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Q&A-China to shift to less imports-intensive production in future; Trade dispute with Australia likely to ease, but geopolitics may hinder: Joanna Konings, ING

China will likely see a structural shift to less imports-intensive production as it moves up the value chains due to its 'Made in China 2025' policy, which will also help the world's second-largest economy keep control over low value-added activity, **Joanna Konings, Senior International Trade Economist at ING,** told the Reuters Global Markets Forum on Wednesday. February 3.

China's post-pandemic recovery along with its strategy of working through the multilateral trade system has been key to the turnaround in world trade volumes, she added.

Konings said there was a "good chance" of trade tensions between China and Australia easing, but a wider geopolitical angle to the dispute may cause roadblocks.

Following are edited excerpts from the conversation:

Q: You recently wrote about how global trade has reached its maximum limit for some time. Could you elaborate on that?

A: Yes, trade volumes made a remarkable recovery after the COVID-19 first wave. Especially, if you think back to the global financial crisis (GFC). Now though there is a capacity constraint on further gains. Many containers have been stranded by blank sailings and some capacity has been diverted away from China-Europe routes to China-U.S.

Q: On average, what has been the change in freight costs for China-Europe as a result?

A: Depending on which rates you are looking at; increases have been between 100% and 400%.

Q: There was an ING report that forecast the sterling at 1.50+ by year-end. What is the reason for that?

A: In the view of our analysts this is about the no-deal Brexit risk premium unwinding. Faster vaccination also gives scope for a relatively early recovery.

Q: What is the thinking behind your view that post-COVID-19 recovery was much faster than post-GFC?

A: This is the parts of demand that have been hit this time versus in the global financial crisis. After the initial collapse in retail sales and production, these came back onstream quickly - some spending was even diverted into retail goods from services, which are not accessible due to lockdowns. So, there is support from both the household and commercial sectors, and within them, from the main trade-intensive parts of demand.

Q: How inflationary do you think the rise in freight and import costs can be for the global economy?

A: We've seen from the second half of 2020 that there are real speed limit effects on returning capacity to normal. It will take a combination of fleet capacity being brought back on to the water, especially on China-Europe routes, and probably new container supply as a faster route to easing the shortage of empty containers. But there is also a view that shipping liners won't be in a hurry to go back to normal. They may take a more active approach to managing capacity going forward.

Q: What's role do you see China playing in global trade in the years ahead, and what are your views on the imbalanced growth of trade, considering China has shown a faster recovery from the pandemic than much of the developed world?

A: China's recovery has been key to world trade volumes performing as well as they have. But we also see in the China-EU investment pact and President Xi Jinping's remarks at Davos, for example, a strategy of working through the multilateral trade system. At the same time, there is 'Made in China 2025' which is moving Chinese production up value chains, while holding on to low value-added activity as well, through automation. So, a structural shift to less imports-intensive production in China.

Q: What about shifts in trading patterns from China given its spat with Australia? In the long term, will Australia end up worse off or will the two nations make peace?

A: The trade tensions between China and Australia have now left a real mark on trade costs between the two nations, and this is what leads to eroded trade flows. From a narrow trade politics angle, there is a good chance the tensions can be eased as both China and Australia are WTO (World Trade Organization) members. But the origins of the dispute are not based on imports causing damage to domestic economies - so there is a wider geopolitical angle to the dispute.

Q: How do you feel global trade is going to evolve with Joe Biden as president of the United States?

A: 'Buy American' is not wholly unexpected, and we can expect the Biden administration to approach other aspects of trade policy similarly, so, seeking to strengthen incentives for domestic production. The key is that the Biden administration won't ride roughshod over its international agreements on procurement or trade tariffs. So, the part of world trade which has faltered under the uncertainty of the trade war years can recover.

There is a general move, not just in the U.S., towards screening foreign investment and considering the reshoring of supply chains. But these are at the country/policy level and it is companies which trade. The Biden administration won't unilaterally lower trade costs but might, as part of a dialogue on reforms to the WTO - which other major trade blocs also want. So, there are reasonable chances of successfully resolving the disputes and lowering tariffs, while also putting the multilateral system on a better footing.

Subsidies act in a trade distorting way and they have been used extensively -- and necessarily -- in the COVID-19 pandemic. But they will need to be unwound all the way to avoid creating new barriers to trade. WTO members, i.e., most countries, have not in the past had a good record at declaring the relevant subsidies at the WTO - so this is an area which needs to work better for trade to really recover.