Navigator

Now, next and how for business

Ireland report

HSBC

Ireland

Some rays of light amongst the Brexit clouds

Ireland's close trading links with the UK leave it more exposed to third-party Brexit risks than other countries. However, the latest HSBC survey shows that while Irish exporters are unsurprisingly negative about the UK's departure from the EU, they are optimistic about the outlook for trade with the UK. Globally, sentiment among Irish firms towards prospects for trade in goods looks stronger than for services. Longer-term, the focus of Irish trade will increasingly shift towards non-traditional markets outside the UK, US and Europe.

Short-Term Snapshot

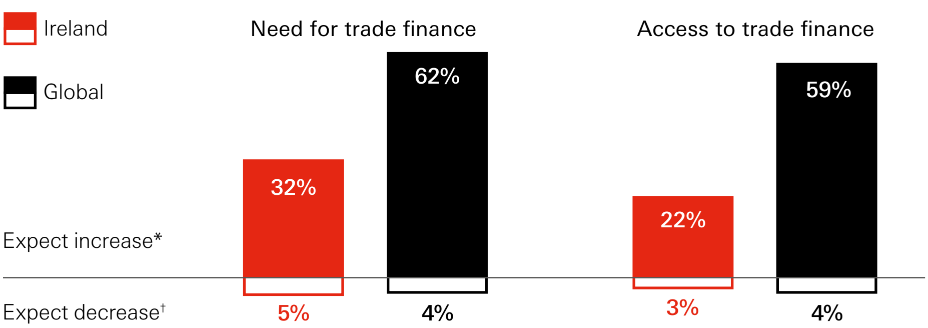
On a headline basis, the Irish economy put in a storming performance last year, with the likely fastest rate of expansion among euro-zone economies. Forecast GDP growth of 6% was up from 5% in 2016. However, that expansion was artificially boosted by the influence of some statistical 'funnies', related to Ireland's status as a hub for multinationals. Goods exports look to have underperformed the wider economy, rising 3.1% in US dollar terms, while a 14.5% rise in overseas sales of services was the best performance in six years. However, these data are particularly prone to distortions caused by multinational transactions.

71% of Irish businesses expect an increase in their trade volumes over the next 12 months, close to that in the UK (72%) and Germany (73%) but a little below the global average of 77%. Notwithstanding Brexit concerns, the UK is seen as top growth market (by 39% of firms), followed by the US and Germany (22% and 19% respectively). Increasing demand for individual products and a favourable economic environment are viewed as the most important drivers of trade growth, probably reflecting a buoyant economic performance in many of Ireland's key export markets.

Action points for business

- Is your firm taking sufficient advantage of buoyant near-term growth prospects in many key export markets?
- Does relative optimism around trade prospects with the UK disguise a failure to adequately consider the consequences of Brexit?

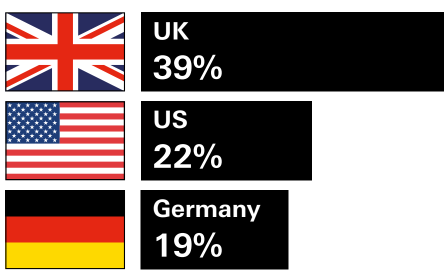
Outlook for trade finance need and access in the next 12 months



*Expect increase = Increase significantly + Increase slightly
†Expect decrease = Decrease significantly + Decrease slightly

Source: TNS Kantar

Which are the top 3 markets where your business will look to expand in the next 3-5 years?



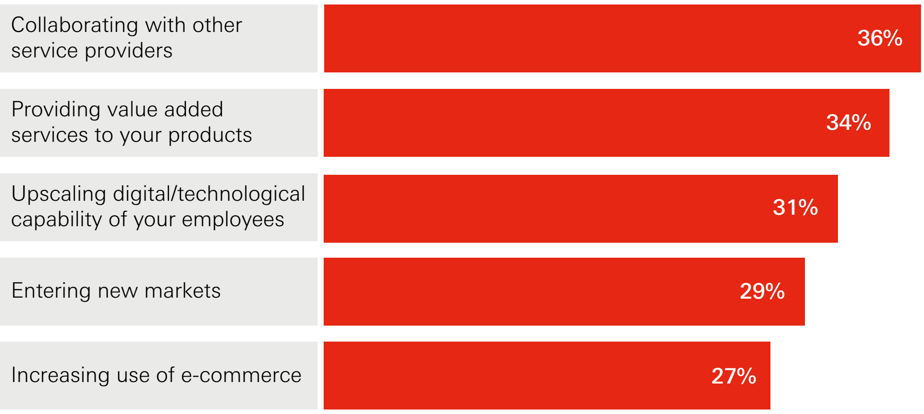
Source: TNS Kantar

But optimism over growth in trade volumes is not matched by expected demand for trade finance. Less than half (32%) of businesses anticipating an increased volume of trade see an increased need for trade finance or that their ability to access trade finance will increase (22%). These proportions are well below global averages of 62% and 59% respectively.

Irish GDP and services exports grew at a storming pace in 2017, but statistical distortions probably played a role.

Relative to other developed economies, Irish trade is very services-orientated. The sector accounted for 56% of total exports in 2017 and since 2000, Ireland has ranked first among countries in terms of growth in the proportion of exports accounted for by services. Services exports in 2017 outgrew growth in goods exports more than four-fold, although this rise may have been distorted by Irish-based multinationals recording sales from foreign subsidiaries as exports. Despite last year's performance, only 43% of Irish firms see services trade increasing in the next 12 months, below global (61%) and developed economy (53%) averages. Collaboration with other service providers and Providing value-added services to existing products were the growth strategies identified most frequently by respondents.

How do you plan to grow your services business?



Source: TNS Kantar

Services account for over half of Irish exports, one of the highest ratios in the world.

On the subject of data and digitisation, the mood music among Irish firms is mixed. 84% are positive that easier access to data will assist in creating a more level playing field for trade. But worries about cyber-security are common among almost all respondents (96%), and 70% see data regulation creating barriers to trade.

Trade Policy Developments

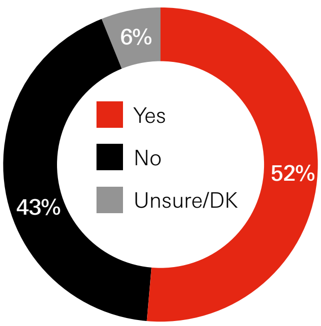
The UK bought 14% of Irish exports and supplied around one quarter of imports in 2017. So the Brexit process and Ireland's (and the EU's) future trading relationship with the UK represent the most important trade policy issues.

Meanwhile, advances by the EU in negotiating or agreeing trade deals with Canada, Mercosur and Japan will also have a bearing on Irish trade, particularly trade in goods. But the influence of those agreements will be limited given the heavy focus of Irish trade on the US, the UK and Europe (collectively accounting for almost 85% of goods exports in 2017).

Action points for business

- Given risks in the key UK and US export markets, have you given sufficient thought to opportunities to diversify overseas trade beyond traditional partners?
- Is there scope to leverage actual or prospective EU trade deals to assist in that diversification?

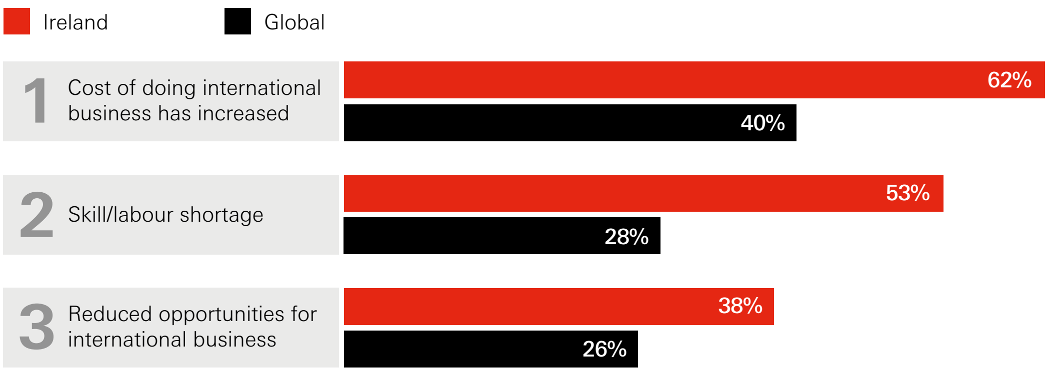
Are governments becoming more protective of their domestic business?



Note: may not total 100% due to rounding

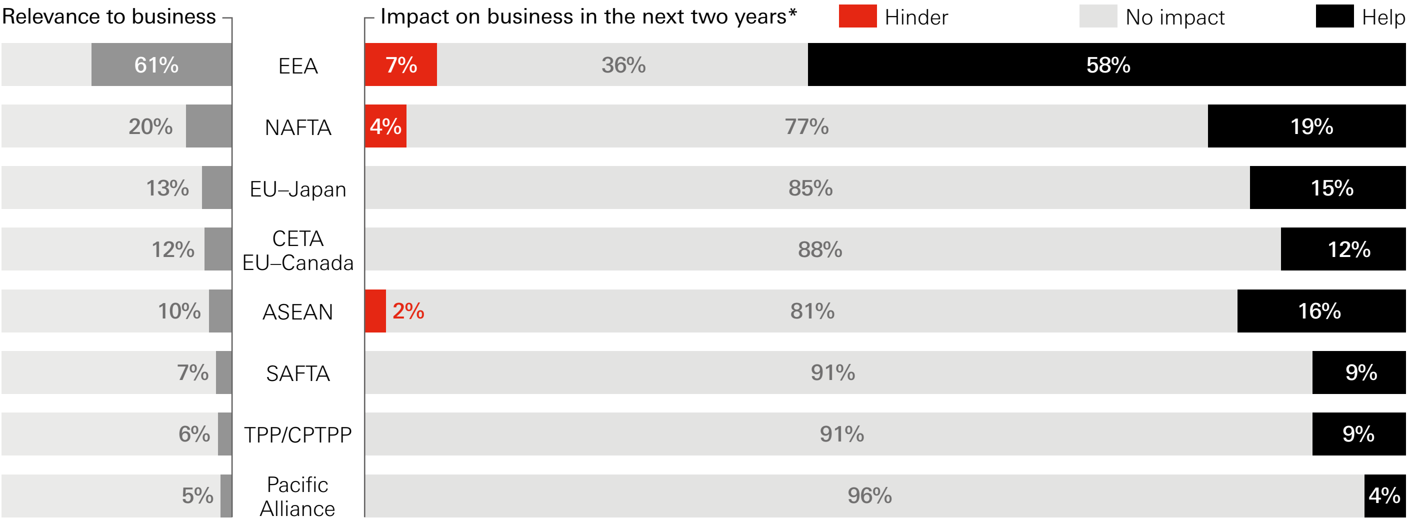
Source: TNS Kantar

Top 3 impacts of protective policies on my business



Source: TNS Kantar

Relevance and impact of trade agreements



Source: TNS Kantar

*May not total 100% due to rounding

75% of survey respondents judge that Brexit will have a negative business effect, and 39% are concerned about the regulatory and political environment in the US, so it is not surprising that a majority (52%) of Irish businesses think that governments are becoming more protective of their domestic businesses. Almost two-thirds of firms affected perceived a resulting increase in costs and 38% reported reduced opportunities for international business.

The majority of Irish firms (61%) in our survey continue to view developments in the European Economic Area as being significant for their business. The EU's activism in pursuing new trade deal could provide some offset to Brexit concerns, but the peripheral nature of the economies in question to Ireland means that developments in the US and UK will dominate Irish attention.

> The UK accounts for just under 15% of Irish exports and almost a quarter of imports, so Brexit is a key risk.

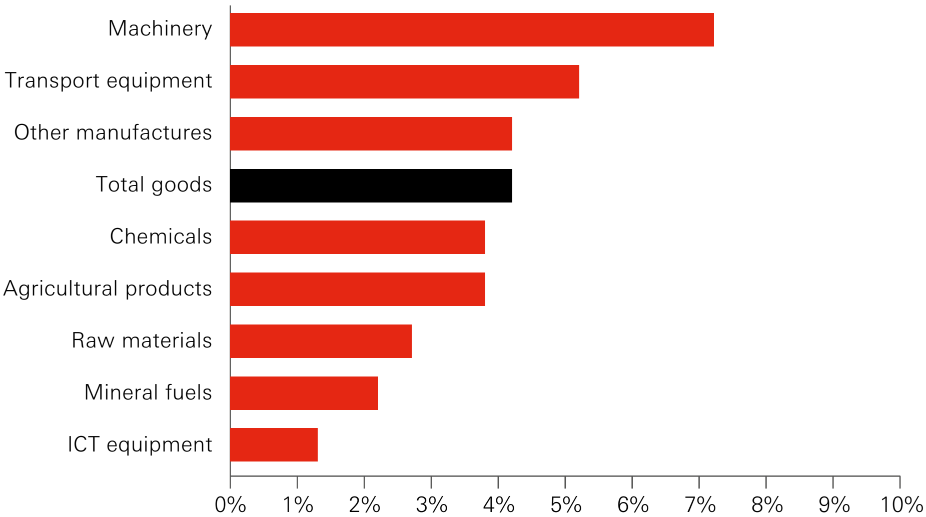
Long-Term Outlook for Trade

We expect the EU and the UK to negotiate a multi-year transition deal beginning in March 2019, implying that Irish trade with the UK should see no immediate disruption following 'Brexit day'. While our projections assume that a free-trade agreement will follow that transition period, there is still potential for Irish exporters to face new non-tariff barriers in selling goods and services to the UK. This may well accelerate the long-running decline in the relative importance of the UK as a market (down from 45% in 1973 to 14% in 2017), although geography and language will mean that the UK continues to be an important partner. Given Ireland's competitive advantages, no serious shift in the composition of Irish goods and services exports is expected. Chemicals, pharmaceuticals and industrial machinery should continue to dominate on the goods side, while B2B, ICT and financial services are forecast to remain the most important forms of services exports out to 2030. But Ireland's low tax advantage will continue to be vulnerable to policy moves in other countries, of which US tax reforms announced in late 2017 are a recent and visible example.

Brexit risk may be underplayed by headline export numbers
Ireland's combination of low business taxation, a skilled workforce and its use as a base by a range of multinational companies all contribute to a forecast showing the nature of Irish goods exports being broadly stable over the next decade. In 2016, exports of chemicals, pharmaceuticals and industrial machinery took the top three slots by value, a ranking which is projected to be unchanged in 2030.

Although 14% of total Irish goods exports went to the UK in 2017, the share is much higher in some sectors which are particularly exposed to tariffs and non-tariff barriers - for example, the UK makes up almost 40% of Irish animal and animal product exports. So the risk of a 'hard' Brexit to Ireland is more acute in certain sectors of the economy.

Exports of goods by sector, 2017-30 (average annual growth)



Source: Oxford Economics

Action points for business

- Have you put in contingency plans to deal with the fallout in the absence of a UK-EU agreement?
- Does your firm have the nimbleness to respond to possible structural shifts flowing from Brexit and efforts by the US to attract multinational activity back home?
- Are you able to adapt to the cultural, product and regulatory differences that are a requirement for success in rapidly growing Asian economies?

A transition agreement should minimise short-term Brexit disruption, but US tax reforms pose another risk.

Top 5 Hotlist destinations of goods exports

Rank	2016	2030
1	USA	USA
2	UK	UK
3	Germany	Germany
4	France	China
5	China	France

Note: Ranking among the 24 trade partners covered in the forecast

Source: Oxford Economics

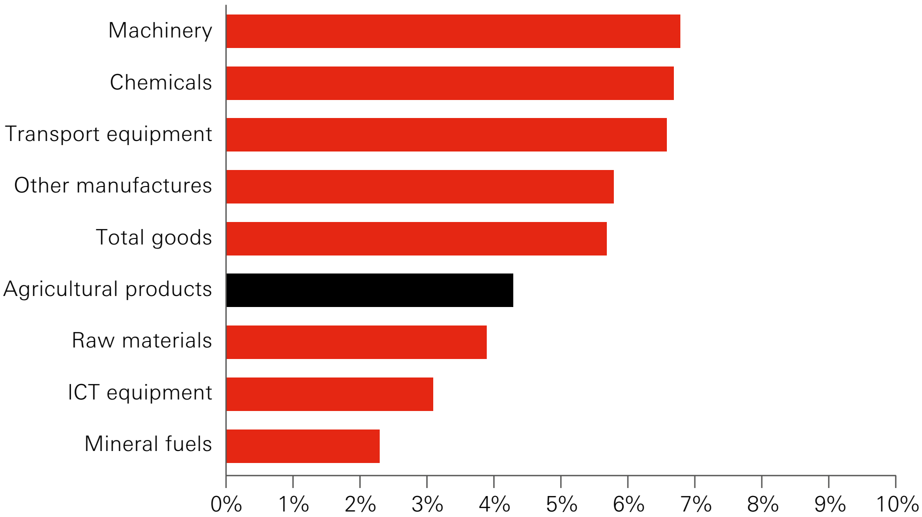
In percentage terms, growth in Irish goods exports is expected to be very much an emerging economy story. Sales to China, India and the UAE (the latter mainly reflecting Dubai's role as a trading hub and gateway between East and West) are forecast to rise by 6-8% per year from 2021-2030. But the top ten countries by growth rates also include several advanced economies, with Singapore and Canada the most important in that grouping. Amongst the economies covered in the HSBC Trade Forecast, traditional trading partners – the US, the UK and Germany – are forecast to hold on to their positions as the most important markets for goods exports in absolute terms. China is forecast to rise from fifth to fourth place as a buyer of Irish goods exports, while France slips behind China to rank fifth.

Emerging markets should be of most importance in driving export growth…

Multinational supply chains mean that developed markets will be of importance for Irish imports

In sectoral terms, prospects for Irish goods imports are very similar to what is anticipated for exports, in part reflecting the importance of cross-border supply chains in various key industries. In 2016, industrial machinery, pharmaceuticals and chemicals constituted the biggest source of imports, a ranking which is projected to remain the same in 2030. These three sectors are also forecast to dominate import growth, accounting for around 40% of the rise in goods imports in the decade up to 2030. The UK's importance as a source of goods imports (around one-quarter of the total), means that post-Brexit trade frictions could act as a drag on growth in imports; to the extent those frictions encourage some import substitution towards domestic suppliers, they may also prompt supply-chain expansion within Ireland.

Imports of goods by sector, 2017-30 (average annual growth)



Source: Oxford Economics

Top 5 Hotlist origins of goods imports

Rank	2016	2030
1	UK	UK
2	USA	USA
3	Germany	Germany
4	France	China
5	China	France

Note: Ranking among the 24 trade partners covered in the forecast

Source: Oxford Economics

That Ireland hosts many multinational operations, with supply chains linked to operations in other, mainly European countries, may go some way to explaining the prominence of those countries in forecast growth in Irish goods imports. Granted, India and China are forecast to take first and second place for import growth between 2021 and 2030, with imports from these countries projected to increase by 9% per year. But Poland, Canada, Turkey and France take the next four places (import growth from Canada should be supported by the Comprehensive Economic and Trade Agreement (CETA) with the EU which came into force provisionally in 2017).

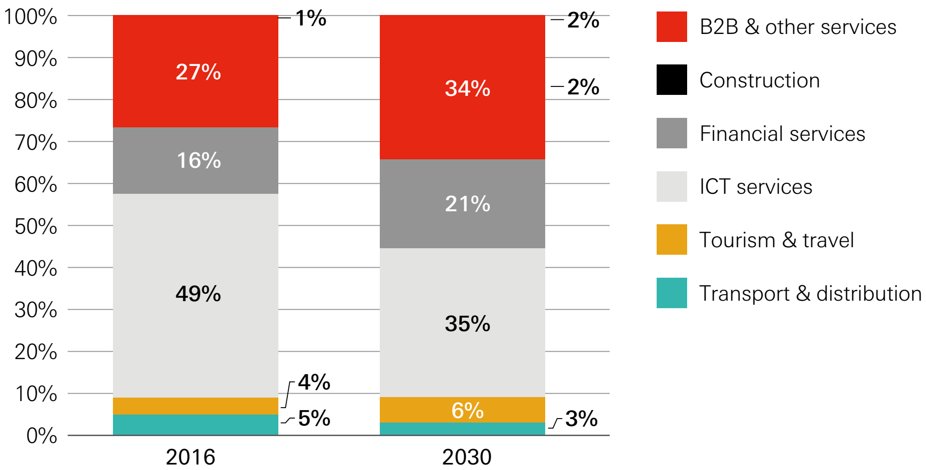
…but the role of multi-national supply chains means that import growth may be more evenly divided between advanced and emerging economies.

The potential for new non-tariff barriers even in the event of the EU and UK agreeing some form of free-trade agreement will probably weigh on the growth of imports from the UK. Indeed, while goods imports from, for example, the US are forecast to rise by 68% in value terms over the decade to 2030, the equivalent figure for the UK is 57%. However, the UK is still forecast to remain in first place as a source of imports by the end of the next decade.

Services exports are forecast to rise to 60% of total overseas sales by 2030.

Services will continue to grow their share of Irish exports
With less than 0.1% of the world's population, Ireland accounted for an estimated 3.4% of global services exports in 2017, a reflection of the outsized importance of services for the Irish export sector. Among different services categories, Business-to-Business (B2B), ICT and financial services are forecast to be of most importance for services exports in the period to 2030, both in level and growth terms, retaining the current positions held by these sub-sectors. As a share of total exports, services are forecast to continue rising in importance. Ireland's low taxation, a relatively well-educated, English-speaking workforce and the possibility of some services activity relocating from the UK post-Brexit, will all help in driving services trade. But tax cuts in other parts of the world, notably the US, and possible moves by the EU towards tax harmonisation could stymie some of Ireland's attractions.

Sectoral shares in total services exports



Source: Oxford Economics

Top 5 Hotlist destinations of services exports

Rank	2016	2030
1	UK	UK
2	USA	USA
3	Germany	Germany
4	France	France
5	Japan	China

Note: Ranking among the 23 trade partners covered in the forecast

Source: Oxford Economics

The UK, US and Germany are forecast to remain Ireland's biggest buyers of services exports in 2030, collectively accounting for around 30% of total sales, a share broadly unchanged from 2017. Despite Brexit and the prospect of Irish exports facing new non-tariff barriers, the UK's remains by far the largest single market for services, with its share rising to 16% in 2030 from 14% in 2017. But in terms of where growth in services will come from over that period, emerging economies dominate. India, Indonesia and China are forecast to take the top three slots, with services sales to these countries forecast to rise by 9-10% per year on average from 2021 to 2030. That said, the proportion of services exports accounted for by the three emerging Asian economies is expected to remain modest, running at 7% in 2030 compared to around 4% in 2017. The prospect of the EU pursuing more CETA-style trade deals, which seek to liberalise trade in goods as well as services, could aid Ireland given its strengths in services.

About the HSBC Navigator

The HSBC Navigator presents a blend of survey evidence, policy analysis, and economic modelling to generate unique and timely insights into the changing landscape for global trade.

The business survey is a quantitative indicator of the short-term outlook for global trade. The survey, which is the largest of its kind, is conducted on behalf of HSBC by Kantar TNS. It is compiled from responses by decision-makers at over 6,000 businesses – from small and mid-market to large corporations – across a broad range of industry sectors in 26 markets. Interviewees were polled on a range of questions including expectations around future growth in trade, trade finance needs, attitudes toward trade policy developments and strategic business plans.

The survey represents a timely source of information on the fast-evolving trade environment. And it can provide a useful contextual setting for interpreting developments in official data. In this way, economists at Oxford Economics are able to blend insights from the survey with their own analysis and modelling of developments in trade.

Oxford Economics has tailored a unique service for HSBC which forecasts bilateral trade in goods and services, in part based on HSBC's own analysis and forecasts of the world economy. A top-down approach is employed, with Oxford Economics' suite of models used to ensure consistency between HSBC's forecasts for economic growth and exchange rates in key countries and the more granular projections for bilateral trade flows presented here.

Oxford Economics employs a global modelling framework, with headline bilateral trade forecasts constructed as a function of demand in the destination market and the exporter's competitiveness (as measured by unit labour costs in nominal USD terms). Exports, imports and trade balances are identified, with both historical estimates and forecasts for the periods 2017-20 and 2021-30.

These headline bilateral trade forecasts for goods and services are also disaggregated by sector, using Oxford Economics' Industry forecasts to inform future production trends and taking into account the historic relationship between output and exports in each sector, by market:

- For trade in goods, sectors are classified according to the UN's Standard International Trade Classifications (SITC) system at the two-digit level and grouped into 30 sector headings.
- For trade in services, we identify five broad sectors: B2B and other services, tourism & travel, transport & distribution, financial services, ICT services and construction.

Drawing on the Kantar TNS survey results and Oxford Economics' long-term forecasts, Oxford Economics produces in consultation with HSBC a global report and specific reports on the following 23 markets: Argentina, Australia, Bangladesh, Canada, China, Egypt, France, Germany, Hong Kong, India, Indonesia, Ireland, Japan, Malaysia, Mexico, Poland, Saudi Arabia, Singapore, Turkey, UAE, UK, USA and Vietnam. The analysis of trade in goods also includes trade with Brazil and Korea for a total sample of 25 key trading markets; for trade in services the analysis also includes Korea for a total sample of 24 key trading markets.

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