

CHINESE-GERMAN TRADE: INCREASING DEPENDENCE

Anthony Morlet-Lavidalie

Since 2016 China has become Germany's main trading partner. German imports from China account for almost 12% of Germany's total trade, and exports account for 8%. Overall, trade with China now accounts for almost 20% of total German trade.

While Germany's trade deficit with China has always been relatively modest in the past, it has widened substantially since the start of 2021.

Germany, which has a particularly high level of industrial production, has a significant degree of dependence on China for imports of strategic inputs, particularly in relation to its supply of rare earths.

The key German industries are also dependent on Chinese domestic demand, because on average around 20% of their sales are made there, and this proportion is continuing to increase.

For Germany, the road to lower dependency is likely to be long and complex, as China is a supplier of essential inputs and a major source of markets for the leading industrial power in Europe.

GERMANY: SHARE OF CHINA IN THE TOTAL OF TRADE

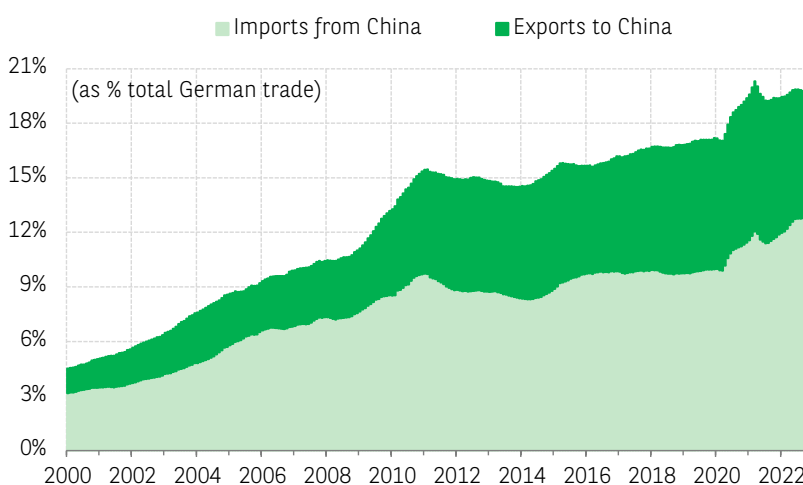


CHART 1

SOURCE: DESTATIS, BNP PARIBAS CALCULATIONS

The trade links between Germany and China have continued to strengthen over the past two decades. While its trade with China accounted for just 5% of Germany's total trade at the beginning of the 2000s (broken down into 3.5% for imports and 1.5% for exports), today it represents around 20% (Chart 2). The weighting of China appears greater in relation to German imports than exports, since 11.8% of imported goods came from China in 2022, while the share of exports to China was 7.5%¹.

PARTICULARLY CLOSE LINKS BETWEEN GERMANY AND CHINA

In Germany, trade relations with China have historically been based on German imports of low value-added goods (durable and non-durable consumer goods, food products) and exports of higher value-added products (intermediate and capital goods). However, this bilateral relationship is structurally, if moderately, skewed in terms of the trade balance. Between 2000 and 2019, Germany saw an average annual trade deficit of EUR 15 bn with regard to China (Chart 1). By way of comparison, the overall German trade surplus averaged EUR 177 bn euros annually over the same period. And this bilateral deficit with China has widened considerably since the beginning of 2021, reaching EUR 81.9 bn in October 2022 over a cumulative twelve-month period.

This fivefold increase in the trade deficit in just two years is mainly due to two phenomena. The first relates to the significant increase in German import prices in the context of shortages of certain inputs, combined with a depreciation of the euro, which has accentuated the increase

¹ By way of comparison, the United States accounts for 6% of German imports of goods compared to 8.8% for exports.

ECONOMIC RESEARCH



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GERMANY: TRADE BALANCE WITH CHINA BY PRODUCTS GROUP

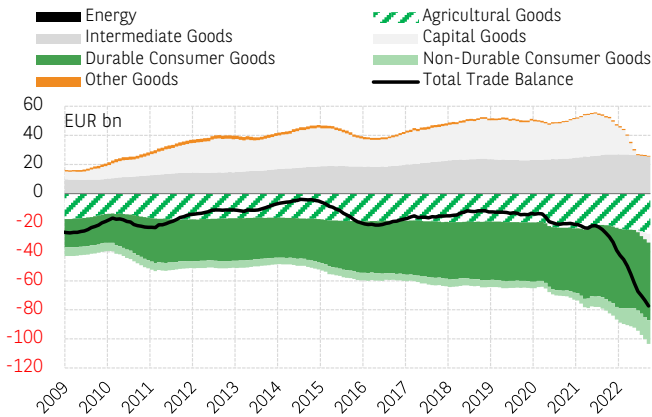


CHART 2

SOURCE: DESTATIS, BNP PARIBAS CALCULATIONS

in import prices. As well as this there is the weakness of the Chinese economy, impacted by its zero-Covid strategy, which has resulted in a significant fall in Chinese demand for capital goods from Germany. Germany is now experiencing a trade balance deficit for these types of goods, whereas in normal circumstances this would be by far the leading export item from Germany to China (over 60% in 2019). And it is in Germany that the deterioration in the trade balance with China is most significant. This same deterioration is much less pronounced for the other major European countries.

Going into more detail, trade between China and Germany is dominated by a few specific products. IT and electronic products are, by far, the types of goods traded most between the two countries, followed by electrical and textile products. Chemical products and car manufacturing, which are among the main export segments from Germany to China, are ranked 6th and 8th respectively.

A STRATEGIC, NOT QUANTITATIVE, DEPENDENCE

Contrary to what one might think, however, Germany is not more dependent quantitatively on Chinese inputs than its European partners. In its Policy Report no. 38 published in June 2022, the IFO showed that *"the share of Chinese inputs in German final production is comparable to that of other European countries such as France or Spain and represents a rather below-average number compared with the other G-20 countries"*. From a purely accounting perspective, China plays an important but not dominant role for Germany as a supplier. Symmetrically, in terms of the importance of China as an outlet market for German goods, the conclusions are similar.

However, this purely quantitative analysis does not say anything about the strategic dependencies. Because while Germany is no more dependent in terms of volumes imported from China than other European countries, it is more dependent in terms of the type of products it imports. In fact, Germany is a major importer of "rare earths" (Box) which are essential in the manufacture of high-added value goods (medical imaging, low-consumption bulbs, hybrid vehicles, rotor batteries for wind turbines). 95% of German imports of rare earths come from China. This very high degree of dependence creates a particularly

significant strategic vulnerability compared to other rare metals, the supply sources of which are generally more diversified: lithium (Chile, Australia), cobalt (Congo), copper (Chile, Peru, Brazil), nickel (Indonesia, Canada, Russia).

WHAT EXACTLY ARE RARE EARTHS?

The term "Rare Earths" is not an accurate description as these elements are not as rare as gold or silver and are as abundant as nickel or copper. On the other hand, they are much more widely dispersed, meaning that extracting them is more costly and more polluting. Rare earths are metals with exceptional electromagnetic properties. They are used in a large number of high-tech manufacturing processes. Although the quantity of these metals contained in each product is often very small, the continuous increase in the production of technological goods has led to a sharp rise in global demand for rare earths.

In 2021, the production of these metals appeared to be extremely concentrated according to data from the "US Geological Survey", since China supplies 61% of global demand (followed by the United States at 16% and Myanmar with 9%). Although the global reserves that are currently known about are more evenly distributed, China maintains a dominant position since it has 37% of the rare earth reserves (followed by Vietnam and Brazil, with 18% each) according to the Statista Research Department data. Although other countries may actively want to exploit their reserves, China is assured of remaining the largest producer in the world for many years since it takes around 25 years from the start of a mining project until production can begin.

SIGNIFICANT DOUBLE EXPOSURE OF LARGE COMPANIES

The major German companies are the most exposed to the Chinese market through a double dependency. China is crucial to them not just for the supply of inputs which are essential to their manufacturing process, but also downstream of production since China continues to be an expanding market offering increasing opportunities for German companies. Major German companies have benefited from Chinese development to become established to a significant degree in the country, to the extent that key industries on average now make 20% of their sales in China, and this share rises to around 40% in the case of Volkswagen, which is the undisputed automotive leader on the Chinese market. German car manufacturers do not want to slow down their development in China, but rather they see a prosperous future there. And this is justified by the fact that the Chinese automotive market is particularly dynamic. In 2011, car sales in China already accounted for 30% of global registrations (18.5 million units out of a total of 60.8 million units) and in 2021 this share increased to around 40%, since 26.3 million of the 66.7 million cars sold worldwide were sold in China, according to figures from the Chinese Association of Automobile Manufacturers. Therefore the largest German manufacturers in the automotive sector, as well as those in the chemicals sector, have significant ambitions for the Chinese market.

If there is no consensus in Germany on the desire for less dependence on China, this is because large companies are continuing to invest massively in China, whereas this is no longer the case for small and



GERMANY: TRADE (IMPORTS & EXPORTS) WITH CHINA BY PRODUCTS GROUP (ANNUAL AVERAGE FOR 2008-2022 PERIOD)

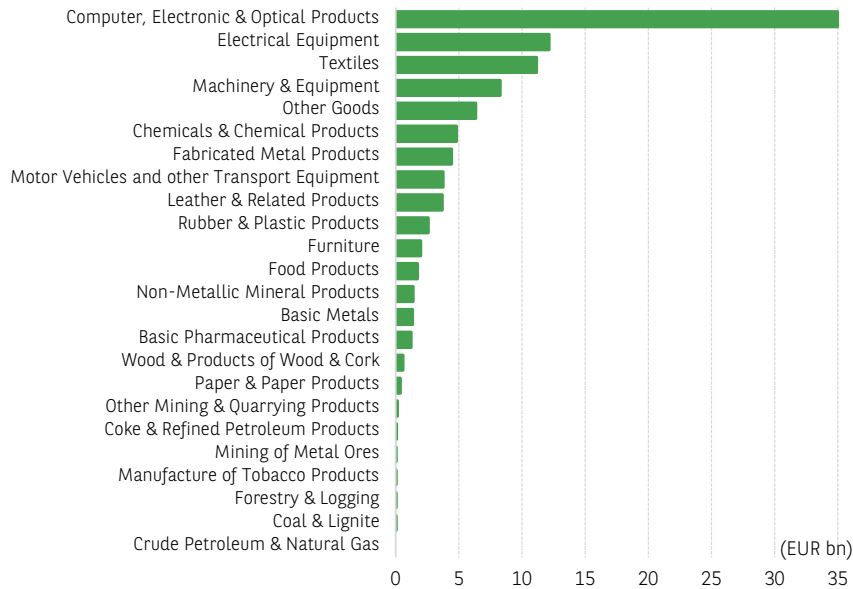


CHART 3

SOURCE: DESTATIS, BNP PARIBAS CALCULATIONS

medium-sized companies (including the Mittelstand companies) according to the recent studies by the Rhodium group. The three major German car manufacturers, Volkswagen, BMW and Mercedes, as well as the chemicals giant BASF, on their own have generated one third of the investments from the European continent to China over the past four years. And this momentum is not weakening, since investments from Germany to China reached a record of around EUR 10 bn euros over the first six months of 2022, according to a study by the German Economic Institute (IW).

This difference in appreciation between companies with regard to the Chinese market makes the government's task more complicated. The government is faced with a highly polarised productive fabric. Small and medium-sized German companies now view China as a competitor, while large companies continue to see China as an opportunity for development and growth.

A DESIRE FOR INDEPENDENCE DIFFICULT TO ACHIEVE

The outbreak of the war in Ukraine on 24 February 2022 has highlighted the vulnerability of the leading European economy in terms of its energy supplies and has forced the country to rethink its view of international relations. The Russia-Ukraine conflict has accelerated the government's desire to rebalance Germany's relations with its main trading partners in order to prevent dependencies on certain countries from growing, as is the case with China.

According to a survey conducted by the IFO in March 2022, of the 46% of manufacturing companies in Germany reporting that they currently rely on high intermediate consumption from China, one in two plans to reduce imports from China in the coming years.

In a strategy paper published on 1st December 2022, the Minister for Economic Affairs Robert Habeck clearly expresses his wish to see Germany's dependence on China reduce. He argues that German companies need to focus on alternative markets.

This echoes his statements before the summer that *"naivety towards China was at an end"*. However, this reclaiming of sovereignty promoted by the government is unlikely to be reflected in a disengagement from China. In this respect, the Chancellor Olaf Scholz closed the door on this route by stating on 4 November 2022, shortly before an interview with his counterpart Li Keqiang in Beijing, that Germany is not *"in favour of a disengagement"* from economic relations with China. The Chancellor explained that he simply wants to reduce *"unilateral dependencies"* while ensuring that *"economic relationships are equitable, with reciprocity, particularly on the issue of openness to investment"*.

Up until now this desire for independence has not been translated into actions, as evidenced by the government's decision on 26 October to authorise an increased stake in the Port of Hamburg by the Chinese company Cosco, despite the reluctance of the European Union and the warnings from the German intelligence services about the consequences of such a decision.

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