DP WORLD

TRADE IN TRANSITION

REGIONAL REPORT: NORTH AMERICA

WRITTEN BY The Economist INTELLIGENCE UNIT

About this research

Trade in Transition is a global research programme led by The Economist Intelligence Unit, sponsored by DP World, which presents private-sector sentiment on international trade. In this year's report, we specifically explore the impact on covid-19 on companies' trade operations and the resulting shift in approach to international trade by private-sector firms.

The research is based on two global surveys of senior executives involved in their firms' day-to-day international trade decisions and transactions. The first survey of 3,000 respondents was conducted between January and March 2020 and the second survey of 800 respondents was conducted between October and November 2020. Both surveys captured perspectives of executives across six regions (North America, South America, Europe, Middle East, Africa and Asia-Pacific). The survey findings were supplemented with in-depth interviews with trade experts and senior executives across regions and sectors.

This report focuses on the key findings from North America.

We would like to thank the following experts for their time and insight:

Darrell Edwards, senior vice president and COO, La-Z-Boy

Trevor Kennedy, director of policy, Business Council of Canada

Daniel Martinez, chief executive officer, Orbia

Torsten Pilz, chief supply chain officer, Honeywell

This report was written by Paul Kielstra and edited by Chris Clague.

Executive summary

The value of global merchandise exports from Canada and from the US each fell by 16% overall in the first nine months of 2020. Mexico did not fare much better. The downturn was sharp but it was also short. By September, Mexico's trade was largely back to 2019 levels; the US and Canada were down only 10% and showing signs of recovery. Executives in the region are optimistic about the future of trade, but are grappling with new complexities, some of which were anticipated, others that were not. There is also a new, more predictable administration in the US, which should relieve some of the strain.

KEY FINDINGS

- **The impact of the covid-19 pandemic and attendant lockdowns has varied markedly by country, sector and even within companies.** In North America, Canada and Mexico experienced deeper but shorter drops in their global exports than US during the spring 2020 peak of the pandemic. This likely reflected a more regional trade focus for companies in the first two countries and a more global one by those based in the US.

- **Concerns about protectionism have not gone away.** In early 2020, executives' biggest worries about international trade involved a collection of issues related to protectionism. While the pandemic has focused attention elsewhere, it has done nothing to reduce the underlying trend toward increased national impediments to trade: according to the European Central Bank, by 2018 over half of G20 exports were exposed to trade distortions, up from 20% in 2009.

- **The pandemic has accelerated a trend toward widespread supply chain restructuring, including greater regionalisation.** At the start of 2020, 36% of North American firms with an extensive supply chain were looking to re-shore part of it – the highest figure for any global region. By the end of the year, 81% of all firms were planning or engaged in substantial efforts to reconfigure supply chains in light of vulnerabilities exposed by the pandemic.

- **North American executives, on average, expect a return to 2019 levels of trade to take one to two years.** Experts interviewed for this study suggest that this estimate may be reasonable but it is very hard to be certain. The problem facing trade is rooted in public health, directly spilling over to the economy. The recovery will depend first and foremost on how quickly the pandemic can be controlled, combined with stimulative economic policies.

SURVIVING THE PANDEMIC

Covid-19 has brought in its wake worldwide disruption of almost every kind of social interaction. International trade is no exception, with many countries experiencing rapid changes in levels of imports and exports. The OECD reports that, even after some recovery from June onward, by September 2020 most major economies had seen a drop in year-to-date cross-border trade in goods of 10% to 15% compared to the same period in 2019. For services, the figure for most countries was around 20%.[1]

Getting through the current downturn remains a substantial challenge made more difficult in those countries where a new wave of covid-19 cases blighted the final months of 2020 and early 2021. Mere survival, however, is not enough. All companies involved in international trade need to keep an eye on how such commerce will evolve over the longer term. The pandemic will certainly have some effect on the latter, but so too will challenges and trends which predated it.

Adding to the salience of such international trade issues for corporate boards, notes Darrell Edwards, SVP and COO at La-Z-Boy, a US furniture producer, is the growing importance of supply chains. A combination of factors, market access for both input purchases and sales, as well as the increasing use of online commerce, means that "This is the era of the supply chain. Those companies that have, and continue to invest in, a robust supply chain will be market leaders. It has never been so important."

This Economist Intelligence Unit report, sponsored by DP World, covers the state of international trade in North American over the first nine months of 2020, the issues that could affect the evolution of trade, and the way supply chains are addressing the attendant challenges. The study is part of a broader series of publications that draw on two extensive, worldwide surveys of senior executives from firms engaged in international trade conducted by The Economist Intelligence Unit: the first, conducted in the first quarter of 2020, before the pandemic's full impact had become clear, had 3,000 respondents worldwide; the second, conducted in October and November 2020, had 800.

THE INITIAL DROP

It was not supposed to happen this way. In our survey fielded in Q1 2020, executives from North America still predicted, on average, that the year would see an increase in international trade revenue of 20%. The projection was optimistic, but at the time, understandable. In January and February 2020 combined, the US, Canada, and Mexico all saw the value of their exports increase year on year.

The pandemic and resulting lockdowns, however, dashed these hopes. According to UN Comtrade data, the value of goods exported from Canada and from the US each fell by 16% overall in the first nine months of 2020.[2] Mexico's decline over the same period was 15%.

The headline similarities obscure important nuances. The extent of the trade downturn varied over time. The three accompanying charts compare the percentage change in the value of exported goods for each country for each of the first nine months of 2020 compared to the same month in 2019.

These illustrate a sharp but short downturn. April and May show by far the biggest drops from the previous year, after which declines pare back considerably. By September, Mexico was largely back to 2019 levels; the US and Canada were down only 10% and showing signs of recovery. Not surprisingly, April and May also saw the highest death rates from covid-19 in the first nine months of 2020 in the US and Canada, although not in Mexico.

The above charts also reflect how regional ties vary in importance to each country. In Canada and Mexico, the lines for North American and global exports in goods nearly overlap because intra-regional trade makes up the majority of their international commerce. For Canada, 75%

[1] *International Trade Pulse. OECD. Updated on 20 October 2020.* Available online at http://www.oecd.org/sdd/its/international-trade-pulse-oecd-updated-october-2020.htm

[2] *These and other trade data in this section are based on EIU analysis of latest data available on Canadian, Mexican, and US exports and imports.* UN Comtrade Database. United Nations. Accessed on December 2020. Available online at https://comtrade.un.org/data

FIGURE 1
US, Canada and Mexico: Monthly exports 2020

Source: UNCTAD

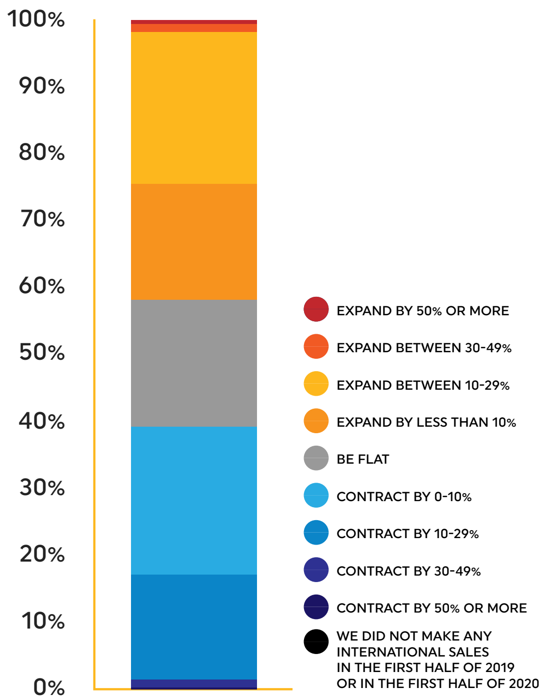
of exported goods in the first nine months of 2020 went to North America – predominantly the US. For Mexico, this number was 82%. Conversely, notes Trevor Kennedy, policy director for the Business Council of Canada, any return to growth in Canada will depend "on how quickly the US can recover. European and Asian trade is not enough to mask the effect of the US".

US exports of goods to North America, in contrast, only made up 33% of its total exports over the same period. The differences in the lines on the US chart between global, regional, and overall trade illustrates that, while its neighbours are important trading partners, US trade is much more globalised. Thus, the V-shape in total exports shown by the other two countries is a more muted curve for the US.

THE VARIETIES OF TRADE EXPERIENCE

The decline in exports during 2020 shown in trade figures does not completely reflect the experience of executives participating in our survey. On average, the North American respondents report that, in the first six months of 2020, their income from international sales rose by 1.3%. This may, in part, reflect survivor bias, with some of those seeing the biggest declines in exports potentially having to go out of business. It also, however, points to another important aspect of trade during lockdown: as with most downturns, there has been no single, universal experience. Instead, business have seen a range of both winners and losers.

FIGURE 2
How much did your firm's company-wide international sales change in the first half of 2020 compared to the first half of 2019.



Source: EIU survey October-November 2020

In our survey, for example, the range of difference between international sales in the first half of 2020 compared to H1 2019 ranged from a 7.2% increase for respondents in the energy sector to a 4.9% decline for those in the chemicals sector. Mr Kennedy has seen these kinds of sectoral differences appear across Canada's economy. For example, he says, "we've had an increase in people spending on lumber. The costs are currently double what they would normally be because everybody is renovating. Anything geared toward households is also in high demand. People are spending money on some things, but not on everything."

Torsten Pilz, chief supply chain officer at Honeywell, has experienced the same diversity of impact even within a single company. Honeywell's aerospace division has suffered from the rapid decline in people flying. The firm's safety division, however, "saw tremendous growth". He adds, "For [our] warehouse automation products and services, we are talking double digits. If you look at personal protective equipment, it is factors of volume. It rapidly became clear we had to do something to provide these products for humanity. For our company, it was also a positive demand shock [that helped counterbalance the negative one in aerospace]."

Adding to the complexity of the economy during the pandemic, the timing of shifts in demand did not follow simple patterns. Mr Edwards explains that, with so many people staying home during lockdowns in different countries, demand for furniture did increase during the pandemic, but not immediately. At first, he says, demand was down; then it began to increase online as people were unable to spend on other areas such as travel; and finally, it surged once furniture stores were allowed to open.

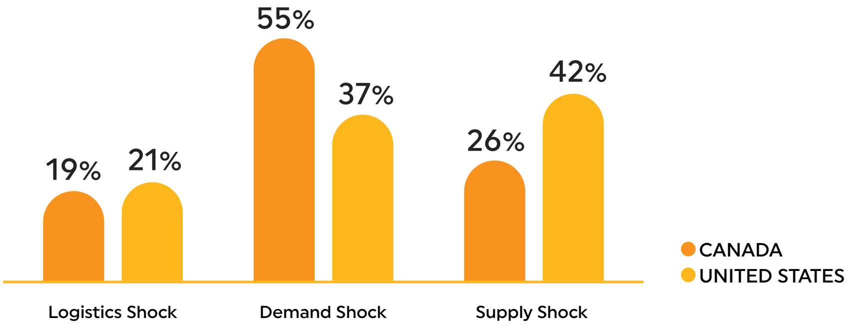
DIFFERENT COUNTRIES, DIFFERENT SHOCKS

The specific ways in which covid-19 hurt North American economies also differed. We asked survey respondents which of three categories of problem—demand shock, supply shock, or logistics shock—has had the greatest negative impact on their businesses. Among North American respondents, logistics shock was the least frequent choice, at 20% of respondents. The region also saw the fewest people in our global survey selecting this option, which was the choice of 31% elsewhere in the world. This likely reflects the large proportion of trade which takes place within North America. As Mr Kennedy points out, throughout 2020, "it has been relatively easy to ship. We have a quality free trade agreement [that covers commerce within the region]."

Although Canada and the US shared a common strength in logistics, covid-19 posed distinct challenges for respondents on different sides of the border. US respondents cited supply and demand shocks with similar frequency, though the former had a slight edge (42% and 37% respectively). Canadians, on the other hand, were far more likely to see a demand shock (55% to 26%).

Mr Kennedy notes that the integrated nature of the North American economies helped to ease potential supply shocks for Canadians.

FIGURE 3
Which of the following shocks had the greatest negative impact on your firm's company-wide international revenues in the first half of 2020?



Source: EIU survey October-November 2020

In addition to that, he adds strong natural resource and agriculture sectors mean that the country's sellers "which are normally focused on exporting raw materials", where, he says, demand has remained strong.

With more globalised sources of inputs, dealing with unexpected and rapid changes among both suppliers and buyers are problems of a similar scale for a large number of US companies. Mr Edwards explains that the nature and specific timing of any challenge "greatly depends on what you are manufacturing, but everybody with a global supply chain has had some disruption".

These can take any number of forms. One example from Mr Pilz illustrates just how complicated supply issues can be. After Malaysia entered lockdown in March 2020, Honeywell's production of safety equipment meant that the authorities quickly declared its operations to be essential, allowing it to remain open at a time when many other businesses were forced to close. Some of its local suppliers were classed in the latter group even though they provided inputs essential for the production of Honeywell's personal protective equipment (PPE). The firm had to work with its Malaysian partners and state authorities for Honeywell's suppliers to be declared equally essential to the production of PPE so that they could continue to operate.

Another example, from Daniel Martinez, CEO of Orbia, a conglomerate headquartered in Mexico, illustrates the risks supply chain disruptions can present to vulnerable populations across the globe. Orbia operates the largest fluorspar mine in the world in the state of San Luis Potosi in central Mexico. After a series of transformations in other parts of Mexico and in the US, that fluorspar eventually becomes a medical-grade refrigerant used by a UK-based firm in its asthma inhalers, providing relief to the hundreds of millions who suffer from the respiratory affliction. "If our mining operation is shut down," says Mr Martinez, "or our production facility in the north of Mexico can't send the product to Louisiana, or if the plant in Louisiana can't send its product to the UK, [asthma suffers] will not be able to use their inhalers." He also notes that those same inhalers "actually proved quite efficient" in treating patients suffering from covid-19.

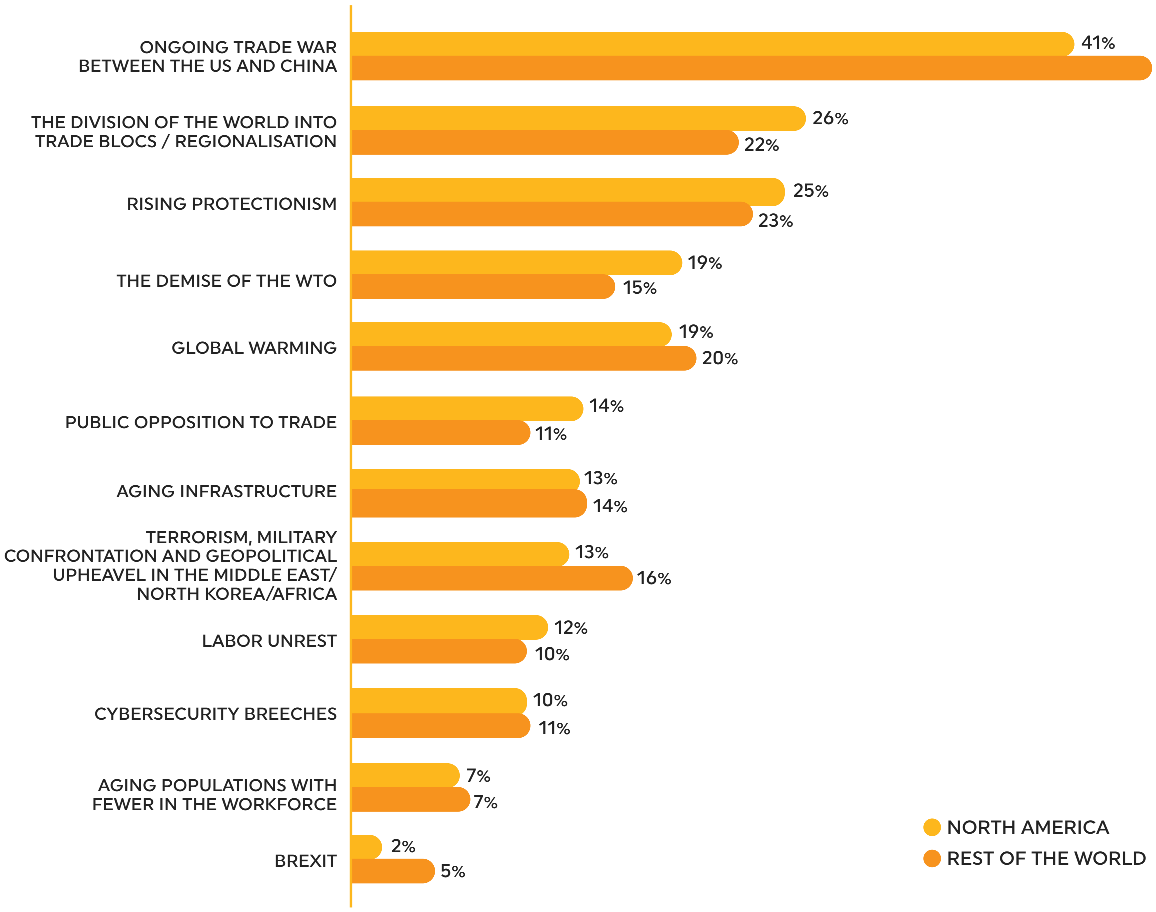
LINGERING PROTECTIONISM

Too close a focus on pandemic-related trade challenges risks missing the bigger picture. Mr Kennedy warns that "all of the trade issues pre-pandemic are still here."

The top three concerns expressed among North American respondents in our March survey each point to some form of retreat from globalisation: the US-China trade war (cited by 41% of respondents in the region); the division of the world into trade blocs (26%); and rising protectionism in general (25%). This is not merely a result of the US being one of the actors in trade war. All three issues are significant concerns further afield, making up the top answers among survey respondents globally. Indeed, even within North America, Mexican respondents are more likely than

FIGURE 4

When you think about global trade over the next two years, what most concerns you?



Source: The Economist Intelligence Unit survey, January - March 2020

their US counterparts to see the trade war as a leading reason for pessimism (50% to 38%).

The US-China trade war is only the most high-profile example of the general advance of protectionism over the last decade. A 2019 European Central Bank analysis found that, since at least 2009, restrictive trade measures by governments worldwide have increasingly outpaced liberalising ones, to the extent that, as of 2018, over half of G20 exports were exposed to trade distortions, up from under a fifth in 2009.[3]

The problem goes beyond the direct effect of tariffs themselves. A Bank of England study in November 2019 found that, up until then, tariffs in the US-China dispute had probably dampened global trade by only 0.1% of GDP in PPP terms. The effect on business confidence, however, was four times as great.[4] Such disputes, notes Mr Kennedy, create a "chill" for companies whose countries are not even directly involved.

TOWARD GREATER REGIONALISM?

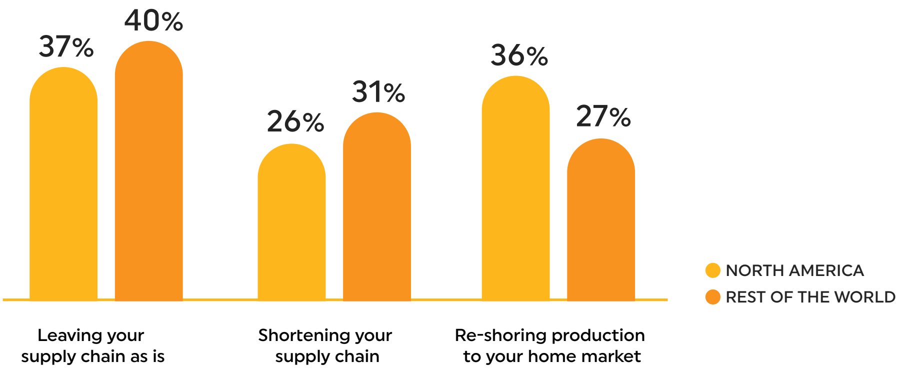
As the examples of Honeywell and La-Z-Boy show, supply chain innovation has become a growing priority for some companies. The more

[3] *The economic implications of rising protectionism: a euro area and global perspective.* ECB Economic Bulletin. March 2019. Available online at https://www.ecb.europa.eu/pub/economic-bulletin/articles/2019/html/ecb.ebart201903_01~e589a502e5.en.html#toc1

[4] *In focus – Trade protectionism and the global outlook. Bank of England.* 7 November 2019. Available online at https://www.bankofengland.co.uk/monetary-policy-report/2019/november-2019/in-focus-trade-protectionism-and-the-global-outloo

FIGURE 5

How long does your firm estimate it will take to reconfigure the most critical part of your supply chain(s)?



Source: EIU survey October-November 2020

recent challenges of covid-19, and the longer standing ones, like rising protectionism, are pushing North American companies to rethink their strategies. Already in our March survey, among those North American respondents whose companies' supply chains ran through two or more countries, simplification was on the cards – 26% reported that plans were underway to shorten supply chains and 36% to re-shore production to home markets.

Other regions also show a widespread interest in rearranging supply chains. However, North America's greater focus on reshoring than evinced in the rest of the world suggests that revisions to the North America Free Trade Agreement—now the United States, Mexico, Canada Agreement, or USMCA—were also a contributing factor. Under the new deal, rules of origin regulations became stricter.[5] This helps explain why Mexican respondents were much more likely to report a focus on reshoring supply chains (50% compared to 20% who spoke of shortening them). In the US, the equivalent figures were 35% and 31%, and in Canada 28% and 23%. As the new rules entered into force on July 1st 2020, it made sense for Mexican firms to seek to bring production back home, where manufacturing costs are lowest among the three nations.

Now covid-19 is driving rapid change as well. In our second survey 81% of North American respondents from all companies—not just those with extensive, multi-national supply chains—say that they are in the process of reconfiguring the most critical parts of these chains because of pandemic-related disruptions. Nor are these minor revisions: respondents report that investment in supply chain restructuring will be the equivalent of 32% of all revenue from the first half of 2020. The median time to completion is also 6 to 9 months.

Among the countries covered in the second survey, this wave of change is more pronounced in the US, where fully 92% are, or have, reconfigured their supply chains in light of the pandemic, against just 69% in Canada. These variations, though important, should not be overstated. Even in Canada, a majority are reshaping supply chains because of the pandemic.

Mr Pilz describes the thinking driving such change. He notes first that "global supply chains may have been the most economically efficient, but they are also the most vulnerable." "What's more," he adds "if they become too long, you are not reactive enough to be responsive to what customers want." Accordingly, Honeywell has for some time pursued a more regional strategy, sourcing from the same parts of the globe where it is producing and selling. He adds that the experience of the pandemic has confirmed the company in this strategy: "We are happy with what we have done. It has paid off for us."

Mr Edwards describes a slightly different

[5] *Overview of Chapter 4 (Rules of Origin) of the US-Mexico-Canada-Trade Agreement*. White & Case. 25 October 2018. Available online at https://www.whitecase.com/publications/alert/overview-chapter-4-rules-origin-us-mexico-canada-trade-agreement

strategy at La-Z-Boy. That company, too, was concerned about supply chain vulnerability, so several years ago it began to diversify its supplier base in terms of geography and the number of companies. He notes that the consistency in supply availability from any given economy during the pandemic still "has not been without challenges". He adds: "But, because we have diversified our supply chain in an effort to mitigate risk and minimise potential disruptions, we have been able to pivot, as needed. We worked hard to build an agile supply chain and some of the work done previously served us fairly well and we continue to work through issues that have invariably surfaced during this unprecedented period." In fact, he adds that the ability of the company to keep operating as well as it has is "a testament to the resilience" of its supply chain.

Neither company is standing still. Mr Edwards explains that the experience of the pandemic has highlighted the need for greater agility still. Mr Pilz adds that companies need to prepare now for a return of better times. He notes that it remains unclear when the aerospace industry will recover, but improved agility will provide a great advantage to companies when this happens. Traditionally, he explains, cycle times in aerospace are quite long. "We are putting a lot of effort into shortening them and making it possible to react quickly."

THE TECHNOLOGICAL LEAP FORWARD

Amid the various challenges arising from the pandemic, almost every company surveyed worldwide adopted at least one—and often more—information-related technology that it had not used before. In North America only three of 200 respondents reported a failure to adopt any new IT, and in two cases that was because the company had already been using all of the technologies covered by our question anyway.

Mr Pilz says that Honeywell also had many of these information technologies in place even before the appearance of covid-19 because it began a digital transformation of its supply chain several years ago. Rather than stopping this, amid the pandemic "digitisation is something we wanted to double down on," he says. "2020 has really accelerated this."

This initiation and acceleration of technology adoption did not come out of the blue. As Mr Pilz puts it, "in the supply chain, technology is the future." Similarly, Mr Edwards explains that, "although no one size fits all, if you are a best-in-class supply chain, you need to have integrated technologies such as the cloud and analytics or have a roadmap to do so."

In our March survey North American respondents expected a range of technologies to have a positive impact on their ability to engage in international trade in the coming years. At the time, slightly more saw benefits arising from the cloud, the Internet of Things, and big data analysis, but blockchain, machine learning, and robotics were not far behind.

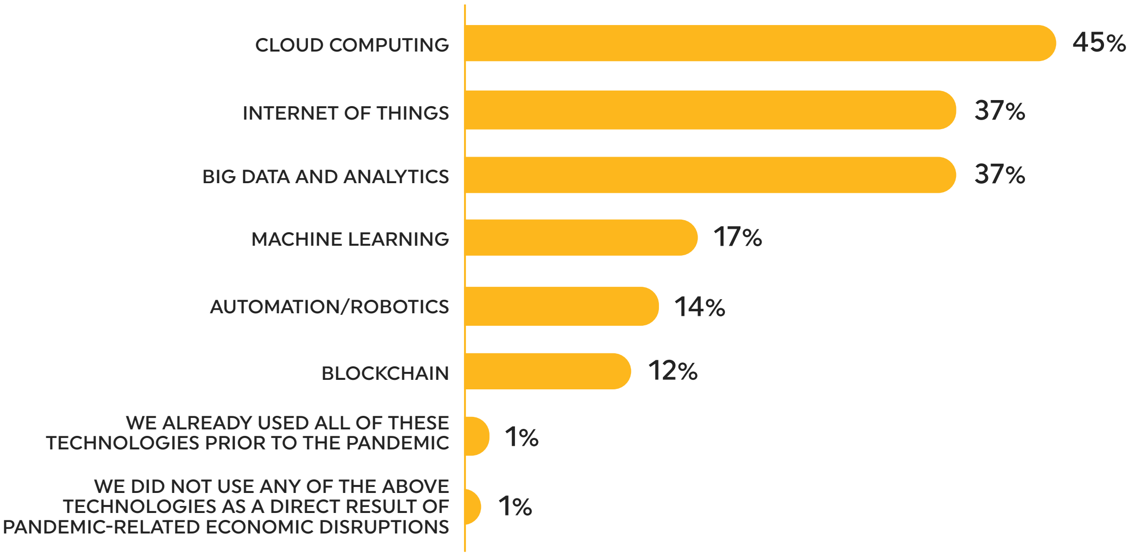
The elevated use of technology is not a temporary expedient for a time of pandemic. It will be permanent. Mr Pilz says that "we have learned that the availability of information at your fingertips is really an asset in such times. That will not go away. It will be our new reality." Similarly, Mr Edwards reports that some of the tools used "worked reasonably well, so we will integrate more technology domestically and internationally." He adds that the experience of the pandemic has also highlighted the importance of agility and the role of information to support it: "Agility will be an ever-evolving process. You will see platforms that will be more and more agile and able to pivot based on consumer demands, market uncertainty, and all those unexpected things that happen.

The data show other firms thinking along the same lines. Among US respondents, 23% believe that enhancing their firm's responsiveness to changes through real-time/predictive data analytics will be the factor having the most effect on how they conduct international trade in the future – the most common answer to that question. In other words, even once the pandemic fades, supply chain digitisation will further accelerate because the experience of 2020 has proven the value and necessity of such change.

THE ROAD TO RECOVERY IN THE REGION

While companies across North America—indeed, the whole world—have been addressing the myriad challenges of covid-19 and its attendant

FIGURE 7
In the first half of 2020, which of these technologies has your company relied on the most (and was not using before)?



Source: EIU survey October-November 2020

restrictions, one issue has hovered in the background: how long will this last? In other fora, this leads to discussions of what some ostensible "new normal" might look like. In our survey, we focused on a simpler question, asking those surveyed when they expect trade to return to the levels of the first half of 2019.

Among North American and global respondents, the median answer was "one to two years."

On the one hand, this may seem puzzling. As the trade data already show, the drop in trade was worst in late spring, but by September exporters had clawed back much of what had been lost.

The reluctance to project such rapid progress into the future reflects the nature of the problem companies are facing: recovery is likely more of a medical issue than a fundamental economic one. The North American trade figures from earlier in this study—artifacts of the lockdown downturn and post-lockdown recovery—may again deteriorate now that a new wave of cases and deaths have hit the US and Canada.

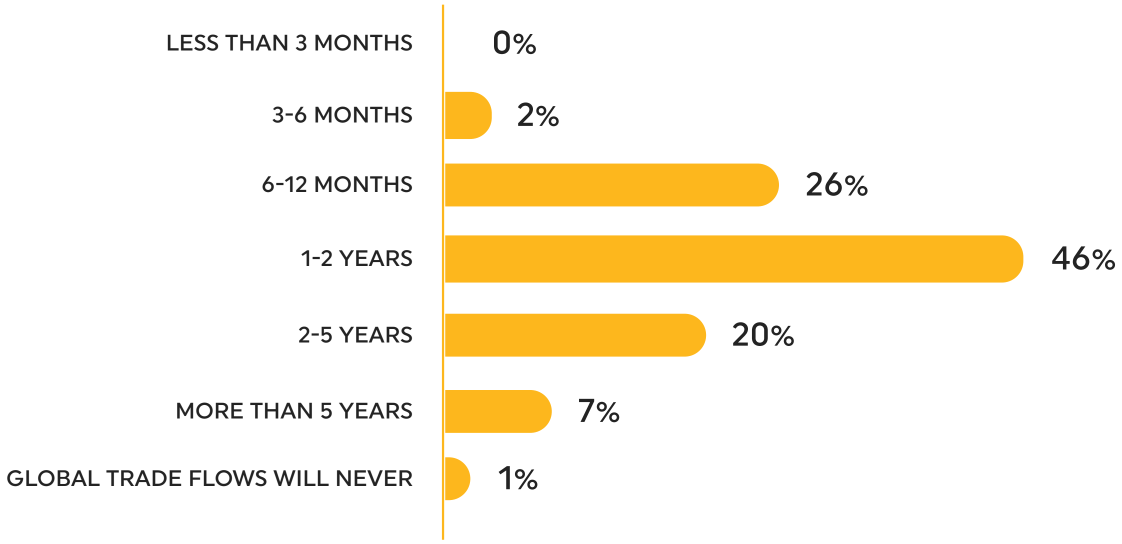
Mr Kennedy pointed out before the recent surge in cases in Japan and South Korea, that "the countries that have brought the virus under control are doing well, even some which rely on exports. Japan might end up growing this year but was facing a recession pre-covid. Asia has done well, so you will likely see a big rebound." Although the economic impact is as yet unmeasured, Japan's recent experience shows, though, the covid genie can all too easily get out of its bottle.

Accordingly, Mr Edwards says, a one to two year "time horizon sounds reasonable, but who knows? It will depend on externalities such as the response to the pandemic, geopolitical uncertainties, even natural disasters." Similarly, notes Mr Pilz, "I really don't know when the recovery will happen. The world needs a medical solution to this problem. Once that is available, things will return to normal petty quickly."

Accordingly, the prospects for international trade in 2021 have as much to do with unexpected shocks, public health policy and skill in vaccine cold chain maintenance as with tariff policy and the application of new information technology to supply chains.

FIGURE 8

How long do you think it will take for the world's trade flows to recover to the same levels as the first half of 2019?



Source: EIU survey October-November 2020

BUSINESS IN AN UNUSUAL TIME IS BUSINESS AS USUAL

Any number of problems thrown up by the pandemic have required innovative and comprehensive responses. As Mr Pilz explains, "every day there [is] something new."

Accordingly, Honeywell organised large cross-functional teams, from government relations through health and safety, to manage these unusual challenges. Through these efforts, none of its facilities had to shut down for more than one day in 2020. Similarly, says Mr Edwards, La-Z-Boy "navigated our vendor base" to maintain as much continuity of supply as possible and continues to do so. And because of its high number of orders, it was able to shift to manufacturing products for which it did have supplies whenever temporary shortages stopped it from making other goods.

That said, the pandemic is not completely sui generis. Facing and overcoming rapidly evolving challenges is what companies should do. Mr Pilz could speak for many when he says, "We have had to be pretty radical and pretty fast. From a supply chain perspective, it has been stressful. But it is what we do for a living. We have been preparing for years to do this kind of thing – almost my entire career."

In some way, every year is likely to be unusual, extraordinary, perhaps unprecedented – or any one of the now clichéd adjectives applied to the pandemic. North American companies will not return to a place of great safety when the pandemic goes away, which is closer to happening now that vaccinations have begun. The threats and opportunities will simply change.