DP WORLD

TRADE IN TRANSITION

REGIONAL REPORT: SOUTH 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 of 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 South America.

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

Fabrizio Opertti, integration and trade sector manager, Inter-American Development Bank.

Carlos Aníbal, executive director, pulp sales, logistics and supplies, Suzano.

Cristina Madriñán, general manager, Buencafé.

Stefan Stern, vice president supply chain, Alicorp.

Leonardo Dall'Orto, VP of integrated planning, supply chain and logistics, BRF (Brasil Foods).

Sergio Maureira, general secretary, Association of Chilean Fruit Exporters (ASOEX).

Jaime Ardila, founder, Hawksbill Group.

Juliana Villegas, VP exports, ProColombia.

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Executive summary

South America endured a deep shock to its economy as a result of the covid-19 pandemic and the policies implemented to curb its spread. For companies sourcing from or selling to international markets, national lockdowns and related measures severely disrupted supply chains. Companies that responded early have managed to expand international sales and minimise disruptions during the pandemic. Many companies have started reconfiguring their supply chains, diversifying their supplier base and a dopting advanced technologies to optimise trade operations. This report explores how companies in South America have responded to the crisis and their approach to international trade in the medium term.

KEY FINDINGS

- **During the pandemic, the supply shock (defined as the difficulty in purchasing raw materials for production) hit South American companies the hardest.** Forty-six percent of respondents stated that supply shocks had the greatest negative impact on their international sales, compared with 30% who cited demand shocks[1] and 24% who cited logistics shocks.[2] As a result, 92% of executives surveyed were in the process of reconfiguring their supply chains as of October-November 2020. Sixty-three percent of them expect to reconfigure their supply chains in less than a year and are allocating about 31% of revenues from H1 2020, on average, towards this effort.
- **Executives in South America are cautiously optimistic about a global trade recovery.** Thirty-six percent of respondents expected global trade to recover to H1 2019 levels within 6-12 months, compared with 27% globally. This optimism may stem from the even trade performance reported in our survey. Respondents to our survey were split evenly (46%) between those whose companies experienced an expansion of international sales and those whose international sales contracted (in H1 2020 compared with the previous year).
- **Executives in South America cited higher-than-average adoption of the Internet of Things (IoT) and cloud computing, but far lower use of big data and analytics to optimise trade operations.** Forty-eight percent of respondents relied on IoT and cloud computing the most during the pandemic. But use of big data analytics, cited by 34% of respondents globally, was only selected by 24% of respondents in South America. There was also a limited recognition of the need to adopt advanced technologies in the medium term. Only 10% of respondents in South America chose this as a factor that would determine their company's approach to international trade up to 2025, compared with 16% globally.
- **Looking ahead, South American companies will concentrate international sales to core markets with higher stability and place greater emphasis on negotiation of new international trade policies.** The highest share of respondents (36%) cited concentrating international sales, double the global average (17%). Negotiation of new trade policies was the most important factor in the medium term for 24% of respondents. Together, these results mean that although the region may continue to rely on China for future trade growth, trade agreements such as the Mercosur-EU one could be vital to diversify risk and reduce market concentration.

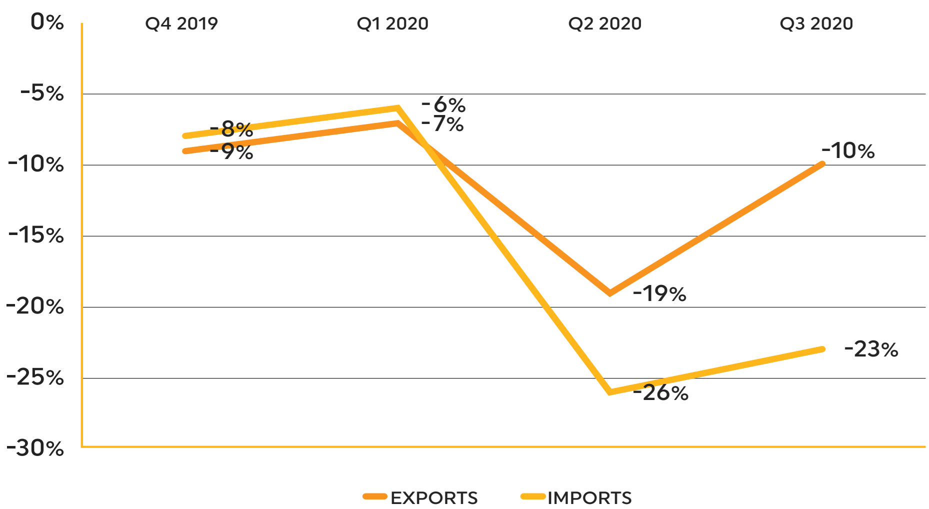
[1] A demand shock is defined as the difficulty in selling goods to customers
[2] A logistics shock is defined as the difficulty in purchasing raw materials for production

State of trade in South America

In 2020, the world grappled with the effects of the coronavirus pandemic and the restrictions put in place to stem its spread. However, the effects in South America have been particularly devastating. In early December 2020, the region's covid-19 infection and death rates were more than double the world's average,[3] and its GDP in 2020 is estimated to have fallen by far more than the global average (-8.1% vs -4.4%[4]). Although multiple coronavirus vaccines have been approved, the rollout of the vaccine in South America is likely to be slow, due to widespread misinformation about covid-19 and challenges with infrastructure.[5] As a result, the region will have to deal with the effects of the pandemic for longer: according to forecasts by The EIU, South America's[6] GDP is expected to grow by 4.1% in 2021, lower than the global average of 4.5%.[7]

This shock to the South American economy led to the collapse of the region's trade activity, already hampered before the pandemic by weak external demand and commodity prices and subdued domestic demand (see Figure 1). The region's international trade plunged even further as the pandemic broke out. "Border crossings, airports, ports, all the hubs for international trade [were] affected by operational restrictions and extra sanitary controls," says Fabrizio Opertti, integration and trade sector manager, at the Inter-America Development Bank. According to the World Trade Organisation (WTO), the value of merchandise exports and imports fell by 19% and 26% year on year, respectively, in the second quarter of 2020 (see Figure 1). Exports recovered slightly in the third quarter (falling by 10% year on

FIGURE 1
Merchandise trade in South America, Q4 2019 to Q3 2020



Source: World Trade Organisation

[3] South American COVID-19 infections and deaths per 1m inhabitants averaged 18,629 and 523 as of December 3rd, compared to global averages of 8,492 and 195, respectively. COVID-19 Coronavirus Pandemic. Worldometer. Available online at https://www.worldometers.info/coronavirus/

[4] IMF projections

[5] Devastated by Covid, Latin America Is Now Unprepared for Vaccine. Bloomberg. 8 December 2020. Available online at https://www.bloomberg.com/news/articles/2020-12-08/covid-blunders-in-latin-america-sow-fears-of-another-on-vaccines

[6] Growth rate for expanded Mercosur countries: Argentina, Bolivia, Brazil, Chile, Paraguay, Uruguay, Venezuela, Peru, Ecuador, Colombia

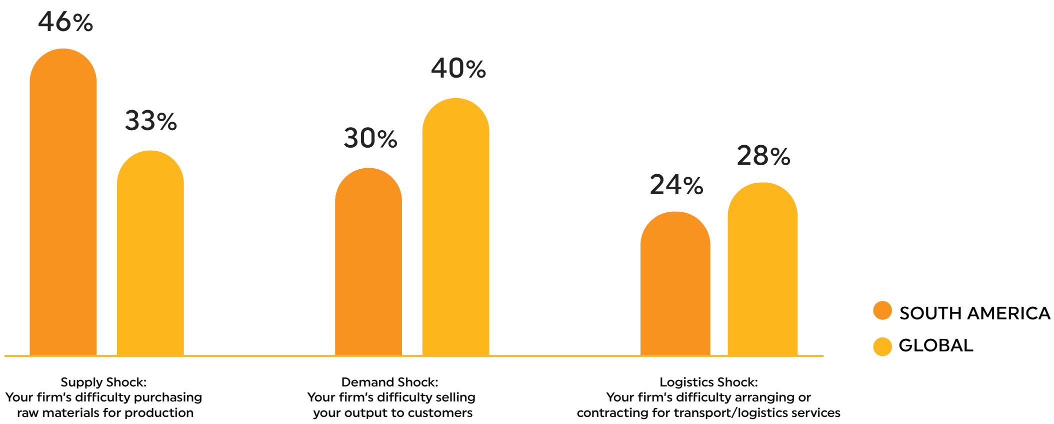
[7] The Economist Intelligence Unit

year) but imports fell by similar rates (23% year on year). The reduction in imports was the sharpest compared to other regions: in the same period, imports fell by 7% in North America, 6% in Asia, 3% in Europe and 13% in other regions.[8]

The sharper reduction in imports than exports is explained by results from our executive survey, conducted in October-November 2020. As a result of lockdowns, respondents in South America were hit hardest by a supply shock—defined as the difficulty in purchasing raw materials for production. Forty-six percent of respondents in South America stated that supply shocks had the greatest negative impact on their international sales (see Figure 2). This may be surprising given that a commodities comprise a large share of total exports from South America, but even those exporters rely on imported inputs and machinery. By comparison, 30% attributed the fall in international revenue to a demand shock (defined as the difficulty in selling output to customers) and 24% to a logistics shock (defined as the difficulty in arranging transport/ logistics services). These trends differ from global results, where 40% of respondents reported that demand shocks had the greatest negative impact, while 33% and 28% were affected by supply and logistics shocks, respectively.

Despite these shocks, companies in our survey were split evenly between those that expanded their international sales and those that experienced a contraction in H1 2020 compared with the previous year (46% of respondents each, with 6% experiencing no change). Product categories that saw exports shrink in H1 2020 include iron ore and oil, a result of disruption in demand from key trading partners (including the US, Europe and other South American countries) as lockdowns were imposed and demand for these products fell. Rising external demand was seen for agricultural goods, particularly from China as the country reopened sooner than other markets.[9] For example, export volumes of soybeans and beef from Brazil to China soared 35% and 33% year on year in H1 2020.[10] The exchange rate depreciation of South American

FIGURE 2
Which shock had the greatest negative impact on your firm's company-wide international revenues in H1 2020?



Source: EIU survey October-November 2020

[8] Third Quarter 2020 Merchandise Trade Value. World Trade Organization. Updated on 4 December 2020. Available online at https://www.wto.org/english/res_e/statis_e/daily_update_e/merch_value_latest.pdf

[9] Exports of South American agricultural products to China had been increasing even before the pandemic, as the region became the alternative to US suppliers, which were affected by the US-China trade tensions.

[10] Trade and Integration Monitor 2020: The COVID-19 Shock: Building Trade Resilience for After the Pandemic. Inter-American Development Bank. November 2020. Available online at https://publications.iadb.org/publications/english/document/Trade-and-Integration-Monitor-2020-The-COVID-19-Shock-Building-Trade-Resilience-for-After-the-Pandemic.pdf

currencies also increased overall export competitiveness in the same period.

In the third quarter of 2020, South American exporters saw a recovery in the prices of key commodities (such as arabica coffee, copper and iron ore). This, along with outperforming agricultural exports, may explain the relative optimism of South America's respondents on the speed of a global trade recovery. In October-November 2020, 36% expected global trade to recover to H1 2019 levels within 6-12 months, compared with 27% globally. Overall, 76% of respondents in South America expected global trade to recover within less than two years.

A majority of respondents in the region also increased international purchases of non-labour inputs in H1 2020 (60% vs 48% globally). Some foreign purchases grew to support the expansion in production of high-demand items. For instance, Colombia increased its purchases of cereals as an input for other agricultural activities and food processing, and Argentina increased its imports of harvesting machinery and fertilisers.[11,12]

Our survey data showing growth in international sales and purchases or some companies, indicate that they have taken important steps to adapt. Those sourcing materials from suppliers or selling to customers overseas have had to diversify their supplier base (by switching to or adding new suppliers), find new logistics partners and target new markets for sales. Through the adoption of advanced technologies in their supply chains, they stayed abreast of changes in key markets and its impact on supply and demand, enabling their businesses to be more agile.

Trade activity in the region has since recovered but there was still an overall decline for the year (WTO forecasts for the full year from October 2020 were at -7.7% for exports and -13.5% for imports).[13] The region's foreign trade will rebound in 2021, but growth rates are expected to be below the global average (5.4% in South America v 7.2% globally).[14]

The shifts in supply chain strategy could have a bearing on regional and global trade patterns, should some of the changes made during the pandemic become permanent. In the next section, we explore the corporate response to these supply chain disruptions, which will set the scene for discussion in the final section on the evolving private-sector approach to international trade.

76%

Percentage of respondents in South America who expect global trade to recover to H1 2019 levels within less than two years from Oct-Nov 2020.

[11] Con US$20.758 millones, importaciones cayeron 19,7% en el primer semestre: Dane. Forbes. 13 August 2020. Available online at https://forbes.co/2020/08/13/economia-y-finanzas/con-us20-758-millones-importaciones-cayeron-197-en-el-primer-semestre-dane/

[12] Intercambio comercial argentine. Indec. July 2020. Available online at https://www.indec.gob.ar/uploads/informesdeprensa/ica_07_20B26114A5B4.pdf

[13] rade shows signs of rebound from COVID-19, recovery still uncertain. World Trade Organization. 6 October 2020. Available online at https://www.wto.org/english/news_e/pres20_e/pr862_e.htm

[14] The WTO projects Central and South America merchandise exports to fall -7.7% in 2020 compared to -9.2% global average. The forecast for 2021 is 5.4% vs 7.2% growth. Trade shows signs of rebound from COVID-19, recovery still uncertain. World Trade Organization. 6 October 2020. Available online at https://www.wto.org/english/news_e/pres20_e/pr862_e.htm

The corporate response to supply chain disruptions

The pandemic triggered a deep assessment by companies of their supply chains, as they responded to the unprecedented changes taking place. "Business as usual" was perhaps an option for only a handful of companies. This is apparent in our survey results: 83% of respondents globally stated that they were in the process of reconfiguring their supply chains in October-November 2020. Among respondents in South America, this figure is even more striking at 92%.

In response to the supply shock, which a plurality of respondents in the region stated had the greatest negative impact on international sales (see previous section), companies were focused on diversifying their supplier base and collaborating closely with existing suppliers. To improve the latter, companies relied on advanced technologies such as the Internet of Things (IoT), cloud computing and big data analytics – to gain real-time insight to optimise trade operations. In addition, companies adopted a host of safety protocols to ensure production and supply of their products were not hampered as a result of covid cases among employees. In this section, we explore how companies we interviewed implemented these strategies, and the challenges they faced along the way.

BUILDING BUFFERS

Experts and entrepreneurs alike state that the process of supplier diversification started even before the covid-19 pandemic hit. "The US-China trade tensions induced an incipient reconfiguration of supply chains, but the coronavirus crisis basically rose awareness on the need to better manage supply chain risks, more specifically by diversifying suppliers," says Mr Opertti of the Inter-America Development Bank. As part of this, companies such as BRF—one of the world's largest exporters of poultry, based in Brazil—started approving suppliers to provide the company with more sourcing options.

In addition, some companies started to move away from the "just-in-time" approach to supply chain management, increasing buffer stocks of critical raw materials. Leonardo Dall'Orto, vice president of integrated planning, supply chain and logistics at BRF, explains: "We increased storage at strategic points, such as in Brazilian ports, to guarantee stock so as not to affect production." BRF also turned to alternative suppliers in the local market on a smaller scale.

While building buffers of raw materials ensured that production would remain on schedule, companies were building buffers of finished goods too, to meet the surge in demand for some product categories. Here the supply chain strategy adopted by Suzano, South America's largest pulp producer, is interesting particularly because of its position as a leading supplier of tissue, a primary component of what became one of the most coveted goods during the pandemic: toilet paper. The company acted promptly to prioritise production lines and relocate inventory as it prepared for changes in the market. "When we started to notice what was happening in China and Europe with covid-19, we decided to immediately move all our products to the ports," says Carlos Aníbal, executive director, pulp sales, marketing and supply chain at Suzano. "Next, we moved all that pulp from the Brazilian port to our ports all over the world, so we increased our stocks closer to our customers."

"The US-China trade tensions induced an incipient reconfiguration of supply chains, but the coronavirus crisis basically rose awareness on the need to better manage supply chain risks, more specifically by diversifying suppliers."

Fabrizio Opertti, integration and trade sector manager, Inter-American Development Bank

Safeguarding supplies closer to home or moving closer to customers have ignited conversations about regionalisation of supply chains. A protracted pandemic, and continued uncertainty around policies to manage its impact, could drive a more permanent shift to a "just-in-case" approach, which could have a lasting impact on the region's trade flows.

However, executives we interviewed indicate that these changes are likely to be temporary. "We have not redesigned the supply chain, but we have increased the base of suppliers and logistics partners to be ready in case of possible problems," says Mr Dall'Orto of BRF.

Jaime Ardila, founder of Hawksbill Group, a consultancy based in Washington DC, concurs: "The original expectation was that companies were going to actually shift production completely to countries in Latin America [away from China] but what happened in the end was some companies created additional production facilities, particularly in South-East Asia, but not to the extent that people had expected." The pre-pandemic supply chain patterns and preferences may thus prevail once the pandemic ends.

TECH-DRIVEN COLLABORATION WITH SUPPLY CHAIN PARTNERS

Since the start of the pandemic, importing raw materials and delivering finished goods to customers overseas required increased coordination between companies and vendors, port and ship operators, and clients. "We said from the beginning that communication and transparency would be key to deal with this kind of situation," says Mr Aníbal of Suzano. An increased level of coordination was required as companies shortened planning cycles from weeks to days. "We started the pandemic by holding meetings every day and now we have moved on to alignment once a week to identify disruptions and bring mitigating actions," explains Mr Dall'Orto of BRF.

The need for real-time insights to support shorter planning cycles drove the adoption of advanced technologies within supply chains. Executives we surveyed in South America stated that they relied on cloud computing and IoT the most (chosen by 48% of respondents each) to optimise trade operations during the pandemic. This is higher than the global averages of 40% and 39% respectively. But use of big data analytics, cited by 34% of respondents globally, was only selected by 24% of respondents in South America. Adoption of big data analytics will be critical, along with cloud computing and IoT, to garner insights that will support better decision making.

Leaders in the region attest to this. "We have a system using big data and analytics that allows me to know two months in advance what is going to be the amount of pulp arriving in one region in the US or Europe or China," explains Mr Aníbal. "With that information, we can make decisions about how to position our products and better coordinate [with] our supply chain [partners]." Similarly, although blockchain was the technology that companies relied on the least during the pandemic, companies such as Suzano are finding applications for it as they optimise trade.

Some of this digital transformation was underway before the pandemic, and technologies adopted during the pandemic are expected to be used long after it ends. Stefan Stern, vice president of supply chain at Alicorp, a Peruvian consumer goods company, says, "We have accelerated the use of big data in an important way and this has helped us to [track] our inventory and employee safety, while remote work has certainly changed our ways [of communicating] for good."

But in South America, the adoption of more sophisticated technologies may not

"We still have a vast number of tier-two suppliers in the region that are family-run companies that obviously had a much harder time making the investments necessary to digitise, because they don't see the [economies of scale] yet."

Jaime Ardila, founder, Hawksbill Group

be feasible for all players in a supply chain. "We still have a vast number of tier-two suppliers in the region that are family-run companies that obviously had a much harder time making the investments necessary to digitise, because they don't see the [economies of scale] yet," says Mr Ardila of Hawksbill Group. "They don't have the depth of capital and the financial wherewithal to take a long-term view for making [such] investments." The supply chain bottleneck therefore may not be with the large companies, but with their supplier base comprising smaller businesses, he adds.

ENSURING BUSINESS CONTINUITY

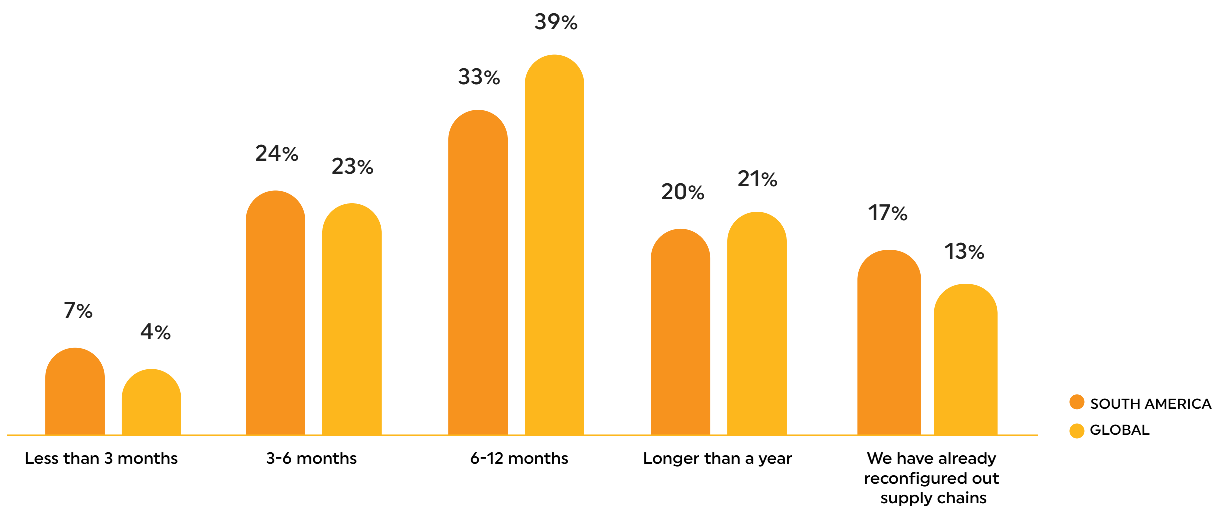
Businesses implemented stringent safety protocols to minimise the spread of covid-19 among their employees and thus reduce disruptions to production. This entailed use of personal protective equipment and reorganising floor plans to limit employee interaction. Cristina Madriñán, general manager of Buencafé, one of the largest freeze-dried coffee plants in the world, says this was a critical strategy for them, as does Mr Aníbal of Suzano. "An outbreak could lock some stages of the supply chain," says Mr Aníbal.

Sergio Maureira, general secretary at the Association of Chilean Fruit Exporters (ASOEX), says that their partners went to great lengths to maintain consumer confidence in their products by intensifying the sanitation of workers, production facilities, packaging and transportation to prevent staff from being infected. "However, we do not know how the customs authorities of countries like China will assess our efforts," says Mr Maureira. China is an important market for Chilean fruit, which represents 20% of total exports, he says. To be effective, safety protocols had to be applied across the value chain, so here too, constant engagement with supply chain partners was required.

FACTORS SLOWING DOWN SUPPLY CHAIN RECONFIGURATION

Although businesses we interviewed have shared examples of tremendous agility during the pandemic, supply chain reconfiguration is a time-consuming and costly affair. Forty-four percent of executives we surveyed in South America stated their companies reallocated 10-29% of their H1 2020 revenues to reconfigure their supply chains, compared with 34% globally. But, on average, South American companies are reallocating about 31% of their H1 2020 revenues, in line with the global average (32%). Those firms lacking sufficient cash on hand would have been constrained in their efforts to adapt their supply chain network during the pandemic.

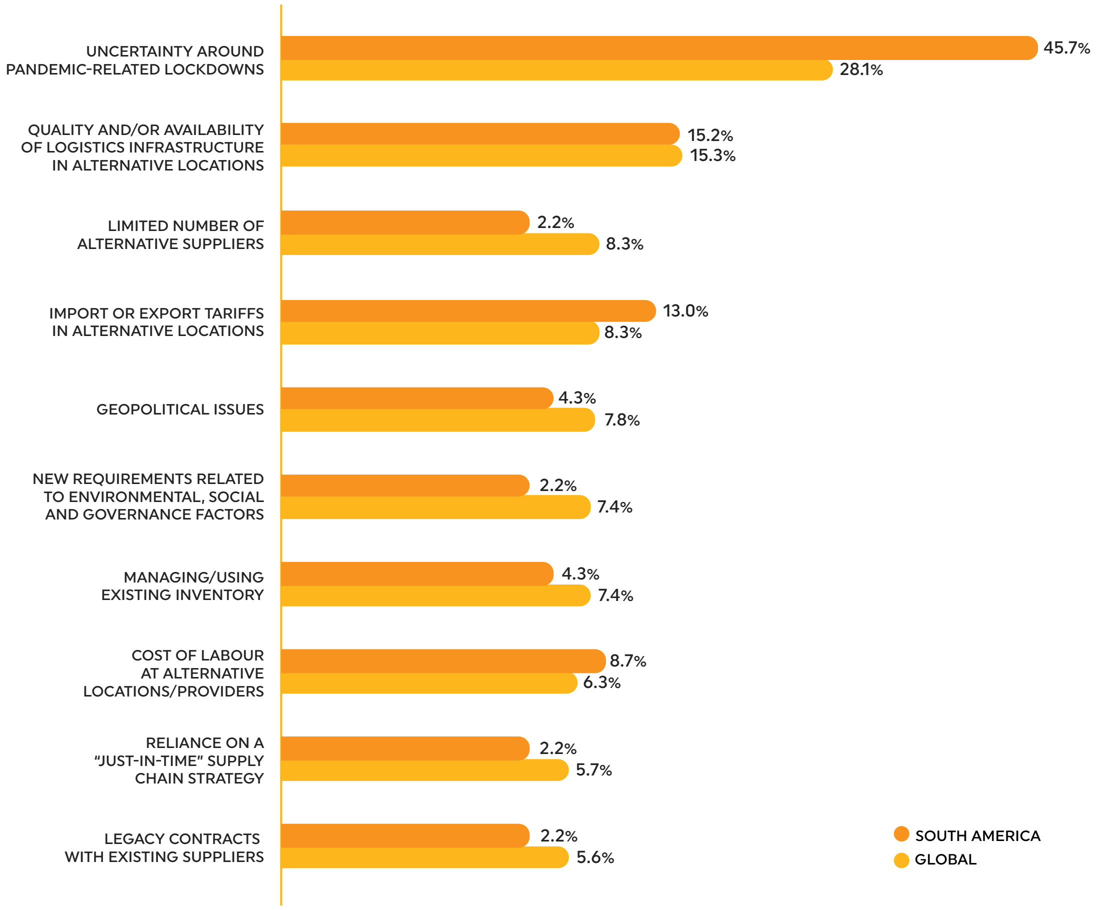
FIGURE 3
Estimated time for supply chain reconfiguration in South America



Source: EIU survey October-November' 2020

FIGURE4

Barriers to supply chain reconfiguration in South America vs globally



Source: EIU survey October-November 2020

In October-November 2020, about 33% of respondents estimated that their supply chain reconfiguration would take between six and 12 months to complete and 24% estimated that it would take between three and six months (see Figure 3). About 20% of respondents indicated it would take them longer than a year.

Negotiating contracts with new suppliers in different regions or pursuing new markets to sell to does not happen overnight, but there are a host of factors that are slowing this process down further. The biggest barrier to reconfiguring supply chains, according to executives we surveyed in South America and globally, is the uncertainty around pandemic-related lockdowns. But the concern was significantly higher in the region, with 46% of respondents in South America citing this compared with 28% globally. Executives we interviewed from Suzano and Alicorp echo this concern; both companies have resorted to ongoing communication with staff and supply chain partners to stay responsive to market changes.

Other challenges that respondents cited include the quality and/or availability of logistics infrastructure and import-export tariffs in alternative locations. But these were cited by far fewer respondents – 15% and 13%, respectively.

Despite the challenges they are faced with, South American executives we interviewed have unequivocally stated they will continue to rely heavily on international suppliers and customers. They have identified clear priorities in their approach to international trade, which we will explore in the final section of this report.

Concentrating on future international trade

Instead of moving away from vast global supply chain networks, executives in South America are doubling down on international trade. This approach will be essential especially at a time when domestic economies are struggling, such that local demand cannot offset international demand. Mr Aníbal explains: "We must remain oriented to international trade. Nowadays, we export 90% of our pulp production, so we essentially produce to sell internationally, and I do not foresee any change in that pattern."

Juliana Villegas, vice president exports at ProColombia, a government agency in Colombia that promotes exports, tourism and foreign investment, echoes this sentiment: "The calls we received from firms enquiring about how to export multiplied exponentially during the pandemic." An internationalisation programme the agency launched in February 2020 received more than 900 applications for 500 spots.

But the approach among South American executives seems to be far more concentrated than their counterparts in other parts of the world. The top two factors that will determine their approach to international trade up to 2025 are concentrating international sales to core markets with greater stability, and the negotiation of new international trade policies (see Figure 5). The former was cited by 36%, more than twice the global average (17%).

So, while on average, they are heeding one of the biggest lessons learnt during the pandemic—not to rely on a single market or supplier—they still intend to focus on a handful of core markets. In the medium term, diversifying their supplier base was a much lower priority in South America than globally. What this means for the region's reliance on China as a market is yet to be seen (exports to China comprised roughly 13% of South America's total exports in 2017, up from less than 1% in 1990).[15] South American exporters rode on the coattails of an early recovery in the Chinese market – which in part contributed to the recovery in commodity prices including of South America's key exports, soybeans and iron ore.[16]

South American exporters must also consider the impact of the Regional Comprehensive Economic Partnership (a trade agreement signed in November 2020 by 15 countries in Asia-Pacific). Their focus on negotiation of new international trade policies in our survey results may indicate a renewed interest in furthering agreements between the Mercosur countries for instance.[17] The initial Mercosur-EU agreement in 2019 may be promising, but political tensions within the bloc as well as between large countries in both regions may delay its ratification.

"Foreign trade will continue to happen, but companies will be looking for alternatives to make their supply chains more reliable. The idea is to decentralise and deconcentrate the supply chain, so as not to depend on a single region."

Leonardo Dall'Orto, VP of integrated planning, supply chain and logistics, BRF (Brasil Foods)

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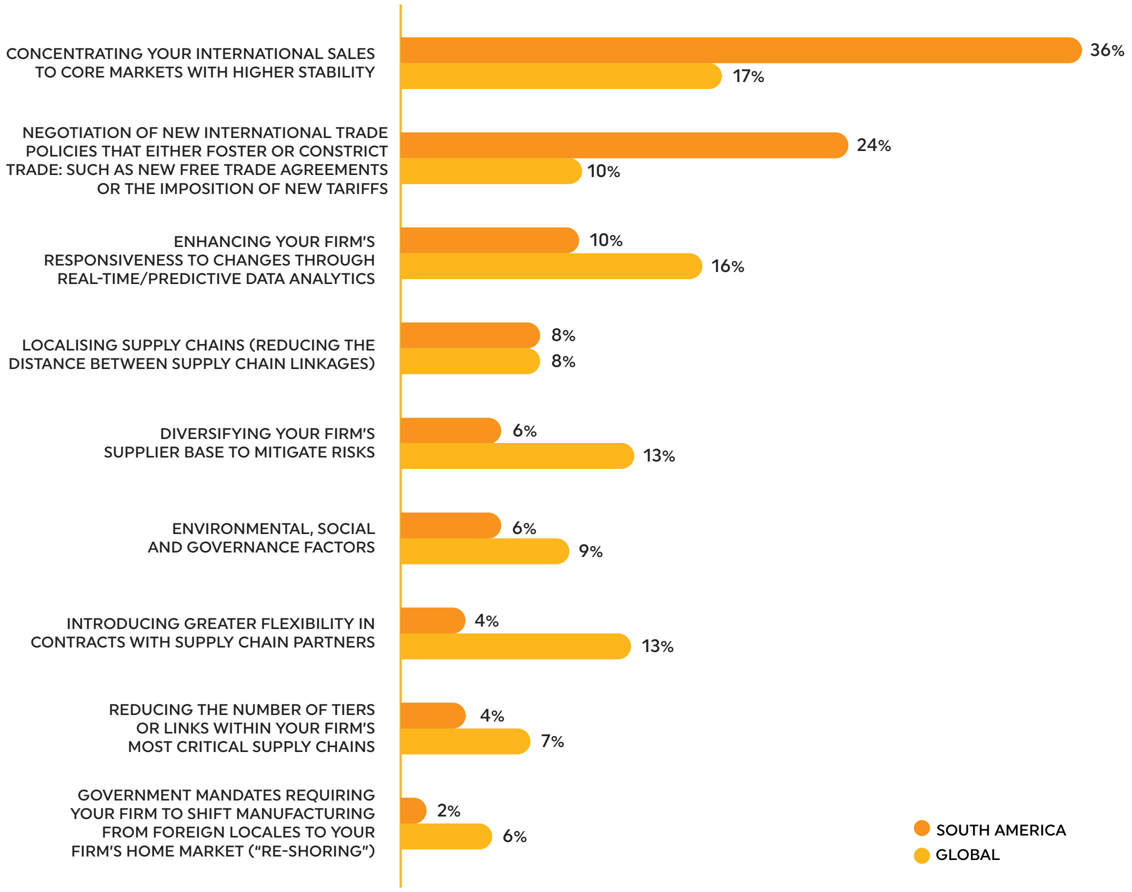
[15] Exports to China and economic growth in Latin America, unequal effects within the region. International Economics. December 2020. Available online at https://www.sciencedirect.com/science/article/abs/pii/S2110701720302481?dgcid=rss_sd_all#:~:text=Fig.,share%20of%2013.82%25%20in%202017

[16] Trade and Integration Monitor 2020: The COVID-19 Shock: Building Trade Resilience for After the Pandemic. Inter-American Development Bank. November 2020. Available online at https://publications.iadb.org/publications/english/document/Trade-and-Integration-Monitor-2020-The-COVID-19-Shock-Building-Trade-Resilience-for-After-the-Pandemic.pdf

[17] A four-country common market comprising Argentina, Brazil, Paraguay and Uruguay

FIGURE 5
Factors that will determine how companies in South America will conduct international trade transactions up to 2025



Source: EIU survey October-November 2020

Another facet of the discussion on future international trade in South America is the role of technology. Across our survey sample in South America, it is worth noting that there is limited recognition of the need to adopt advanced technologies to stay responsive. Only 10% of respondents chose this as a factor that would determine their company's approach to international trade up to 2025, compared with 16% globally, a distant third on the list of priorities (see Figure 4). "The region is behind the rest of the world in introducing modern technologies into supply chains, particularly the digitisation of a lot of processes, not only in the private sector, but at customs and government agencies," says Mr Ardila. Closing this gap, he adds, requires significant public and private investments, as well as new regulation to allow digitisation itself (for example, to permit e-invoicing, e-signatures and e-certifications).

As companies in South America continue to engage in international trade and rely on it for business growth, they must remain agile, to respond to future crises and disruptions. The adoption of advanced technologies could help deliver such agility (while being mindful of other risks these pose such as cyber-attacks), but just as important are strategies to diversify risk. "Foreign trade will continue to happen, but companies will be looking for alternatives to make their supply chains more reliable," says Mr Dall'Orto. These alternatives could include moving inventory closer to production sites, or new suppliers that can cope with quality and volume. "The idea is to decentralise and deconcentrate the supply chain, so as not to depend on a single region."