

## Q2 2021 Outlook: Words become actions, threats going nowhere

MARCH 31, 2021

Global supply chains continued to face tough conditions in Q1'21 with logistics congestion culminating in the Suez Canal blockage, continued demand growth and cost inflation in freight and industrial commodities.

Those will take much of Q2'21 to unwind while corporations will start to tackle the need to increase prices and adapt their supply chains. There's also an unwelcome return of medical protectionism to be dealt with.

Trade policy will be most dynamic in the U.S., with the Biden administration set to announce the result of a critical supply chain review and evolve its relations with China. Relations between the EU and U.K. may deteriorate rapidly in the event that the EU-U.K. TCA is not approved by the EU Parliament.

### ***The great demand boom: Aug. 2020 - ? 2021***

The seeds of the challenges faced by global supply chains during Q1'21 were sown in the second half of 2020 and are unlikely to unwind before the end of Q2'21. Global trade activity has continued to be robust, though there's a clear two speed recovery in progress.

Global exports climbed 13.2% year over year in January, based on S&P CapitalIQ data, largely due to the strength in exports from China on a comparator basis which included the start of the pandemic. Exports from the U.S. and EU meanwhile fell by 0.7% and 8.9% respectively, with the latter likely including the drag from Brexit as outlined in Panjiva's research of March 19.

A similar pattern is emerging in February with exports from 17 countries that have reported data having increased by 21.2%, or 6.2% excluding China, with shipments from the U.S. down by 5.7%. The U.S. downturn includes the travails of the automotive industry and is dependent on continued elevated trade with China, the prospects for which are discussed below.

## Global trade recovery uneven across time and across geographies

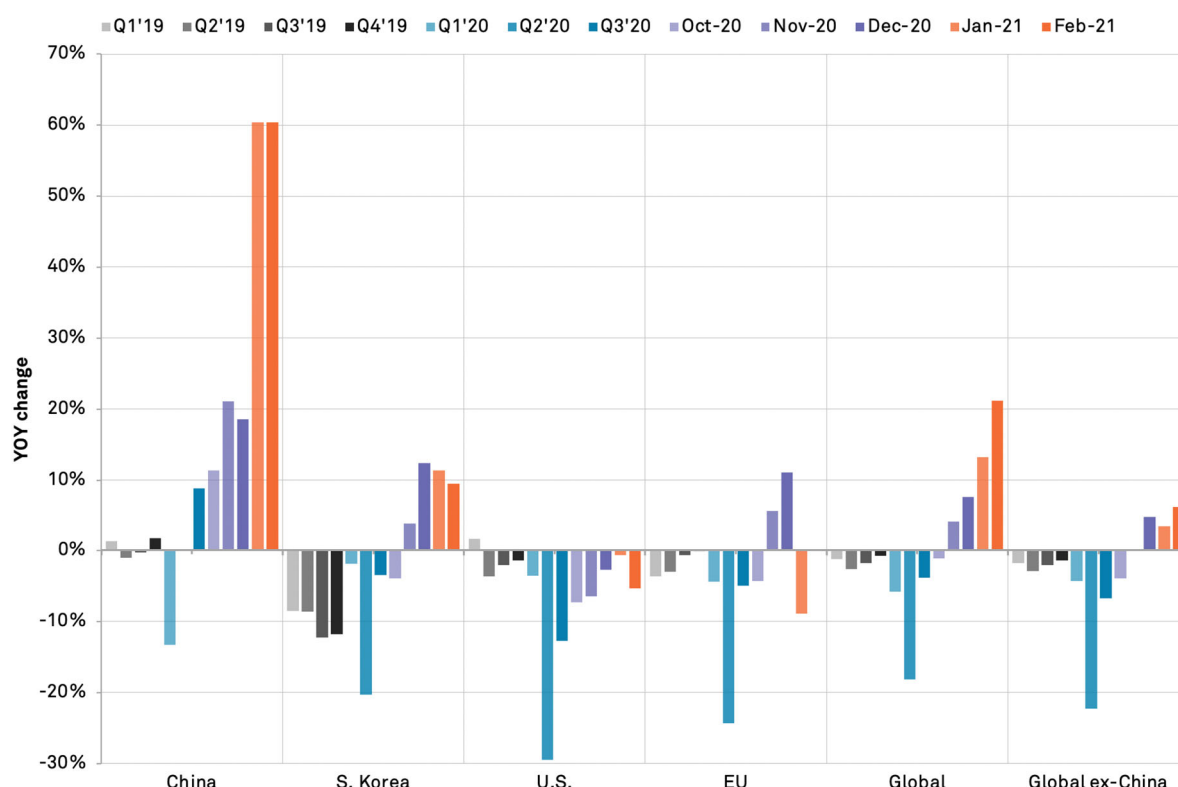


Chart segments global export growth by origin. Source: Panjiva

What happens next for global trade will depend on: the rate of vaccination roll-outs globally; the extent to which consumer spending shifts to services from goods; and whether companies choose to actively switch their supply chain strategies.

The latter could prove particularly important given the hangover of port congestion and exogenous challenges such as the [Suez blockage](#) will likely continue to disrupt logistics networks for much of the remainder of the quarter.

Firms will need to decide whether to ship early for the peak season. That's not without its risks however, particularly for seasonal retailers in the fashion and toy industries where consumer tastes may not match corporate planning.

[Panjiva's data](#) shows that U.S. seaborne imports of containerized freight per day reached 101,250 TEUs in the first half of March, the highest since at least 2017 and 13.0% higher than the prior three-months average. That would suggest clearing of congestion as well as demand are factors at play.

## Demand, decongestion drives daily handling to record high

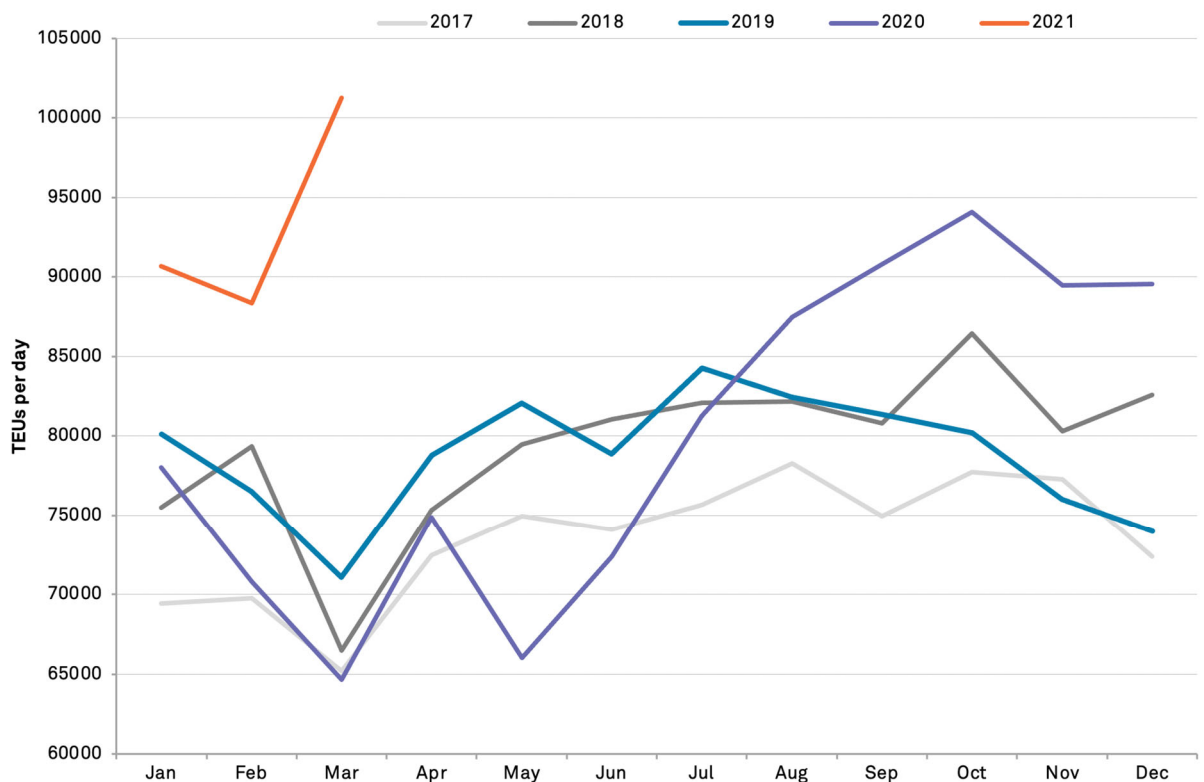


Chart shows U.S. seaborne imports of containerized freight on a daily average basis.  
Source: Panjiva

### *The unwelcome return of medical protectionism*

Having stated that demand depends on vaccinations, those depend on availability of the doses. In that regard there's been an unwelcome return of medical protectionism. The European Council heads of state meeting has provided support for proposals from the European Commission to tighten the rules covering exports of COVID-19 vaccines amid concerns about vaccine makers not meeting their commitments.

Specifically the new regulation identifies "*exports which are subject to the authorisation mechanism may be channelled via countries so far exempted from the export authorisation requirement*". As a result the list of exempted countries has been greatly reduced from the original with Switzerland and Norway now no longer exempted among others.

The new rules also identify situations where exports are continuing to countries with production capacity that aren't exporting or that have lower COVID-19 incidence rates with the regulation stating "*Member States should refuse export authorisations accordingly*".

That regulation could have a marked impact on exports to the U.K. as well as any shipments to the U.S. There are signs the new rules are already being applied. Italian authorities are withholding export approval for a GlaxoSmithKline vaccine on suspicion it may be part of a COVID-19 rather than meningitis, [Bloomberg](#) reports.

The EU's new regulatory action comes with two significant risks. First is the potential withholding of key supplies, particularly from the U.K., as a retaliatory measure. The EU and U.K. are holding talks *"to ensure a reciprocally beneficial relationship"* recognising their *"interdependencies"* which may mitigate that risk.

The second is that other countries follow suit, leading to a return to the significant degree of medical protectionism that beset the early part of the pandemic. In that regard India has reportedly paused exports of the AstraZeneca vaccine, the [BBC](#) reports, in order to support a ramp up of its own vaccination program. Indian exports had been a key part of supplies under the Covax and Quad programs for emerging markets.

There are already clear signs of a restriction on U.K. imports of medical supplies. Panjiva's analysis of official data shows that U.K. imports of medicines fell by 42.2% sequentially in January and by 38.7% compared to a year earlier. That was largely down to a 51.9% sequential decline in imports from the EU, equivalent to a 42.9% decline.

The downturn will partly have reflected stockpiling in December ahead of the introduction of new trade arrangements. Imports from India meanwhile have started to scale up, rising by 38.4% sequentially and by 25.3% year over year.

## U.K. pharmaceutical imports reverse after late 2020 stockpiling

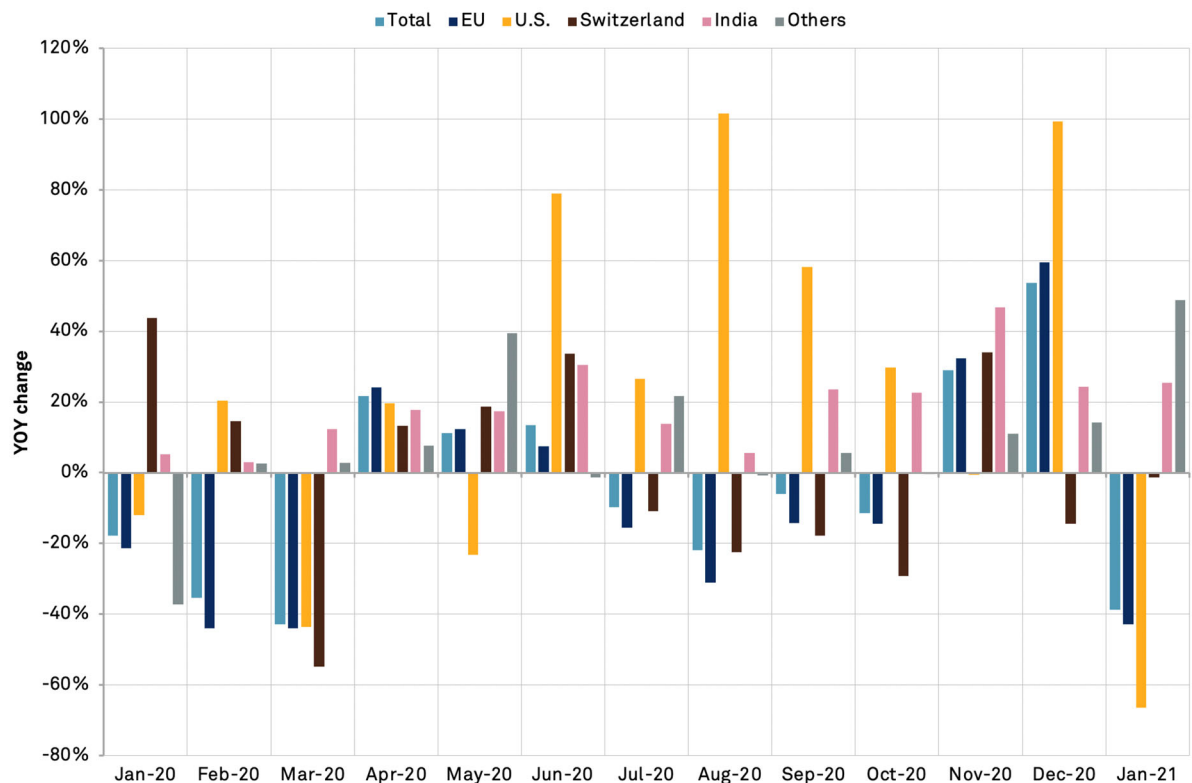


Chart segments U.K. imports of pharmaceuticals by origin. Calculations based on ONS figures.  
Source: Panjiva

The distribution of vaccines globally will likely take more than the remainder of 2021 to complete, with herd immunity levels even in the more advanced countries unlikely to be achieved by the end of Q2'21. That will maintain the need for all the other products needed to protect against, diagnose and treat COVID-19 on an ongoing basis.

U.S. imports of PPE have been in steady decline since the summer of 2020. That may reflect increased domestic manufacturing as well as laxer standards in many states.

Supply chains have also faced challenges from limitation to imports linked to Top Glove linked to forced labor accusations. Panjiva's data shows that daily average imports of masks dropped to their lowest since May in the first half of March with a 42.6% slide from the prior three months' average. Similarly, imports of rubber gloves fell by 44.0% and eyewear by 30.0%.

## Medical supplies in steady decline in 2021

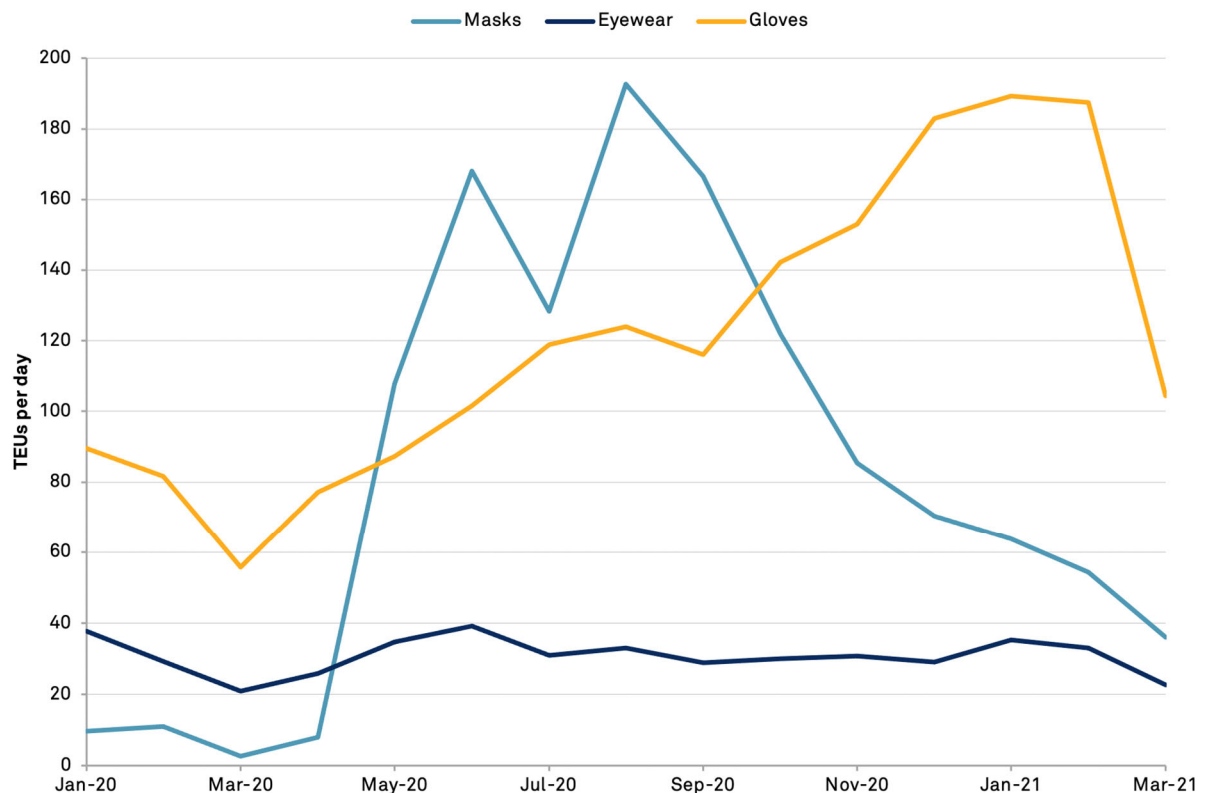


Chart shows U.S. seaborne imports of medical supplies by product on a daily average basis.  
Source: Panjiva

### *The sustainability of supply chain inflation*

The upward pressure on supply chain costs, including logistics and commodities caused by elevated demand and largely fixed supply, has continued throughout Q1'21 with little sign of abating. Most forward markets indicate a steady drift down in the remainder of 2021 though that would still leave costs well above longer term averages.

The matter is particularly pressing in terms of logistics costs where annual contract rounds can take spot container rates, which have increased by 26.2% year-to-date in 2021 according to S&P Global Platts data, and lock them in for up to a year.

The blockage of the Suez Canal is just the latest reminder that logistics networks also face exogenous shocks that long-term contracts can do little to obviate. Companies face the challenge, however, of making long-term decisions in a short time frame with not all the information is yet available. Examples include the impact of the Suez Canal blockage or consumer demand post-COVID-19.

Panjiva's analysis also shows a basket of seven industrial commodities plus freight has increased by 23.0% year-to-date. More information on the impact on corporate supply chains should emerge in the reporting on Q1'21 earnings from late March onwards (see more below). For context the basket of seven products plus freight climbed 40.9% in Q1'21 through March 25 compared to Q4'20.

## 2021 shaping up to be the year of living expensively

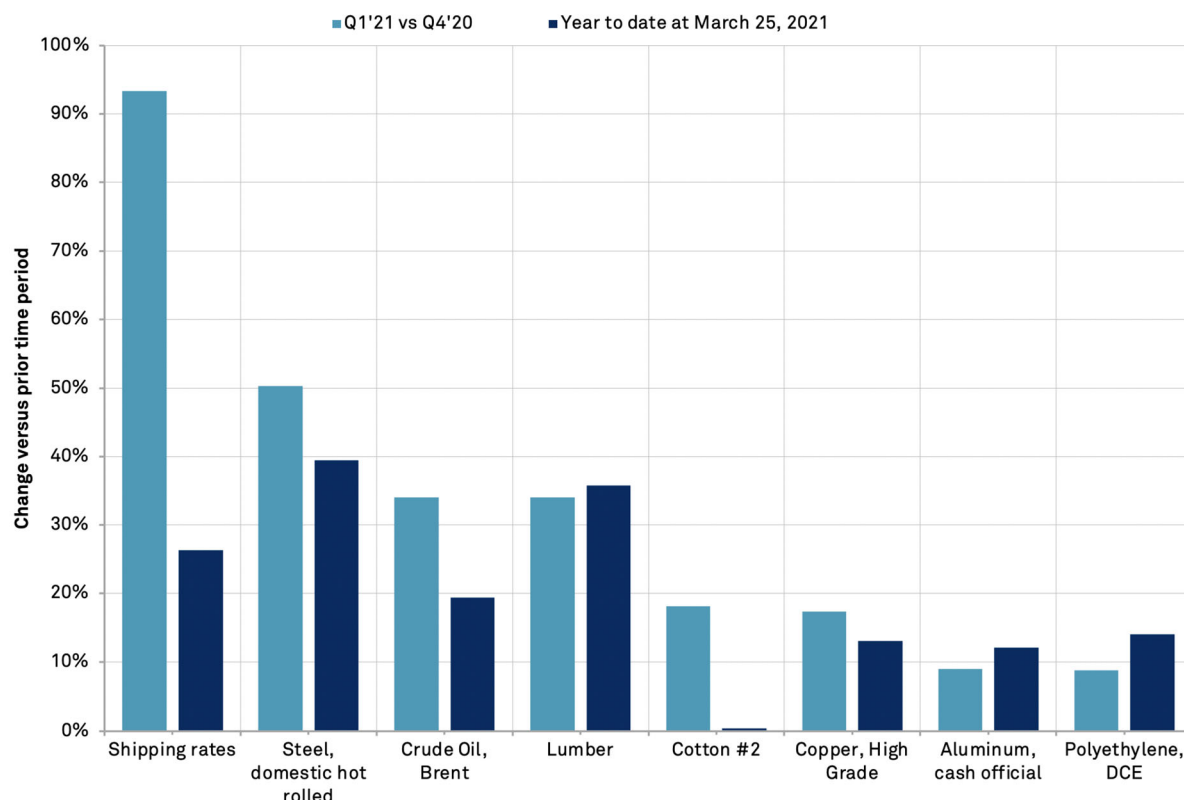


Chart compares change in selected commodities plus global container shipping rates. Calculations based on S&P CapitalIQ and S&P Global Platts data. Data at March 25, 2021. Source: Panjiva

The elevation in costs may take several months to propagate through supply chains and reach consumer prices. The speed of transmission is in part a function of long-term corporate decision making (see below) as well as the time taken to ship products and the prevalence of hedged / contracted prices.

Import price inflation, excluding food and fuels, already reached 2.9% in February 2021, its highest since December 2011 while producer price indices for the last two stages of intermediate manufacturing reached 5.5% and 4.5% respectively in February. Consumer prices meanwhile have increased, but only to 1.7%.

## Inflation pressures building through supply chain into consumer prices

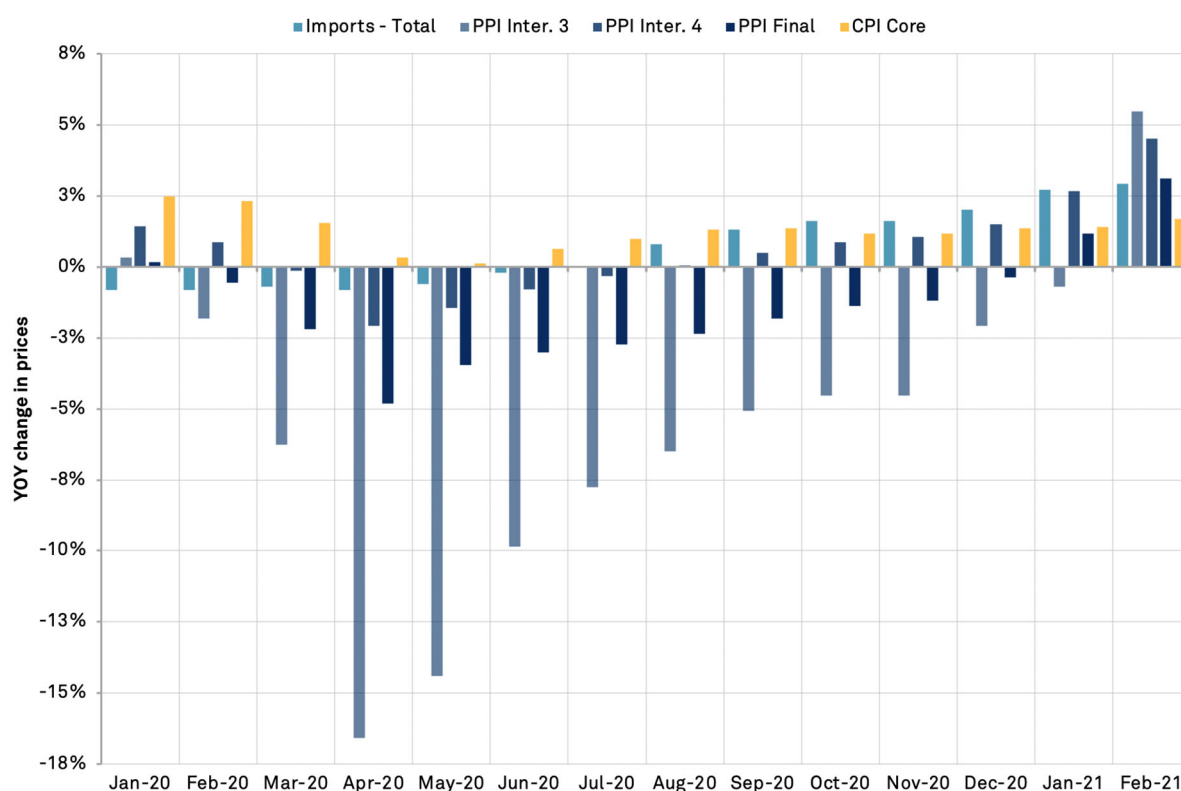


Chart compares change in price indices. Calculations based on Bureau of Labor Statistics and S&P CapitalIQ figures.

Source: Panjiva

### *The time to make post-pandemic supply chain decisions is nigh*

Supply chain decision makers have spent most of Q1 focused on dealing with higher costs, disrupted logistics operations, parts shortages and a continued pandemic drag on demand as well as the continued uncertainties of the trade policy environment (see below).

Panjiva's analysis of over 7,000 companies globally, updated to March 25, shows that 23.8% of firms discussed freight issues in conference calls held in Q1 compared to 18.0% in Q4. The proportion discussing logistics and supply chain issues rose to 37.6% and 50.2% respectively suggesting the topics are at least attractive investor attention.



## Freight inflation the new tariffs for concerned investors

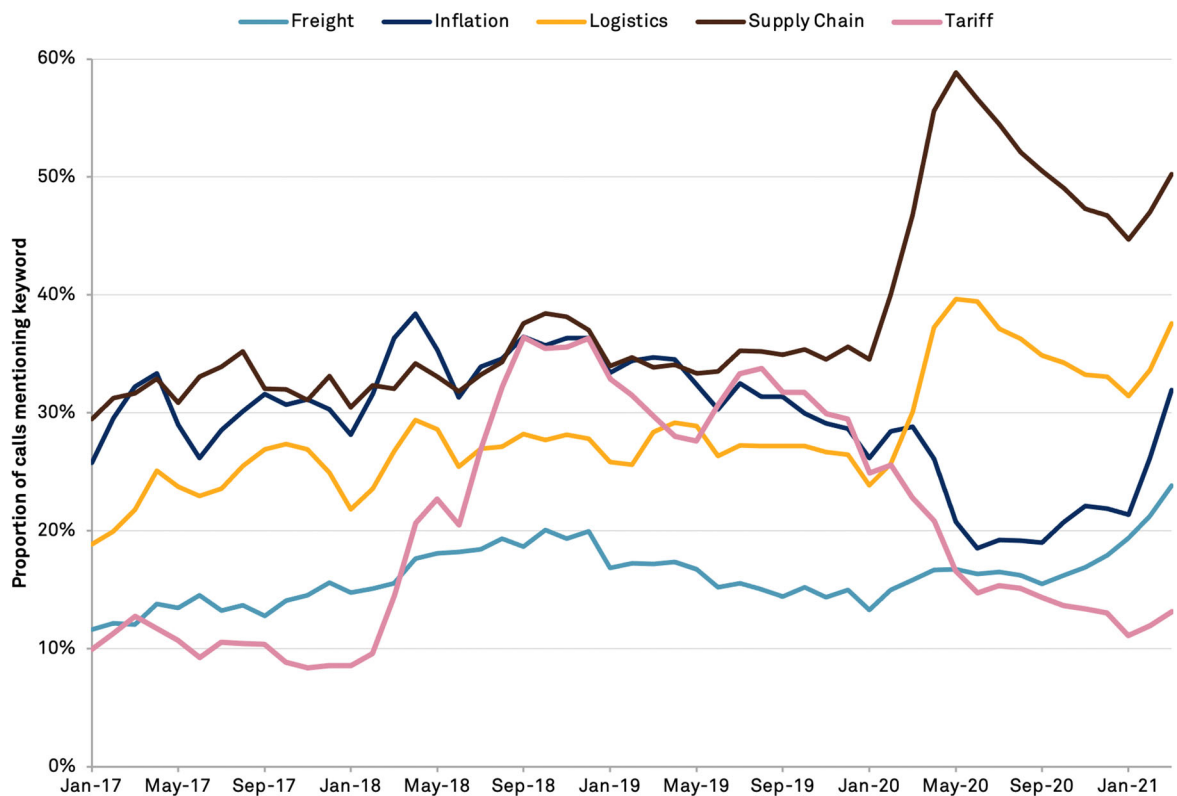


Chart shows proportion of events including keywords mentioned in corporate conference calls on a monthly and three month average basis.  
Source: Panjiva

Few firms have yet to discuss either their short- or long-term reactions to the challenges. There are signs of price increases being planned which will feed into the inflation issues raised above. Indeed, 28.0% of firms mentioned the phrase “price increase” during Q1, including office furniture maker Steelcase, compared to 19.9% in Q4 and a trough of 16.3% in Q2’20.

## Price increase discussions back to mid-2019 levels

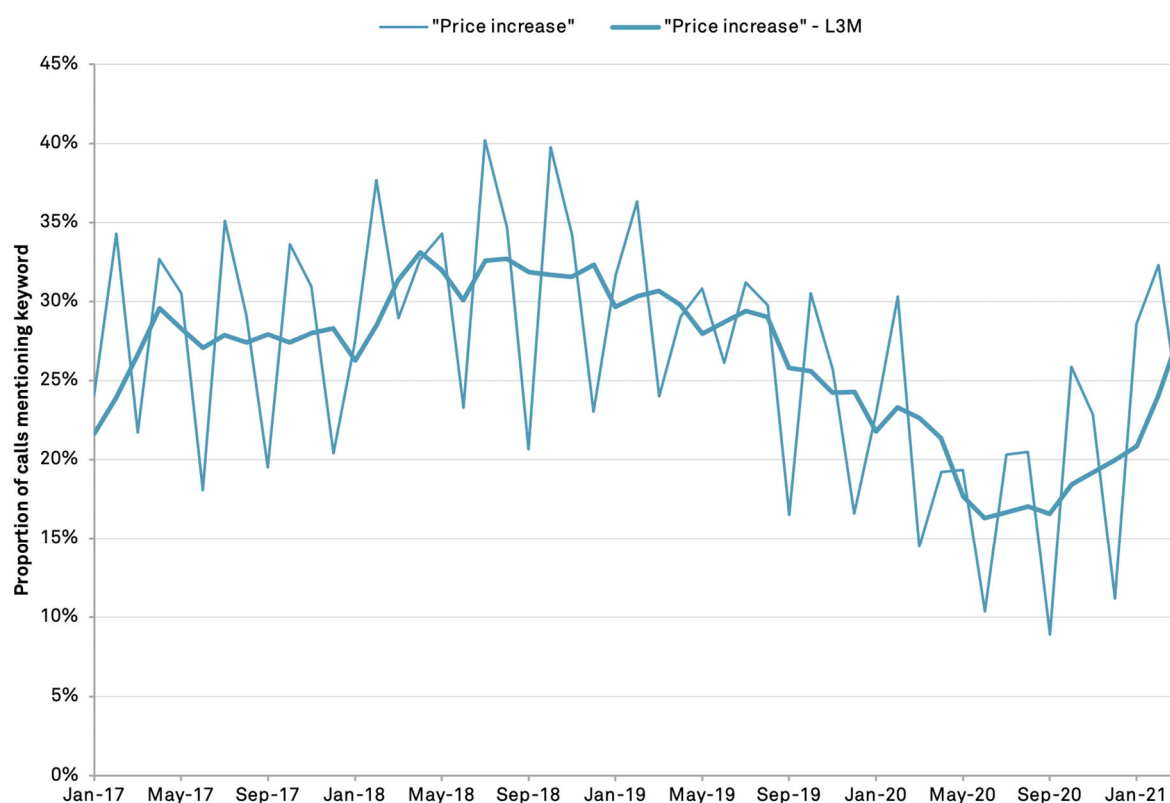


Chart shows the proportion of corporate conference calls mentioning “price increase” on a monthly and three month average basis.

Source: Panjiva

Another short term reaction is to adapt products while investigating long term options. Automakers Ford and General Motors have removed fuel control devices from their light trucks to tackle the ongoing shortage of semiconductors though the industry at large has simply cut manufacturing due to the shortage of those components as well as foam and chemicals after the Texas winter storms.

The two firms appear to have taken different routes to maintaining parts supplies recently. U.S. seaborne imports linked to Ford dipped 11.7% lower year over year in January but have since doubled in the first three weeks of March, bringing the Q1'21 total 26.0% higher than the same period of 2020 and 23.1% higher than the 2019 level. General Motors meanwhile may have steadily reduced its imports, accelerating to a 36.8% cut in March which resulted in an 18.3% drop versus Q1'20 and a 31.1% slide versus Q1'19.

Longer term options including diversifying suppliers, using close-to-market suppliers (for example in Mexico or Canada), retaining higher levels of inventory and signing more resilient supply and logistics contracts appear to still be on the table in most industries.

It's worth noting that strategic reactions to the Trump administration's tariffs only emerged in the months after they were imposed in mid-2018 and are still ongoing today. Adidas is one example of a company that has leveraged its tariff lessons to pandemic realities.

### Ford, GM following different paths in 2021

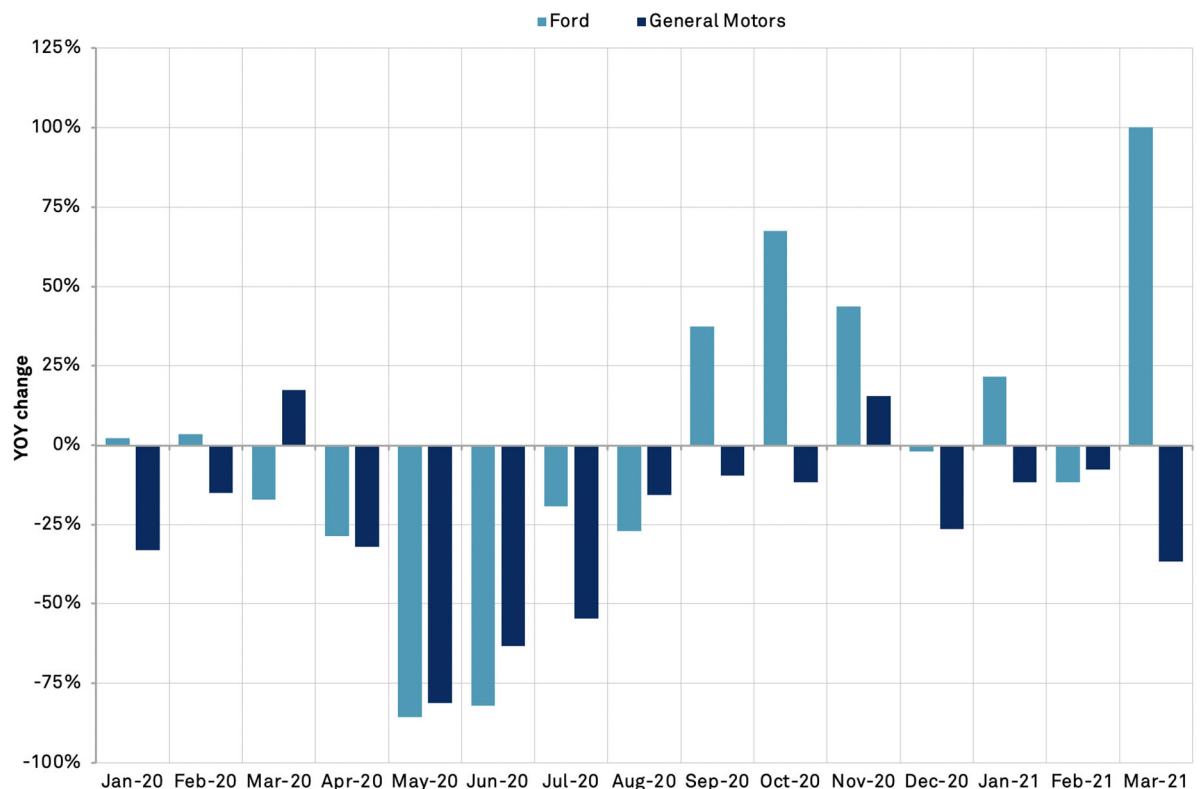


Chart compares U.S. seaborne imports of containerized freight by consignee.  
Source: Panjiva

### *The Biden administration's first and next 100 days*

During its first 100 days in office the Biden administration has:

- Secured the confirmation of Ambassador Katherine Tai as U.S. Trade Representative and Secretary Gina Raimondo to run the Commerce Department;
- Paused an ongoing trade spat with the EU and U.K. regarding aerospace subsidies to allow for four months of negotiations;
- Launched a review of critical supply chains with recommendations due by early June;
- Continued tariffs on imports from China under the section 301 program as well as leaving the phase 1 trade deal in place;

- Continued tariffs on steel, aluminum and solar power equipment enacted by the Trump administration, despite outlining ambitious renewable energy plans; and,
- Launched consultations on potential section 301 tariffs linked to digital services taxes being implemented by six countries including the U.K.

Notably, little or no action has been on long term trade deals, though the principles of ensuring labor and environmental issues are adequately represented have been restated.

The passage of the \$1.9 trillion stimulus package includes checks for consumers which may support the continued, historic surge of imports to the United States as well as providing funding for healthcare, supporting medical supply chains.

The stimulus bill may be followed by an infrastructure bill which could include support for logistics infrastructure including roads, rails and ports. The latter may be timely given the challenges experienced by U.S. seaports in the past few months in addressing congestion.

Panjiva's analysis of official data shows that employment in the logistics sector has recovered 93% of the jobs lost during the pandemic as of February 2021. Total payrolls in the U.S. logistics sector were 0.5% lower than a year earlier in February at 5.22 million positions. Employment in the waterborne sector doing particularly badly with a 13.2% year over year reduction despite the 18.2% surge in traffic on U.S.-inbound seaborne trade lanes, Panjiva's data shows.

## More boxes, fewer dockers drives congestion challenge

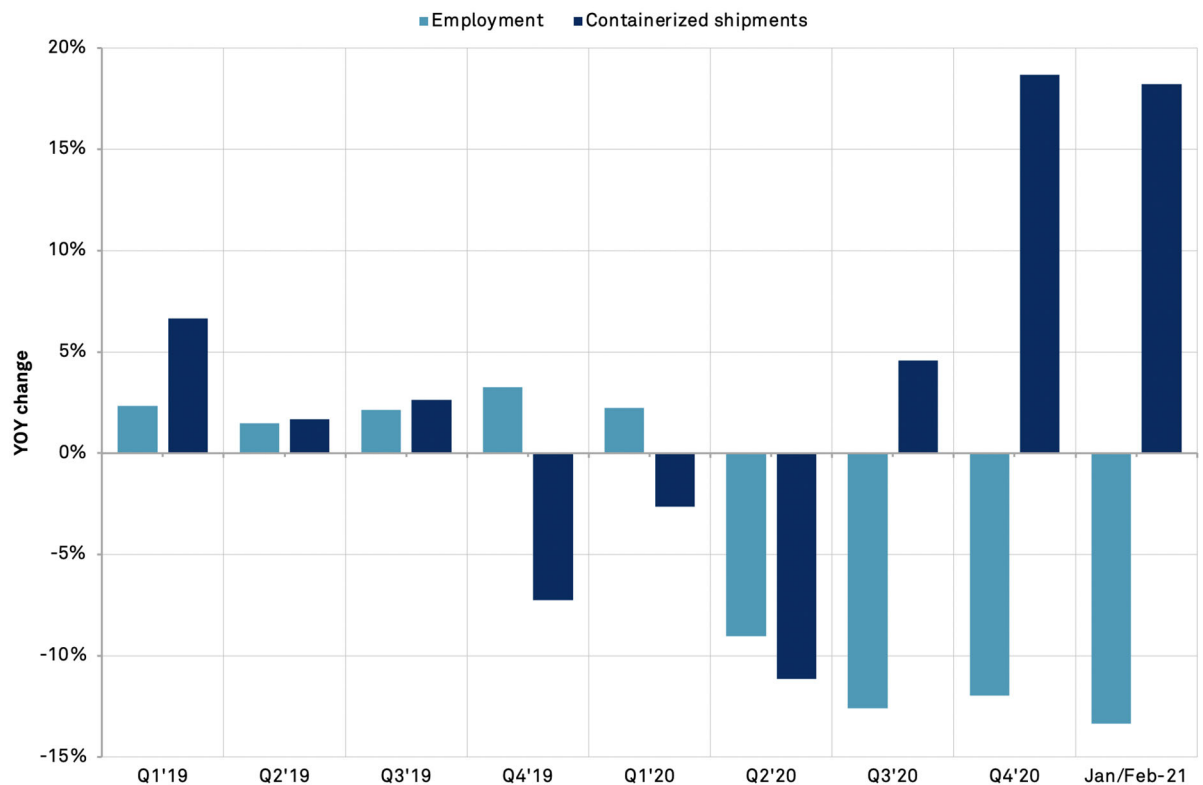


Chart compares U.S. seaborne imports of containerized freight to employment in waterborne transportation sector. Calculations include Bureau of Labor Statistics data.  
Source: Panjiva

Looking ahead to the next 100 days many of the administration's actions will focus on continuing or delivering on the initiatives launched already.

One question that needs to be answered during Q2'21 is whether the administration wishes, or is able, to extend Trade Promotion Authority. Initial disputes under the USMCA trade deal will indicate the administration's attitude towards compromise with its neighbors.

One of the most critical of these will be the implementation of the strategic supply chain Executive Order which covers pharmaceutical ingredients, critical minerals, large-scale batteries and semiconductors.

The latter is potentially the most pressing given the near-term impact on the automotive industry but one where private sector considerations are the most important and where the administration may have little leverage. New plans from IBM to build new fabrication facilities in the U.S. will help.

The review covers imports worth \$51.0 billion in 2020, led by \$31.8 billion of semiconductors with just 5.6% sourced from China. One question is the

administration's tolerance for "secure" to count allied nations in North America (Canada, Mexico), Europe (EU and U.K.) and Asia (Japan and South Korea). Imports from China only accounted for 9.0% of imports in aggregate though in some products the ratio is much higher.

Pharmaceutical ingredients worth \$16.3 billion were dominated by the EU, the U.K. and Switzerland which represented 70.3% of the total, though the share sourced from China was a still considerable 15.3%. Imports of critical minerals worth \$2.33 billion are more diffuse, though the concern is specifically China's dominance of rare earth materials. Imports of large capacity batteries are led by the EU, Japan and South Korea with 78.8% of the total though shipments from China are expanding rapidly.

Widespread commitments to relaxing environmental commitments for mining and processing, tax breaks for manufacturing and federal backstop purchasing commitments are all potential, tangible actions the administration could take.

### Strategic rivals generally only a small part of critical sourcing

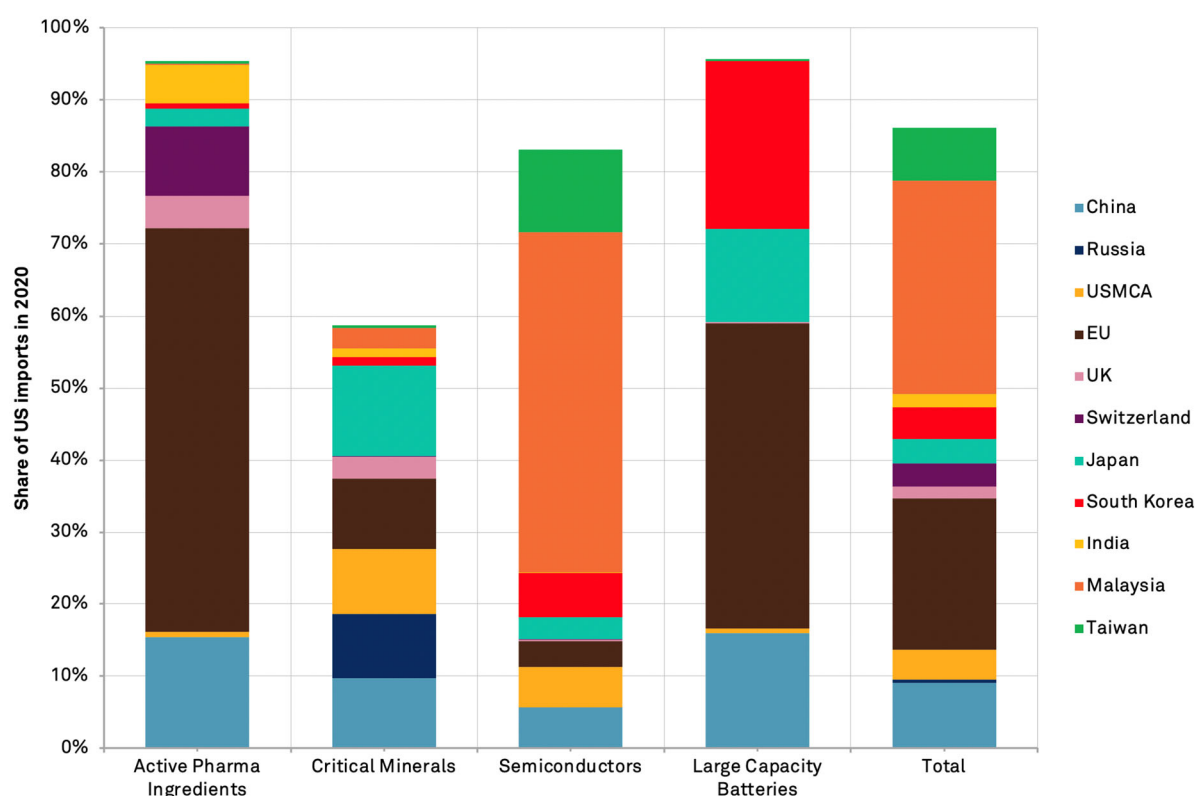


Chart segments U.S. imports of selected products in 2020 by origin.  
Source: Panjiva

With regards to China the initial contacts have come with a hawkish stance with little discussion of trade policies at an initial meeting in Alaska. The administration has instead focused on coalition building and appears to view

trade policies as somewhat tangential to that. Potential flashpoints regarding sanctions linked to Xinjiang and Hong Kong as well as security matters in Taiwan are all likely to be bigger preoccupations.

From a practical perspective a review of China's purchasing commitments under the phase 1 trade deal is overdue as of mid-February with no apparent timetable for it to be carried out. Panjiva's analysis of [official data](#) shows China's purchases of phase 1 products fell \$53.1 billion behind target in 2020 and are already \$13.0 billion behind schedule in 2021. Recovering the gap may be easier said than done.

Exports of agricultural products were 11.3% higher in February 2021 versus the same period of 2017, but are highly dependent on seasonal deliveries of soybeans and were \$6.14 billion behind target in 2020. Shipments of energy products were 9.2% lower in February 2021 than February 2017, though those are partly contingent on volatile crude oil prices covered by a market conditions clause in the phase 1 trade deal.

The bigger challenge lies in shipments of manufactured products. They fell by 0.1% in February 2021 versus 2017 and account for 54% of purchases targeted under the phase 1 trade deal. Shipments of pharmaceuticals jumped 126.0% in February versus 2017, likely reflecting the strictures of the pandemic and state control of the healthcare supply chain.

Exports of industrial machinery and vehicles meanwhile fell by 6.9% and 56.4% respectively. The Chinese government may find it difficult to mandate private spending by corporations and consumers, particularly while maintaining a publicly hawkish stance towards perceived U.S. interference in internal affairs.



## Lackluster growth in Chinese buying of U.S. manufactured goods

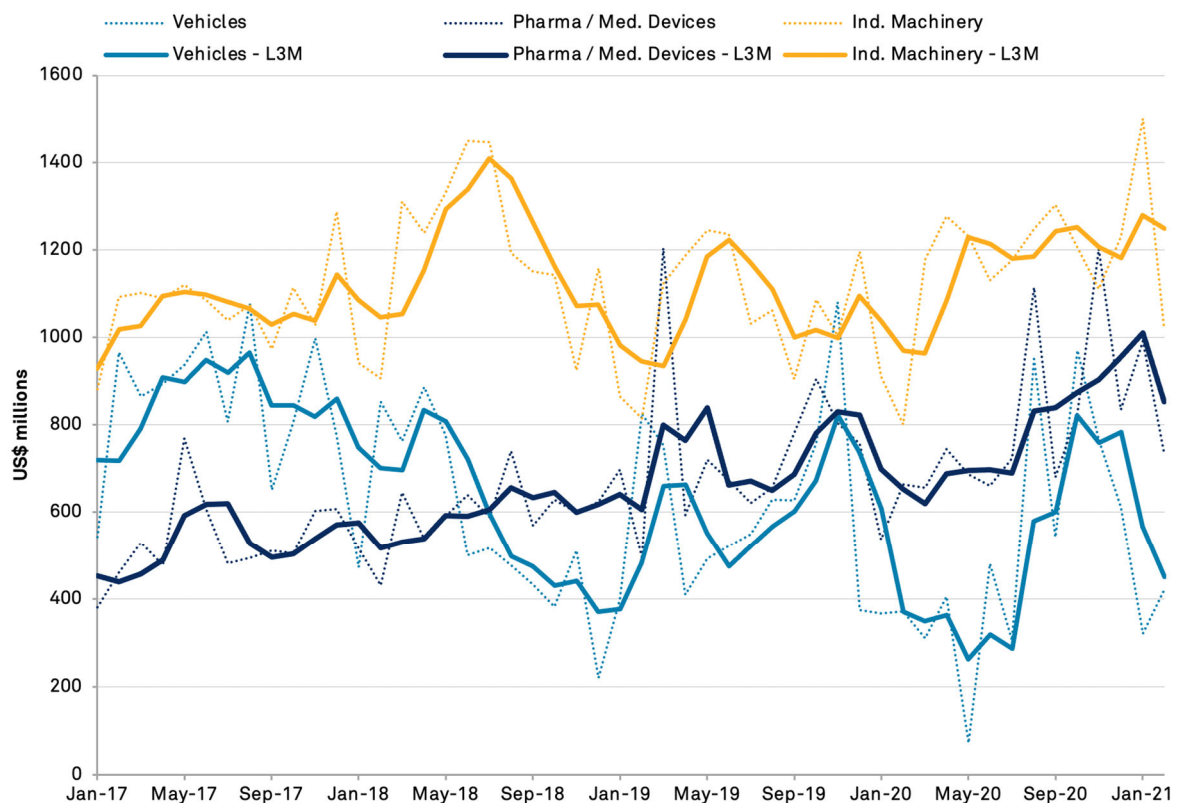


Chart shows U.S. exports of selected products covered by the phase 1 trade deal on a monthly and three-month average basis.  
Source: Panjiva

### *The slow motion Brexit car crash and restructuring of the world order*

While U.S.-China strategic confrontation is the most significant area of uncertainty for global supply chain planning, it is by far from being the only geopolitical risk for supply chains.

Relations between the EU and U.K. have worsened since the start of 2021 and the application of new trading arrangements under the Trade & Cooperation Agreement. Frictions have related to U.K. decisions on border controls, particularly in relation to Northern Ireland as well as the EU moves with regards to vaccines outlined above.

The U.K. has already postponed the full implementation of import inspections and may do so again if trade doesn't normalize during the Q2'21. The EU Parliament meanwhile is scheduled to vote whether to approve the TCA, or not, during April. Should it choose not to do so the TCA may become void and trade relations between the EU and U.K. will revert to "WTO rules". That will lead to a surge in tariffs and potential further complications for customs policy.



The EU accounted for 46.5% of U.K. exports in 2020, Panjiva's analysis of official data shows, including energy products such as power and natural gas which are not covered by tariffs and where the U.K. remains part of integrated European networks. Among the larger product lines the EU accounted for 74.0% of dairy products exports while in consumer goods the EU accounted for 67.9% of clothing. There's also a risk to integrated supply chains where the EU represented 67.4% intermediate automotive goods, namely road vehicles.

Elsewhere developments in global trade policy could prove to be relatively minor during Q2'21 as governments remain focused on tackling the pandemic and reflation their economies with short-term measures. The ratification process of the Regional Comprehensive Economic Partnership may accelerate after China's NPC approved the deal and called for other countries to follow suit. There's no firm deadline for expansion of CPTPP, though the U.K. is trying to accelerate its membership as part of a broader "Indo-Pacific tilt" from the Johnson administration.

The World Trade Organization finally has a new Director General, Ngozi Okonjo-Iweala, though there is unlikely to be much action on reforming the dispute settlement process until later in 2021. EU actions towards implementing carbon border taxes and digital services taxes may complicate matters in that regard.

### Post-Brexit slowdown follows pandemic reversal

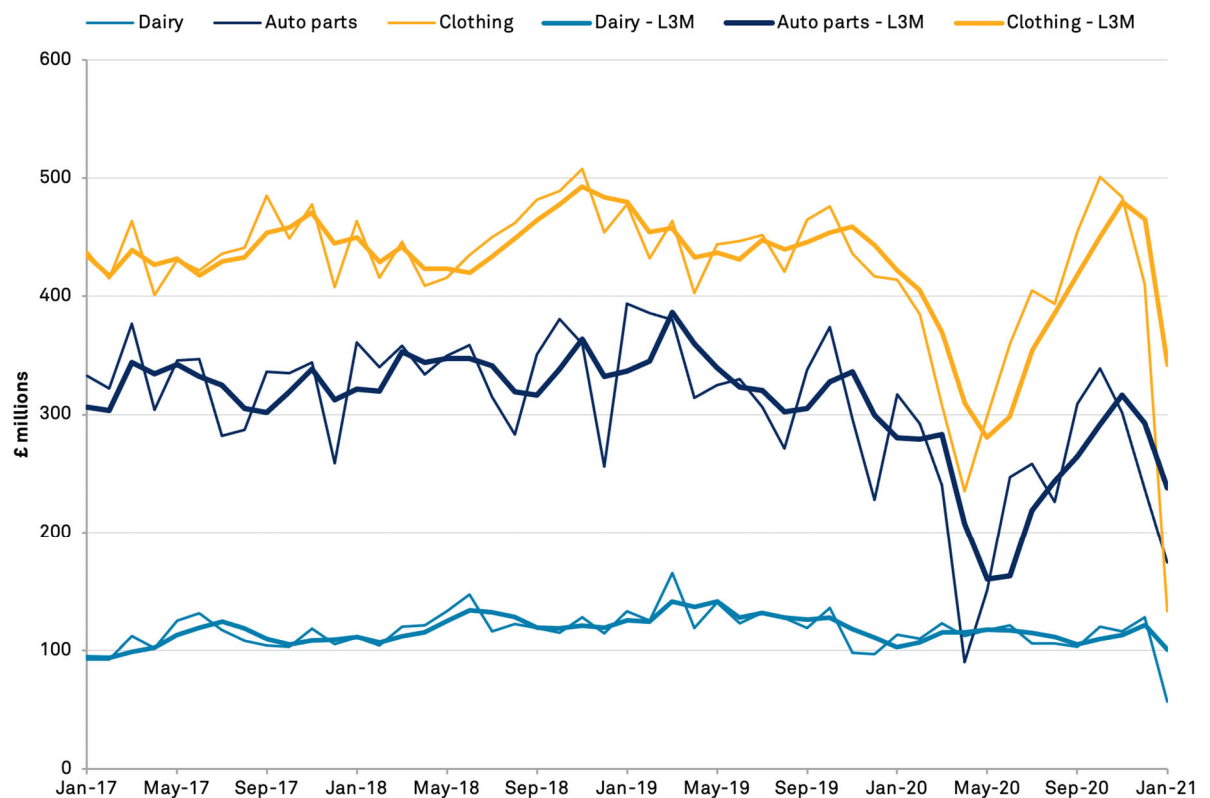


Chart compares U.K. imports from the EU by product on a monthly and three-month average basis.  
Source: Panjiva