

# GERMANY TRADE REPORT



# IN BRIEF

- Uncertainties such as Brexit and weak global demand loom large. But German manufacturers' propensity to innovate leave it better positioned than other EU economies.
- Industrial and transport equipment will continue to be the key drivers of German goods exports, reflecting expertise and ongoing innovation in these industries.
- Germany's lesser-known services sector has growth opportunities, including in ICT and other service sectors with complementarities to Germany's manufacturing industry.

The faltering trade outlook is testing the resilience of German manufacturers. However, they look set to meet that challenge with past performance suggesting a strong appetite for innovation in the manufacturing sector. Trade opportunities also exist within services, although policy reforms will be necessary to fully realise this potential.

## LONG-TERM OUTLOOK

### ECONOMIC OUTLOOK

The German economy has had a strong start to the year, although cyclical indicators published more recently have been more mixed, indicating that political and economic uncertainties are beginning to weigh on business sentiment. Indeed, machinery and equipment investment contracted in Q2 2016 and we expect business investment to remain weak in coming quarters. This is also consistent with the subdued trend in industrial production, which tends to be closely related to developments in global trade.

Adding to the uncertain outlook, German elections are due in the summer next year. Even though the elections are not expected to lead to substantial changes in policy,

they are likely to incline businesses towards caution in the interim. Reflecting these developments, our expectation is therefore that GDP growth will slow in the near term, from an estimated 1.7% in 2016 to 1.3% in 2017.

Over the medium term, our projections also imply a structural slowdown in the rate of economic growth as the population ages. Although the recent surge in immigration has provided a temporary counterbalance to the declining working-age population, it will not be sufficient to completely offset this trend. While this will tend to dampen prospects for German exporters, innovative firms would still be able to expand production through increased automation and outsourcing of supply chains.

## EXPORT CORRIDORS TO WATCH - GOODS

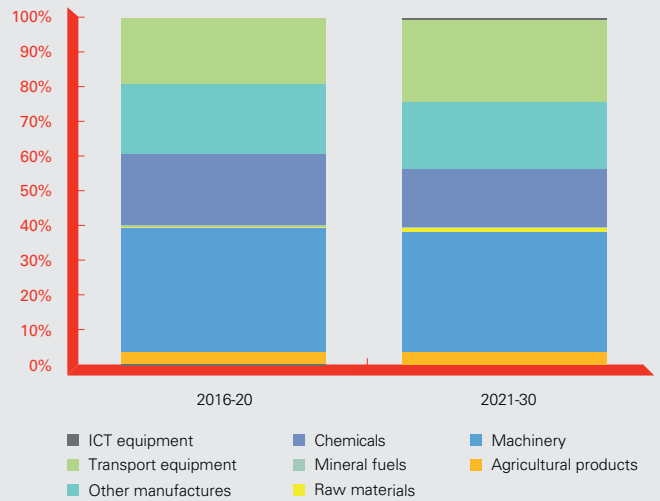
We expect German prowess in industrial machinery will continue to be the leading driver of merchandise exports in coming years. In particular, Germany's expertise in precision engineering means that it will continue to maintain a competitive advantage in producing machine tools for manufacturers around the world. Germany is also at the forefront of technological advances in a range of industrial and electrical equipment. For example, Germany is pushing heavily for energy efficient technology in machinery; Germany has a strong presence in the emergence of 3D printing technology; and it is a world leader in robotics, meaning it is well placed to capture the trend towards automation in a variety of sectors.

Another key driver of growth will be German exports of transport equipment, which are expected to contribute close to a quarter of the increase in merchandise exports across 2021-30. German exports in this sector include several well-known brand-name cars, but also a significant quantity of aerospace products. German capacities in this sector are embedded in a number of European cross-border cooperation-structures, such as the French-German Airbus consortium.

German exports of chemicals will also play a significant role, with pharmaceuticals the most dynamic sub-sector. German pharmaceutical companies invest heavily in R&D, with Germany placed first in clinical trials conducted in Europe and second worldwide. This will ensure that Germany will continue to export innovative new pharmaceutical products in coming years.

The major export destinations for German products will broaden in coming years, as rapid growth in emerging markets encourages exporters to look further afield for business opportunities. While the US will retain its position as Germany's largest export market in 2030, China is expected to move into second place, displacing France and the UK.

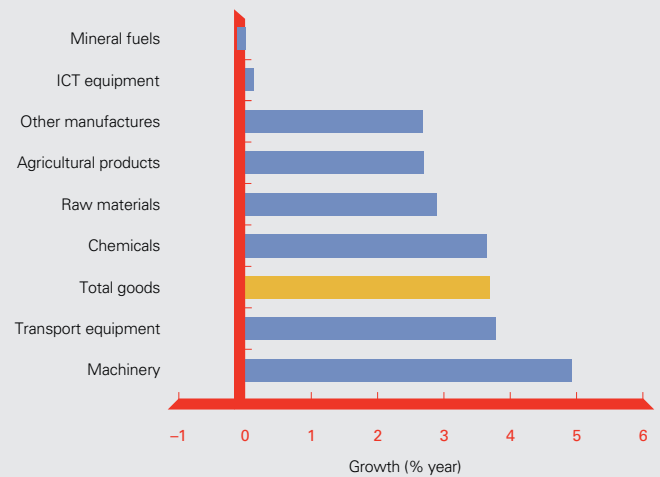
### Sector contribution to increase in goods exports\*



\* Chart shows the contribution from each sector to the projected increase in total merchandise exports over the relevant period.

Source: Oxford Economics

### Exports of goods by sector, 2016-30



Source: Oxford Economics

### Top 5 Hotlist Export Destinations

Rank	2015	2030
1	USA	USA
2	France	China
3	UK	France
4	China	UK
5	Poland	Poland

Source: Oxford Economics

Note: Ranking among the 24 trade partners covered in the HSBC Trade Forecast. Fastest-growing trade routes are listed in the Annex.

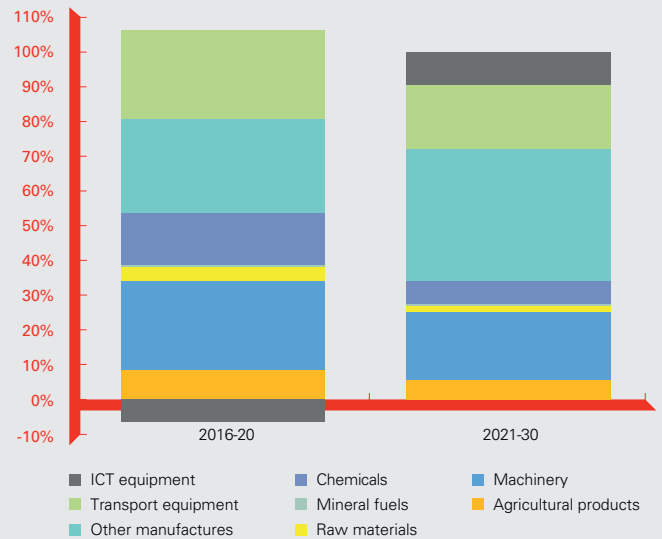
## IMPORT CORRIDORS TO WATCH - GOODS

At a sector level, the key drivers of German merchandise imports are expected to be similar to exports, with industrial machinery and transport equipment the most important contributors to growth. In part, this reflects mutually beneficial trade in the same products, but it is also driven by cross-border supply chains as German companies outsource production. In addition to growing its existing supply chains across Europe, Germany will also look further afield to source components from emerging markets with increasingly sophisticated manufacturing capabilities. Other inputs to Germany's manufacturing sector, such as scientific apparatus and minerals manufactures will also continue to provide a key part of the economy's import growth.

Another key growth area for imports to Germany will be ICT equipment. As well as reflecting expanding consumer demand for high-tech gadgets, imports in this segment will also increasingly feed into Germany's innovative manufacturing sector. This reflects ongoing developments in smart manufacturing, with processors going into everything from fork-lift trucks to metal cutting tools.

Emerging economies are forecast to grow in importance as sources of German imports, with shipments from countries including Vietnam, China and India growing at rates of 7-8% a year in the decade to 2030. This will ensure that China becomes the largest source of imports to Germany by 2030, displacing France. Germany's manufacturing sector will also strengthen ties with industrialising countries in Eastern Europe – Poland is expected to retain its position as the third largest originator of imports in 2030.

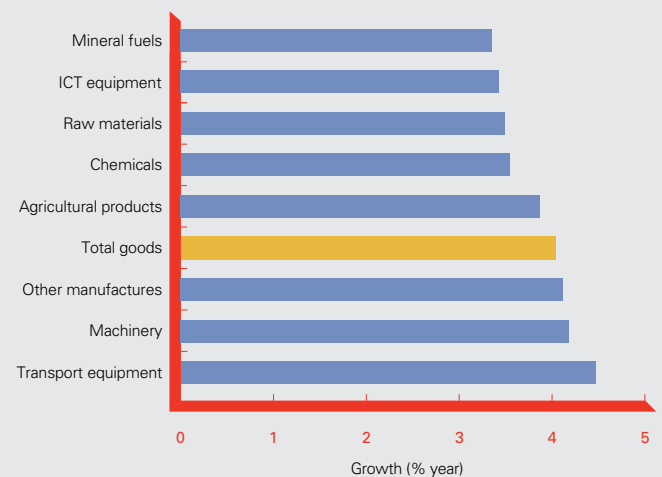
## Sector contribution to increase in goods imports\*



\* Chart shows the contribution from each sector to the projected increase in total merchandise exports over the relevant period.

Source: Oxford Economics

## Imports of goods by sector, 2016-30



Source: Oxford Economics

## Top 5 Hotlist Import Origins

Rank	2015	2030
1	France	China
2	China	France
3	Poland	Poland
4	USA	USA
5	UK	UK

Source: Oxford Economics

Note: Ranking among the 24 trade partners covered in the HSBC Trade Forecast. Fastest-growing trade routes are listed in the Annex.

# SPECIAL FOCUS: TRADE IN SERVICES

**German services have historically lagged the manufacturing sector in growth performance, in part reflecting a difficult domestic regulatory environment. Our projections indicate that one of the strongest performing sectors in coming years will be ICT services, reflecting strong global demand and the increasing application of ICT software in smart manufacturing technology.**

## RECENT TRENDS IN SERVICES TRADE: 2000-15

Compared to other developed economies, Germany is far better known for its manufacturing prowess than for services. This characterisation is not completely valid, as services account for the bulk of domestic activity and the sector has managed to gradually increase its share in total German exports, from 13% in 2000 to 16% in 2015. Nevertheless, the importance of services in trade still lags well behind other large European countries, such as the UK (44% of total exports) and France (32%).

The main destination for German services has for some time been the United States, which accounted for 21% of German service exports in 2000; although this share has since fallen to 17% in 2015, the US remains Germany's key market for services. The UK represents the second largest export market with a 10% share, while France is third with 6%. China has made strong gains in recent years, which has seen its share of German services exports rise strongly from just 1% in 2000 to 5% in 2015.

Germany has a strong focus around specialised business services – the B2B and other services category accounted for 44% of total services exports in 2015. A key strength in this area is ancillary services to Germany's dynamic manufacturing sector. Examples here include engineering services and repair services for German made industrial equipment. Similarly, around 10% of exports are ICT services, where German firms

are able to leverage their technical expertise. Germany has a number of large multinational software companies, as well as a growing number of innovative startup firms.

Although there are evident areas of strength in Germany's business services sector, productivity growth has actually been relatively low over the past decade, especially in professional, scientific and technical services. One reason for this appears to be that innovation policy is overly focussed on the manufacturing sector and regulations affecting business conduct are unusually tight for a developed economy. For example, the activities of professional service providers such as architects, engineers and lawyers are constrained by compulsory chamber membership and restrictions on share ownership in their firms. This suggests that reducing barriers to productivity and competition would help to revitalise these sectors and boost trade.

In terms of size, Germany's second-largest services export sector is transport and distribution, which accounted for 20% of service exports in 2015. Germany has a strong presence in container shipping, although revenues in this sector have suffered from the recent weakness in global trade. On the other hand, a bright spot recently has been air passenger traffic, which has benefitted from the decline in oil prices – Germany is host to a number of airlines, with Lufthansa and Air Berlin being the largest.

Also significant for Germany is the tourism sector, which accounted for 16% of total service exports in 2015 (albeit down from 25% in 2000). While the US and UK represented Germany's largest Travel & Tourism export markets in 2000, this has been shifting as visitors from Poland, and more recently China, have increased significantly. Business travel linked to Germany's large and successful merchandise export base is relatively more important for Germany than leisure.



# SPECIAL FOCUS

## OUTLOOK FOR SERVICES TRADE: 2016-30

Our projections indicate that the value of German service exports will expand at an average annual pace of close to 6% a year over the period 2016-30. This is relatively modest by international standards, which in part reflects the need for policy reforms to enhance competition and support innovation. Germany's share of global exporters in global services trade is therefore expected to drop back somewhat from 5.3% in 2015 to 4.8% in 2030.

Looking forward, the main destination for German service exports is expected to still be the United States in 2030. However, by that time, the share of total German service exports is expected to have fallen to 13%, which will put it within touching distance of the UK, expected to account for 11% of German service exports in 2030. Meanwhile, China is expected to further expand its share of German service exports to 7% by 2030. India will also be a fast-growing market over this period, albeit smaller in overall size.

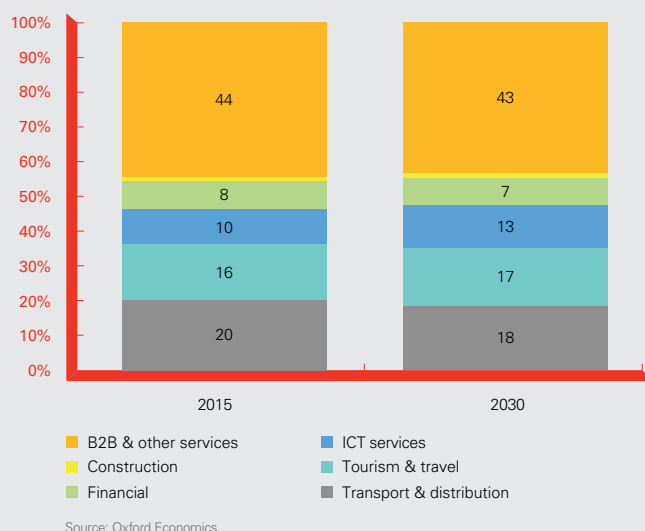
Our projections indicate that the overall structure of German service exports is not expected to change substantially in the years to 2030. One of the strongest performing sectors will be ICT, helped by the increasing application of ICT software in big data and cloud computing, as well as in smart manufacturing technology, which is expected to become more of a focus for German manufacturing firms. Our projections show this sector's share of service exports rising from 10% in 2015 to 13% by 2030.

Conversely, our projections indicate that growth in B2B and other services will not prove as dynamic as in the past. This reflects the difficult domestic regulatory environment in this sector, as well as more subdued global demand for some of Germany's niche engineering services.

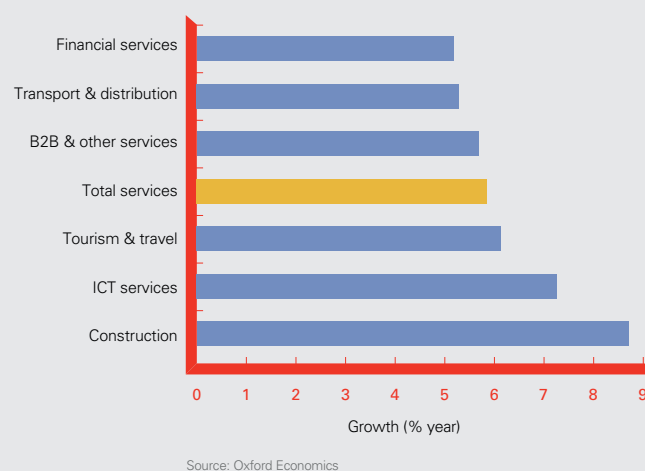
We also expect the share of the transport and distribution sector to edge lower, especially in the near term as container shipping and airfreight revenues are dampened by the difficult environment for merchandise trade. Although the sector should recover over the medium term, the share in total service exports will have fallen from 20% in 2015 to 18% by 2030.

Conversely, we expect that tourism revenues should stage a moderate recovery in coming years. Chinese visitors will be the key driver, accounting for around a quarter of the projected expansion.

### Sector shares in total services exports



### Exports of services by sector, 2016-30



### Top 5 Hotlist Services Export Destinations

Rank	2015	2030
1	US	US
2	UK	UK
3	France	China
4	China	France
5	Ireland	Poland

Source: Oxford Economics

Note: Ranking among the 23 trade partners covered in the HSBC Trade in Services Forecast. Fastest-growing trade routes are listed in the Annex.

## DOWNSIDE SCENARIO FOR TRADE

# ANNEX

## GERMANY'S FASTEST GROWING TRADE ROUTES

### Fastest growing goods exports (% year)

Rank	Destination	2016-20	Destination	2021-30
1	Vietnam	10	Vietnam	8
2	UAE	8	China	8
3	India	8	India	7
4	Mexico	6	Malaysia	7
5	Malaysia	6	Turkey	6
6	Turkey	5	UAE	5
7	Canada	5	Saudi Arabia	5
8	Singapore	5	Egypt	5
9	Ireland	5	Canada	5
10	Poland	5	Korea	4

Source: Oxford Economics

### Fastest growing goods imports (% year)

Rank	Destination	2016-20	Destination	2021-30
1	Vietnam	11	Vietnam	7
2	India	9	China	7
3	Bangladesh	9	Bangladesh	7
4	Canada	8	India	7
5	Malaysia	7	Mexico	6
6	Turkey	6	Turkey	5
7	Ireland	5	Malaysia	5
8	Poland	5	Canada	5
9	Japan	5	Ireland	5
10	Mexico	4	Poland	4

Source: Oxford Economics

### Fastest growing services exports (% year)

Rank	Destination	2016-20	Destination	2021-30
1	Turkey	10	India	11
2	Korea	10	Indonesia	10
3	Malaysia	9	China	10
4	UAE	9	Argentina	9
5	Poland	9	Mexico	8
6	India	8	Egypt	8
7	Australia	8	Saudi Arabia	8
8	UK	7	Malaysia	8
9	Vietnam	6	UAE	8
10	Singapore	6	Turkey	8

Source: Oxford Economics