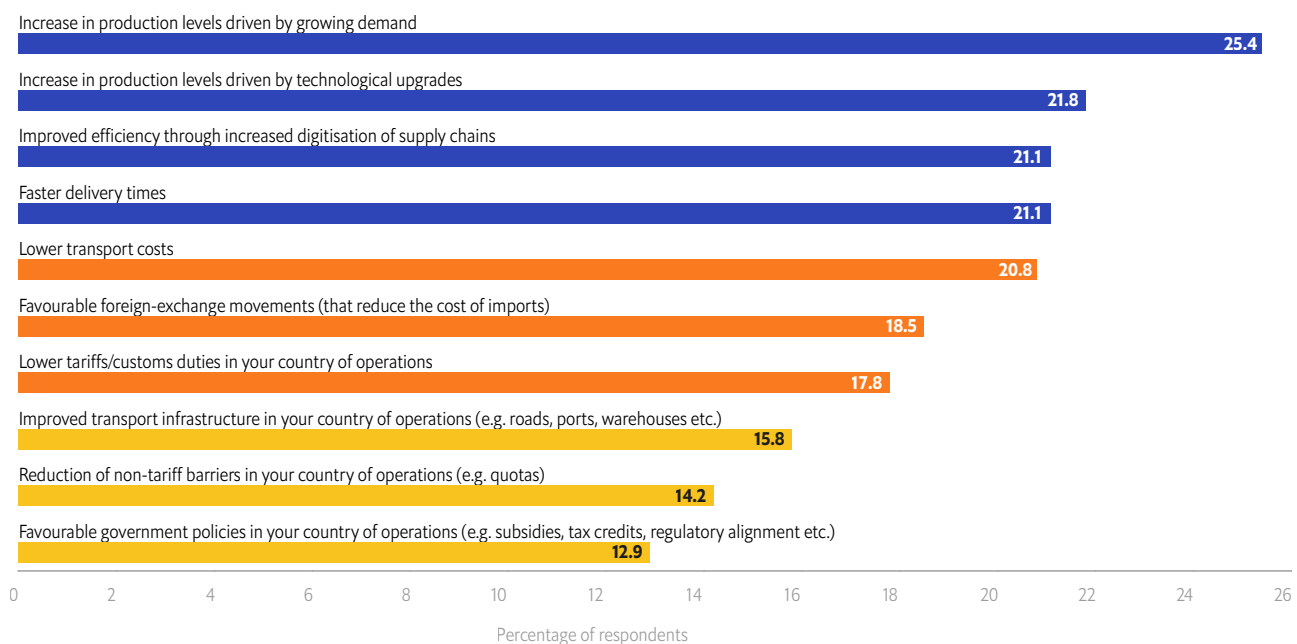
Export growth in Africa will largely depend on how economic growth plays out in its key markets. The top destination for Africa's exports is the EU. In 2020, 33% of its exports went to the EU and 31% of its imports came from the EU.⁷⁷ Europe is set to experience an economic slowdown in 2023, predominantly because of the war in Ukraine. As such, companies are turning to expanding their operations into new markets, cited by 22% of executives as a key driver of export growth. China and India are, respectively, the second- and third-largest markets for African exports. As the Asia-Pacific region is expected to produce healthier growth rates than other parts of the world in 2023, African businesses may turn to this region to export more broadly, as many of their goods are already present in the region.



⁷⁷ https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Africa-EU_-_international_trade_in_goods_statistics#Africa.E2.80.99s_main_trade_in_goods_partner_is_the_EU

Figure 37: Drivers of export growth in Africa, 2023

Source: Economist Impact Trade in Transition survey, conducted September-November 2022.

Figure 38: Drivers of import growth in Africa, 2023

Source: Economist Impact Trade in Transition survey, conducted September-November 2022

To develop creative solutions for the tough trading environment, a deeper understanding of the challenges facing African executives is required. Transport costs in Africa are higher than the global average. Around one-quarter of the executives from Africa who took part in our survey cited higher transport cost as the key limitation to export and import growth in the region. For instance, according to Merian Sebunya, chair of the National Logistics Platform in Uganda, it takes around US\$1.80 per kilometre to transport a cargo container in East Africa, compared with an average of around US\$1 worldwide.⁷⁸ Moreover, the interior of the country is vast, with only a few extensive waterways passing through it, requiring the use of more road haulage and railways that are fairly old, further increasing the difficulty of intra-continental trade.

In an effort to increase frictionless trade that will offset some of the logistical and transport issues, the African Continental Free-Trade Agreement (AfCFTA) is being negotiated. However, there are still some issues that are holding up its full-fledged enactment. As Abel Kamau, trade policy manager at the Kenya Association of Manufacturers, points out: “There are two key things holding it back. The regional economic blocs are yet to give the tariff offers to AfCFTA, and there are some pending rules of origin, which are being negotiated upon.”

Inflationary pressures are further exacerbated by unfavourable foreign-exchange movements, which were cited as a top impediment to import growth by 21% of executives in Africa, compared with 15% globally. “As of now, we are also experiencing rising interest rates and inflation because of what’s happening in the West. The weakening of the Kenyan currency and other African currencies against the dollar and other hard currencies has weakened the purchasing power and exposed the economies to inflation,”

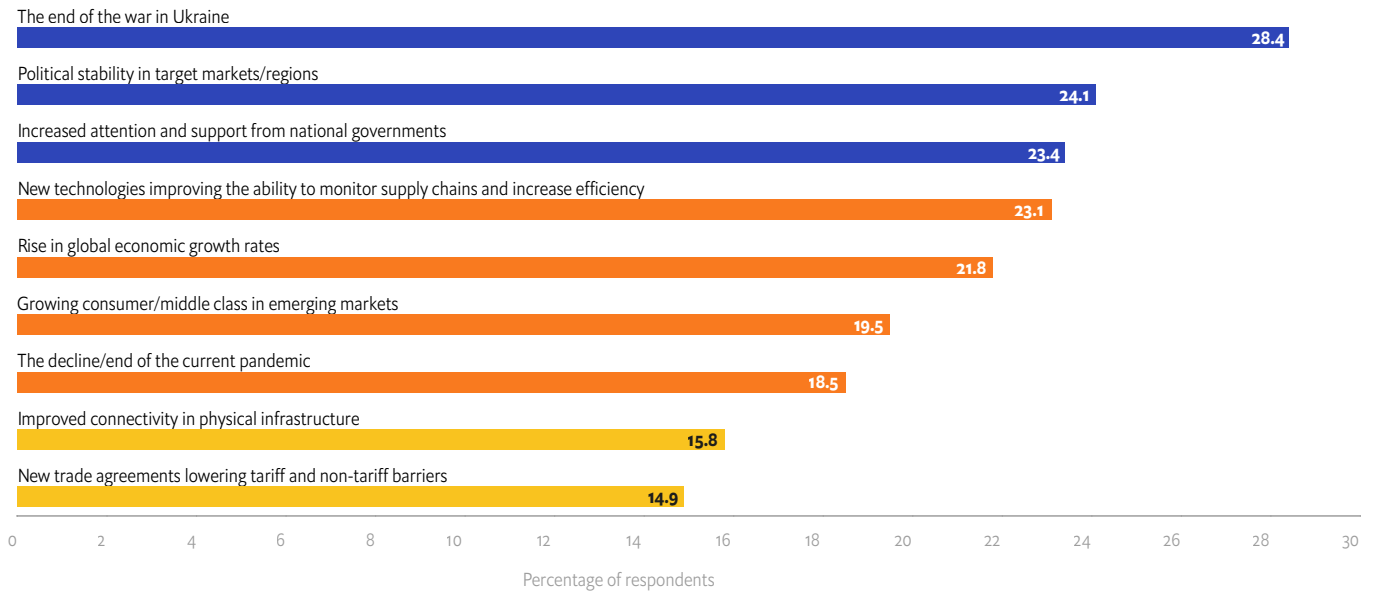
comments Mr Kamau. The weakening currency is a particularly acute problem because of Africa’s debt-servicing obligations. External debt-servicing costs have surged to 11% in 2022, from an average of 4% pre-pandemic.⁷⁹ This leaves countries in the region with less access to public-sector support both directly and indirectly in the form of better infrastructure development, as funds will be used to service debt instead of being invested in their economies.

While a weakening of several African currencies makes imports more expensive, it makes exports more competitive in global markets. Executives in the region are looking to take advantage of this as growing demand in key markets (25%) and expansion of operations into new markets (22%) are primary growth drivers for exports in 2023.

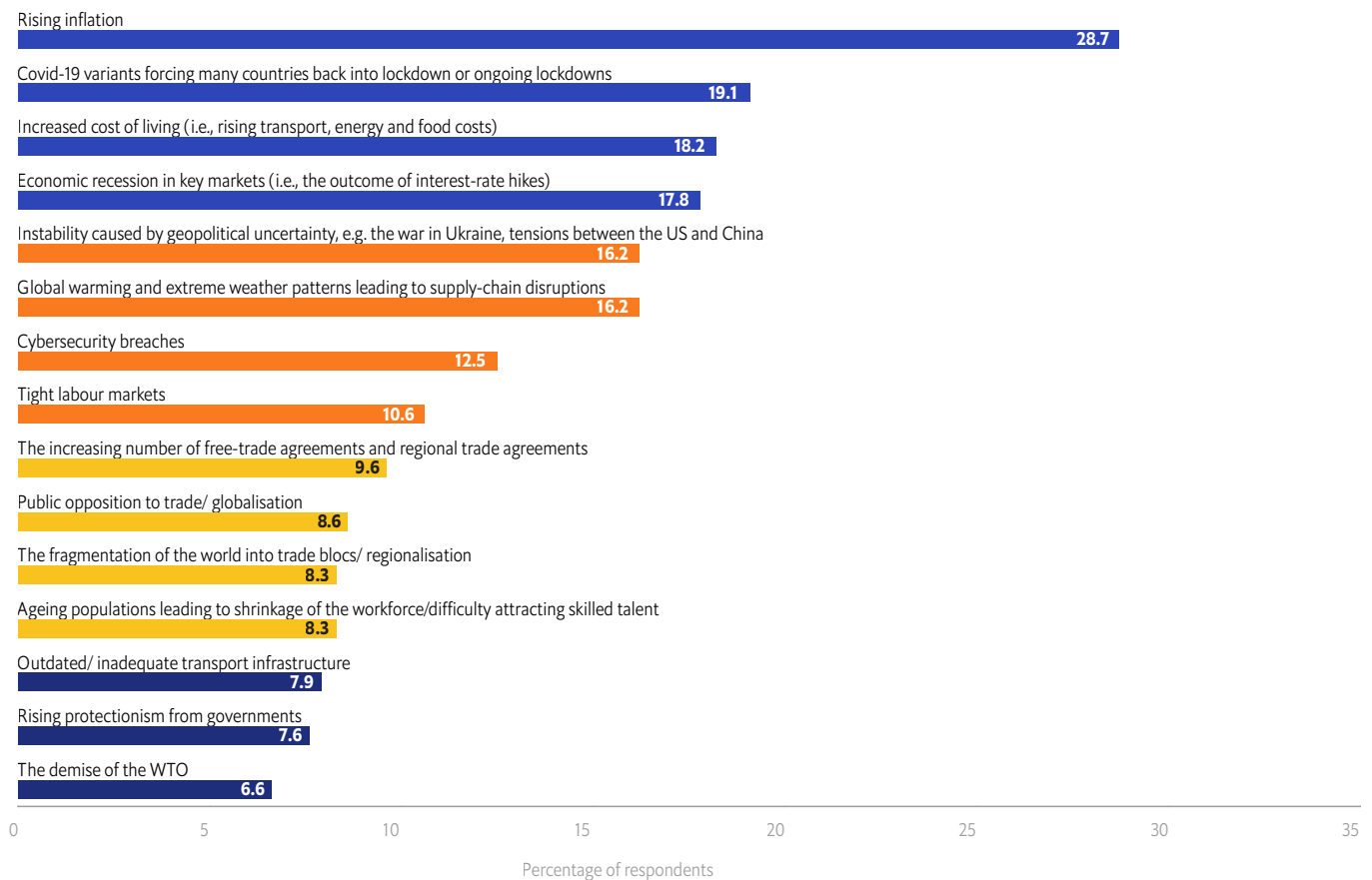


⁷⁸ <https://www.independent.co.ug/transport-costs-in-east-africa-community-choking-business/>

⁷⁹ <https://odi.org/en/insights/rising-interest-rates-are-threatening-debt-sustainability-in-africa/#:~:text=External%20debt%20servicing%20costs%20have,the%20high%20risk%20list.>

Figure 39: Reasons for optimism about trade over the next two years, Africa

Source: Economist Impact Trade in Transition survey, conducted September-November 2022.

Figure 40: Reasons for pessimism about trade over the next two years, Africa

Source: Economist Impact Trade in Transition survey, conducted September-November 2022.

Asia-Pacific

China’s zero-covid policy has dampened economic growth in Asia-Pacific’s largest economy, dragging the region’s average real GDP growth down from 5.8% in 2021 to 3.6% in 2022, according to estimates from The EIU. Although a more pragmatic approach to covid-19 management in China is expected next year, real GDP growth is forecast to remain flat at 3.5%. In line with this, the WTO forecasts export volumes to grow by just 1.1% in 2023, compared with 2.9% in 2022.⁸⁰ The biggest impediments to export growth, according to the executives surveyed in Asia-Pacific, are high transport costs (which stem from the surge in energy prices) and falling demand in key markets (such as the US and Europe), cited by about 20% each.

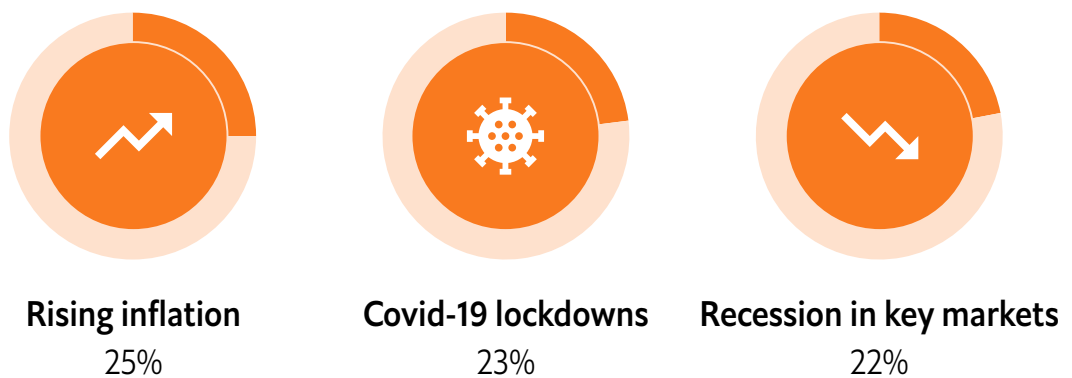
The Asia-Pacific trade landscape is also being shaped by global geopolitical trends—less so by the war in Ukraine and more so by US-China trade tensions and the risk of a China-Taiwan conflict with US intervention. The US has now put controls on specified chips, the equipment needed to make them and the personnel required to design them, all in an effort to deny Chinese capabilities for this sector.⁸¹ “I think companies expect it to be

challenging, more challenging than it has been,” says Deborah Elms of the Asian Trade Centre.

In light of these geopolitical tensions, companies in Asia-Pacific are responding in two key ways. The first is undertaking more due diligence of their supply chains (cited by 33% of executives surveyed). At a time when companies are already struggling in a high-cost environment, these efforts impose a greater administrative burden on firms operating in the region.

But companies are also focused on expanding into new and stable markets (also cited by 33% of executives). Mr Lawrence at Chatham House adds: “For most companies it’s not that there’s any legal restriction, it’s more that if they expect a deterioration in US-China relations over the next few years, they don’t want to be overweight in China.” This may be the impetus for the region’s primary approach to supply-chain reconfiguration: diversifying and increasing their supplier base, cited by a majority of executives in Asia Pacific (51%). The US tech giant Apple has already been shifting its supply chains away from China and expanding its presence in India and Vietnam. The number of large suppliers Apple has registered in the two countries has risen from 18 in 2017 to 37

Figure 41: Top reasons for pessimism among Asia Pacific executives about global trade over the next two years



⁸⁰ https://www.wto.org/english/news_e/pres22_e/pr909_e.htm#:~:text=The%20new%20WTO%20forecast%20estimates,than%20what%20was%20previously%20projected.

⁸¹ <https://www.csis.org/analysis/export-controls-dust-begins-settle>

in 2021.⁸² The company is also moving ahead with the latest iPhone production in India and has plans to commence MacBook laptop production in Vietnam. However, as Ms Elms points out, businesses “can easily produce whatever they want in whatever quantity almost instantly in China and have it in 10,000 pieces by Friday. You don’t have those options in most of the rest of the world.” Therefore, businesses must undertake a cost-benefit analysis when determining whether to include China in their diversification supply-chain strategy.

As a result, within the region, some countries even stand to gain from the worsening trade and geopolitical tensions. This explains the net GDP impact of the trade tensions modelled using the GTAP database (see “About this research” for more details). Overall, in the next 12 months GDP in Asia-Pacific would fall by only 0.01% (the smallest impact compared with other regions such as North America (a fall of 0.07%) or the Middle East (a fall of 0.31%)) as a result of ongoing tensions between the US and China.

Interestingly, just 19% of executives said they were regionalising their supply chains, which means that companies still have to fully exploit the new regional free trade agreements, such as the Regional Comprehensive Economic Partnership and the ASEAN Free Trade Area.

South America

Forecasts from the WTO show that South American export volumes will remain almost flat in 2023 (0.3%) compared with 2022.⁸³ The top impediments to export growth, according to executives surveyed, will be high or uncertain tariffs in export markets (cited by 24%), followed by higher transport costs (19%). A fall in imports by 1% in 2023 compared with 2022, according to WTO estimates, is expected as a result of

rising inflation as well as high transport costs.

There are a number of factors driving these outcomes. The most noteworthy has been the fallout from the war in Ukraine. Although Russia and Ukraine account for less than 1% of South America’s trade, the global impacts on energy, fertiliser and food prices are ultimately impacting South America as well.⁸⁴ These two interlinked trends are the top sources of pessimism about global trade among executives surveyed in South America (37% cited rising inflation and 21% cited instability caused by geopolitical uncertainty).

The impact of inflation on South American trade is mixed. Although importers of oil and gas (as a source of energy but also for fertiliser production) will face higher import costs, exporters of food will benefit in the short term, explains Fabrizio Operti, integration and trade sector manager at the Inter-American Development Bank. The net effect balances out, as we can see in the results of the GTAP model (see “About this research” section for more details on the methodology). In our “inflation” scenario the impact on South America’s GDP over the next 12 months is 0.0008% (representing a small net increase in real GDP of US\$30m).

“But the biggest force will be the deceleration of markets around the world, [particularly] China, the EU, and the US to a certain point as well,” states Mr Operti. A slowdown in global demand expected next year will dent overall export growth (The EIU forecasts a contraction in the euro area of 0.3% and anaemic growth of 0.2% in the US in 2023).

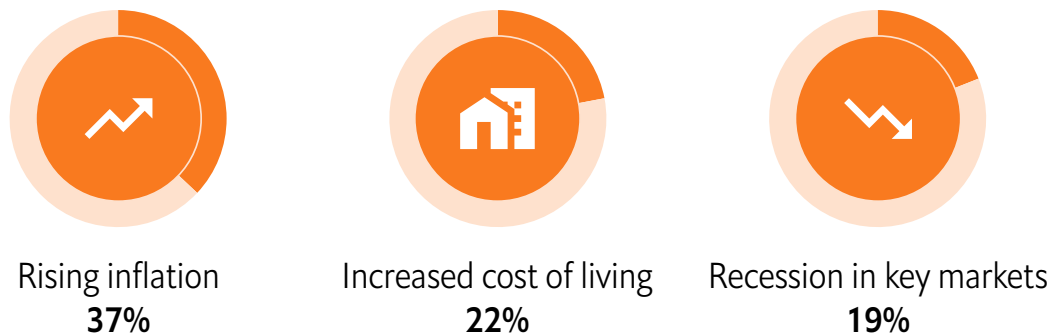
In response to the geopolitical and economic volatility on the global stage, companies in South America are adopting a host of strategies

⁸² <https://www.economist.com/business/2022/10/24/the-end-of-apples-affair-with-china>

⁸³ https://www.wto.org/english/news_e/pres22_e/pr909_e.htm#:~:text=The%20new%20WTO%20forecast%20estimates,than%20what%20was%20previously%20projected.

⁸⁴ <https://publications.iadb.org/publications/english/document/The-fallout-of-the-war-in-Ukraine-on-Latin-America-and-the-Caribbean.pdf>

Figure 42: Top reasons for pessimism among South American executives about global trade over the next two years



Source: Economist Impact Trade in Transition survey, conducted September-November 2022.

to increase resilience. On the demand side, the most effective strategy, according to 48% of the executives we surveyed, is exporting products to new markets. Given the ongoing war, there has been an opportunity for South American firms to serve countries that need to substitute imports from Russia and Ukraine. This is most likely to benefit countries such as Brazil (for exports of iron, meat and soybeans) as well as Chile (for exports of copper), according to analysis conducted by the Inter-American Development Bank.⁸⁵

On the supply side, the most effective strategy has been to adopt new technologies for inventory management, cited by 42% of executives in the region, significantly higher than the global average (30%). Among the top two technologies that executives say they have started using this year for supply-chain management are 5G solutions (40%) and advanced automation and robotics (38%). 5G solutions allow for greater connectivity, delivering real-time insights, and automation helps to drive greater efficiency with the aim of lowering operational costs.

Most interestingly, although the largest share of executives are still predominantly diversifying

their supplier base (46%), there has been a sharp increase in the number of firms regionalising and reshoring since we conducted this survey last year. The percentage of respondents diversifying their supplier base has reduced by 13% from 59% last year. The share of those who are regionalising and reshoring has increased to 23% (vs 12% in 2021) and 10% (vs 3% in 2021), respectively. One example is CTC Global, a US-headquartered power-grid solutions company, which opened a conductor production facility in Paraguay in 2022 to be closer to its South American customers.

But for such a strategy to succeed, barriers to intra-regional trade must be addressed. High tariffs in South America are a concern (with Venezuela and Brazil applying the highest tariff rates of 14% and 8%, respectively).⁸⁶ In December 2021 negotiations with Mercosur, a common market including Argentina, Brazil, Paraguay and Uruguay, ended without any agreement on import tariff reduction.⁸⁷

Beyond this, non-tariff barriers must also be addressed. "There are very important trade restrictive policies that need to be overcome," explains Mr Operti. "We're talking about harmonisation of our 33 preferential trade agreements in the region."

⁸⁵ <https://publications.iadb.org/publications/english/document/The-fallout-of-the-war-in-Ukraine-on-Latin-America-and-the-Caribbean.pdf>

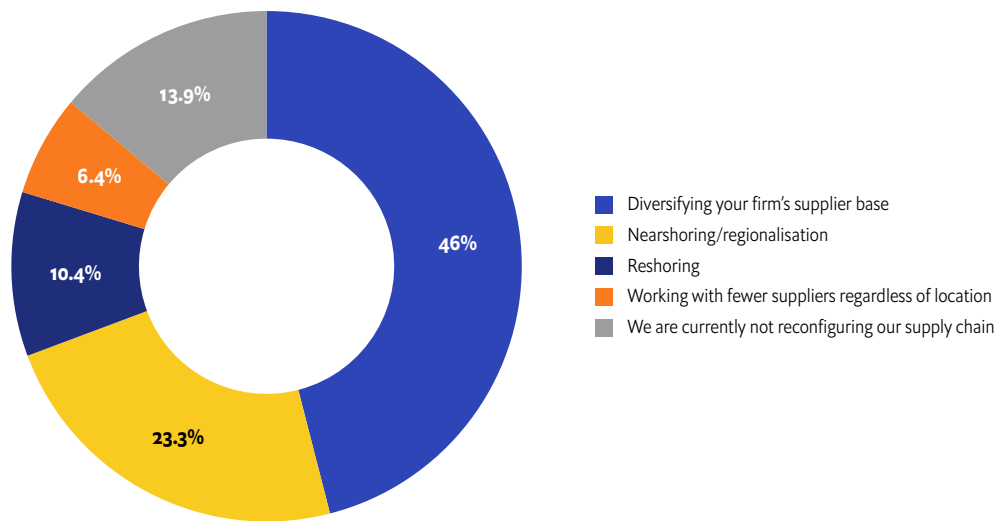
⁸⁶ https://data.worldbank.org/indicator/TM.TAX.MRCH.WM.AR.ZS?most_recent_value_desc=true

⁸⁷ <https://www.reuters.com/business/mercosur-meeting-ends-without-deal-import-tariff-cuts-2021-12-17/>



More broadly, to enhance South America’s trade competitiveness its governments must return to the fundamentals, especially infrastructure development. Ultimately, Mr Operti says, “the countries that will have better ports, better airports, better connectivity, better human capital, are those that will benefit from this reshifting of supply chains.”

Figure 43: Primary approach to supply-chain reconfiguration by South American companies, 2022



Source: Economist Impact Trade in Transition survey, conducted September-November 2022.

Conclusion

Supply-chain disruptions, originally caused by covid-19 and once thought an anomaly, have become commonplace in today's trading landscape. While growth in trade is still projected to be positive, this macro picture does not account for the more micro issues affecting specific regions and sectors. Executives are having to factor in multiple scenarios and develop an agile strategy that can be altered in line with future headwinds and disruptions.

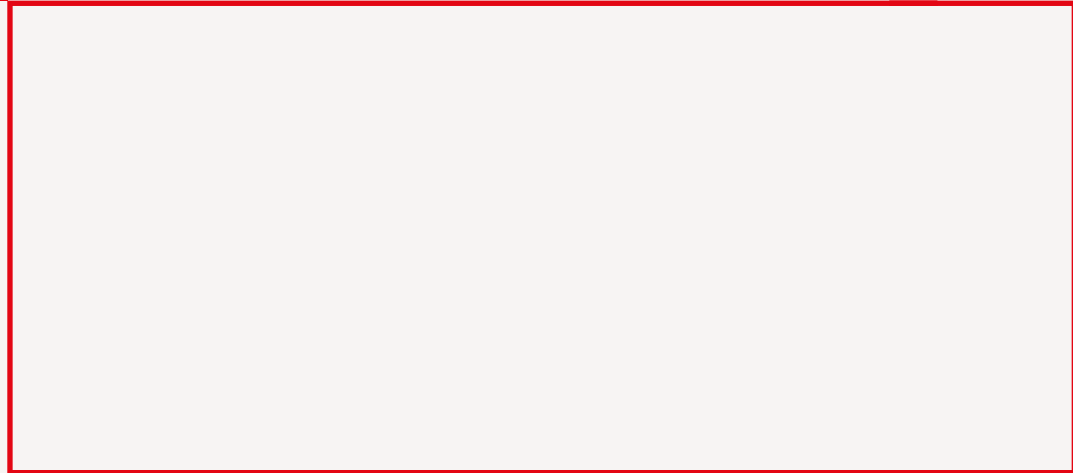
Geopolitics is becoming one of the most influential factors affecting trade and supply-chain operations, with 96% of the executives we surveyed making changes to their supply chains in response to geopolitical events. Even beyond the war in Ukraine and US-China tensions, other shocks such as cyber warfare can inhibit the proper functioning of economies around the world. This is increasingly leading to more protectionist government policies. The most notable examples come from the US in response to China's growing aggression through forced technology transfers, state-sponsored subsidies and their civil-military fusion strategy. Recent US legislative changes have also been more protectionist, such as the Infrastructure Bill and the CHIPS and Science Act, both of which aim to incentivise and prioritise US and North American manufacturing. Similar protectionist policies can be seen the world over, and if they continue they will only lead to a further fragmentation of the global trading system. "The arteries [of global trade] are clogged," says Mr Opertti of the Inter-American Development Bank. "We need to unplug the arteries of trade and we need trade facilitation measures that are lagging in order to operate."

Yet within this increasingly suffocating trade landscape businesses are finding ways to respond and grow. Altering supply chains either through diversification, regionalisation or reshoring to build resilience is one response. The widespread and increasing adoption of a plethora of technologies is yet another. Such changes will help businesses to overcome the adverse economic consequences associated with recent geopolitical shocks, as demonstrated by the GTAP analysis. Even in this context expansion is still on the mind of business executives, so being agile, having a business strategy and using scenario planning are essential to achieve this goal.

Ultimately, to resolve the most pressing issues and facilitate frictionless trade requires both private-sector and public-sector involvement. Ms Elms of the Asian Trade Centre comments that governments need to solve trade problems too, but "government solutions are often wildly out of date, clunky and difficult". Therefore, streamlining trade policy at all levels needs to be prioritised. While the many "players", all with their own respective interests, would make this difficult, progress has been made. This was demonstrated by the developments at the WTO's recent 12th Ministerial Conference,⁸⁸ which led to the Agreement on Fisheries Subsidies and a decision on the e-commerce moratorium, showing there is still a will among countries to work together to solve the pressing trade issues of the day. Only through further progress can trade flourish.

⁸⁸ https://www.wto.org/english/news_e/news22_e/mc12_17jun22_e.htm

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