



Global Macro Research - Insight

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Reshoring: Shifting sands or cyclical waves?

Geopolitical pressure and the pandemic era meltdown in global supply chains could push governments and firms to reshore manufacturing. Mexico aside, it is hard to see a shift in the data so far, and a trend may only emerge with time.

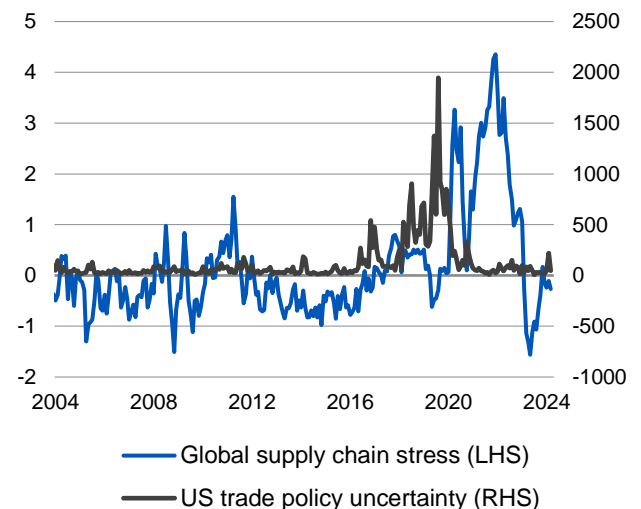
Key Takeaways

- Globalisation has stalled and a policy backdrop aimed at reinforcing national security and supply chain resilience could shift production patterns and entrench this slump.
- It is difficult to discern if widespread reshoring is already taking place. Foreign Direct Investment (FDI) data do not yet point to a marked shift, but these are lagged, and investors waiting for concrete evidence may miss out.
- Mexico has witnessed a surge in non-residential investment and captured a larger share of US trade since President Trump's trade war against China. India has also tripled its exports of electrical goods and appears well placed to benefit from reshoring.
- US tariffs have had a notable impact on bilateral trade flows, with Vietnam another winner. But it is tough to parse out structural change from trade data.
- We remain sceptical that DM policy (be it national security or carbon border taxes) will be sufficient to drive 'onshoring' of manufacturing back to DMs. But – alongside Mexico – it could push investment away from China and into the rest of Asia.
- APAC's centrality within the global trade network confers a strong starting advantage, while there is no need for these manufacturers to 'nearshore' to gain access to one of the fastest growing consumer markets in the world: that of China and emerging Asia.
- US policy will be important in determining the pace, extent and composition of shifting production patterns and in upcoming work we will consider how a Biden or Trump victory this year would impact the outlook for reshoring and globalisation more broadly.

Incentives to reshore

Trade tensions surged during President Trump's term in office, while global supply chain stress hit record highs as the pandemic exposed critical weaknesses (see Figure 1).

Figure 1: Supply chains have been hit by the twin shock of changing trade policy and pandemic-induced stress



Source: Federal Reserve Bank of New York, Global Supply Chain Pressure Index; "Measuring Economic Policy Uncertainty" by Scott Baker, Nicholas Bloom and Steven J. Davis at www.PolicyUncertainty.com; abrdrn; April 2024

While trade policy uncertainty has moderated under President Biden, trade tensions with China have not, and the prospect of renewed trade wars looms large over a second Trump Presidency. Moreover, Russia's invasion of Ukraine and conflict in the Middle East have further increased the focus on supply-chains in national security.



As such, there are strong reasons why both governments and firms may wish to rethink where, how and for whom they produce. This reflects the new geopolitical landscape, and the realisation that supply chains need to shift from 'just in time' to 'just in case'.

Reshoring has arisen as a term to encapsulate this theme and goes by many names, which we can broadly divide into three types: production could be *onshored* back to developed markets, *near-shored* to countries neighbouring the US or euro area, or *friendshored* to politically aligned emerging markets, which could still be a long distance away, for example within APAC's already deep supply chains.

Regardless of the exact form, reshoring can also simply be thought of as an evolution of *offshoring*, which is the already established process of manufacturing goods overseas to try to reduce the cost of labour and manufacturing.

However, despite seemingly strong reasons to relocate, there remains a large degree of uncertainty as to whether reshoring is occurring at scale, and what form it could take.

A clear picture of reshoring is yet to emerge

Judging the pace and scale of reshoring is not easy. One must disentangle actual outcomes from counterfactuals, while cyclical dynamics can obscure the structural change we are actually interested in.

First, manufacturing shifts are commonplace.

We should expect lower value-added manufacturing to relocate out of countries such as China over time as a natural part of their development paths, reflecting workers becoming higher skilled and better paid. Much the same thing occurred among East Asian economies such as Taiwan and South Korea in the 1970-1980s.

Second, high quality timely data are relatively sparse.

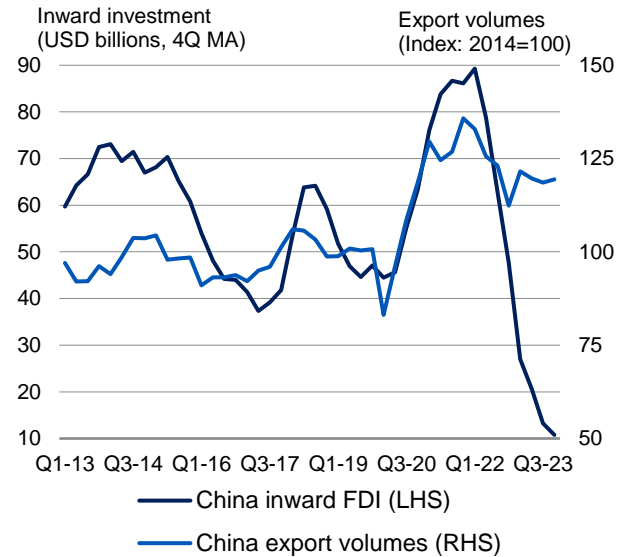
Foreign direct investment (FDI) should (in theory) provide the cleanest read on reshoring, as it focuses on new investment and will most likely capture investment by foot-loose multi-national enterprises. But FDI data are typically only released with a long delay, and for some countries there is a lack of granularity.

FDI can also be sensitive to cyclical dynamics. For example, FDI into China moved alongside the ups and downs in global trade in prior years, even during the Trump trade war (see Figure 2). That said, the recent sharp drop – which is much larger than might be expected given the retrenchment in exports – may be a signal that a more fundamental shift is occurring. Indeed, President Biden has prohibited outward US FDI into China in sensitive sectors.

But there is little sign of FDI rotating into other EMs on anything like the scale of the FDI drop witnessed in China (see Figure 3). Rather, the long-standing slow upward march in APAC FDI (which is roughly half India, half APAC ex. China ex. India) has continued. And while the

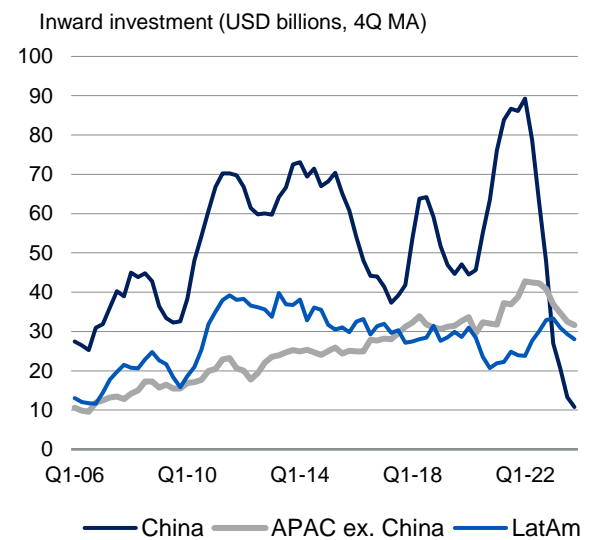
acceleration of FDI into LatAm could be a sign of reshoring gathering momentum, this also comes off the back of a period of notable weakness.

Figure 2: The sharp drop in China's Foreign Direct Investment may be a sign of reshoring...



Source: Haver, abrdrn, April 2024

Figure 3: ...but FDI has not yet rotated into other EMs



Source: Haver, abrdrn, April 2024

Mexico and India stand out as potential winners

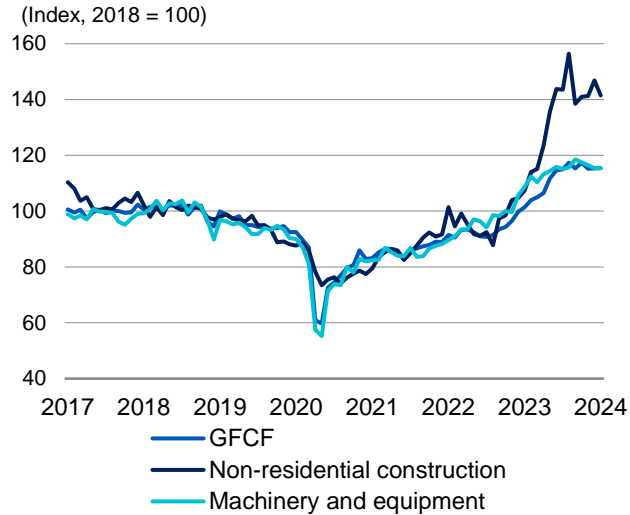
It could simply be too soon to see evidence of reshoring in FDI flows. But if we broaden the net to include more timely data, there are some indications that Mexico and India are either already benefiting, or are well placed to do so.

Mexico does not pose any national security concerns to DMs, and benefits from being a member of the US-Mexico-Canada (USMCA) free trade zone.



The surge in gross fixed capital formation (GFCF) – and in particular non-residential construction – seems indicative of reshoring gaining traction (see Figure 4). That said, GFCF data will also pick up domestic firms’ expansion and government investment.

Figure 4: Mexican construction surge points to near-shoring gathering pace



Source: Haver, abrdrn, April 2024

Banxico has estimated that 16% of firms could be benefiting from near-shoring trends if one takes a pretty broad view on second-round effects.

And the Mexican government also says that there are more than 400 firms investing in Mexico due to nearshoring. There have certainly been some high-profile announcements - particularly centered on autos: Tesla investing \$5bn in Nuevo Leon, for example.

There also tentative signs that India is benefiting from reshoring, even if FDI is yet to accelerate.

It may be starting from a low base, but exports of electrical goods have more than trebled to \$3.5bn since 2019 (see Figure 5). The relocation of some of Apple’s iPhone manufacturing to India and government efforts to attract more foreign investment into its manufacturing sector show some tentative signs that it is benefitting from supply-chain shifts.

Indeed, India’s geopolitical alignment with the West over reducing dependency on Chinese supply makes it well positioned to benefit from *friendshoring*. Similarly, it’s attractive demographic trends, relatively large English-speaking workforce, and government reform efforts to attract manufacturing investment are factors why optimism around India’s economy has risen amongst investors.

Figure 5: Indian electrical goods exports have tripled since the pandemic struck



Source: Haver, abrdrn, April 2024

Trade shares illustrate the impact of US tariffs on China, and the Eurozone’s pivot away from Russian energy

Similar to judging reshoring using domestic investment data instead of FDI, it can be hard to confidently infer reshoring from trade data.

US trade with Mexico could rise if multi-national enterprises’ manufacturing shifted from Asia to Mexico to take advantage of the USMCA free-trade zone and avoid risks associated with US-China tensions. But it could also reflect Mexican domestic firms gaining market share, or even US firms relocating south of the border.

In reality, both dynamics could take place simultaneously, making parsing the reshoring aspect problematic.

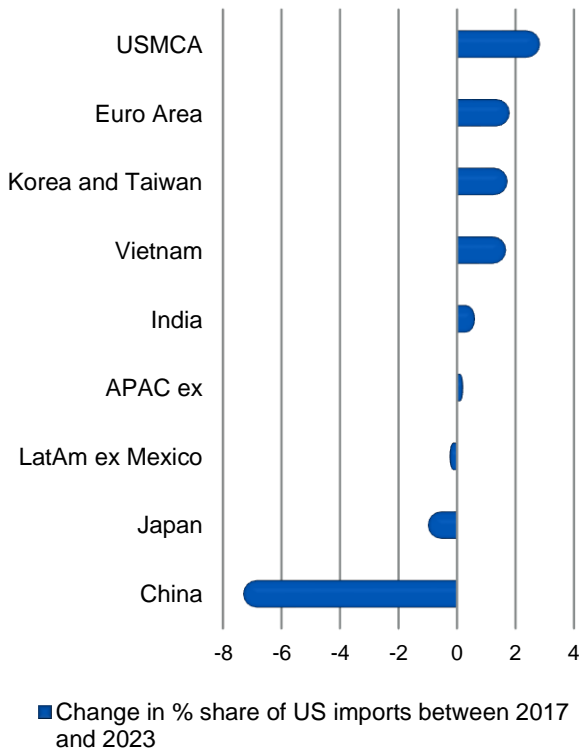
‘Shift-share’ analysis provides a partial solution, allowing us to consider how the share of US and Eurozone imports has changed, and thus inferring whether reshoring may be taking place.

Since President Trump began the trade war with China in 2017, we can see that:

- The share of US imports from China has fallen by more than 7pp.
- In contrast, trade with USMCA partners (Mexico and Canada), Vietnam, Korea and Taiwan, and the Eurozone has increased by between 1.7 to 2.8 percentage points, replacing China’s share (see Figure 6).



Figure 6: US trade actions against China have contributed to a shift in US imports to elsewhere in North America, parts of Asia and the Eurozone



Source: U.S. Census Bureau, abrdrn, January 2024

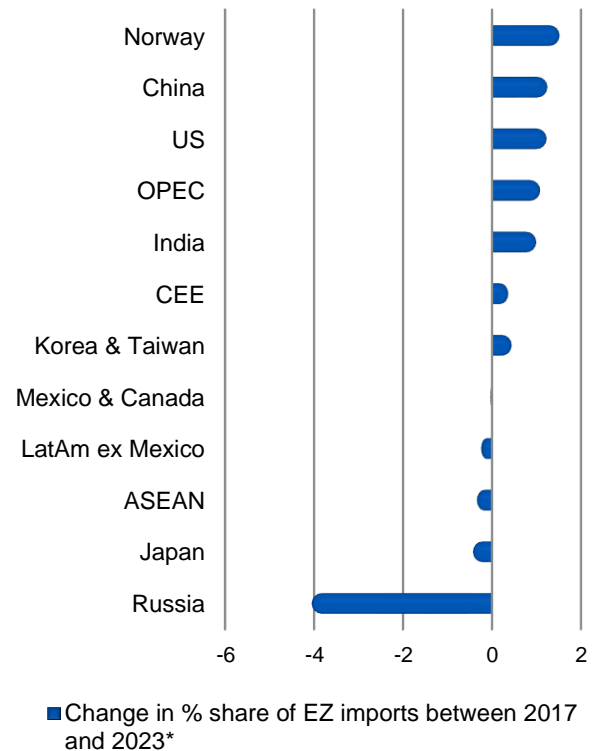
The rising share of imports from Canada and Mexico (USMCA) could certainly be consistent with a degree of nearshoring having already taken place.

Vietnam’s rising share could reflect a combination of reshoring within APAC and China moving up the value chain. Indeed, Vietnam is regularly mentioned by firms as a key investment location compatible with a ‘China+1’ strategy (i.e. reducing dependency on China by diversifying some elements of production to other economies).

On the other hand, the rising trade share from Korea and Taiwan most likely reflects surging demand for semiconductors, rather than reshoring out of China.

Inferring reshoring from Eurozone data is difficult since the pivot away from Russian energy dominates the shift-share figures (see Figure 7). Overall, the change in Eurozone import habits seems to be more muted: many changes in import share are less than 0.2 percentage points and – unlike the US – Europe has become more, not less, reliant on Chinese goods.

Figure 7: Eurozone trade with China has increased, while Russia’s invasion of Ukraine has caused a marked change in energy imports



Note: 2023 = latest 12 months of data. Source: Haver, abrdrn, January 2024

Could investment by-pass EMs altogether and ‘onshore’ back into DMs?

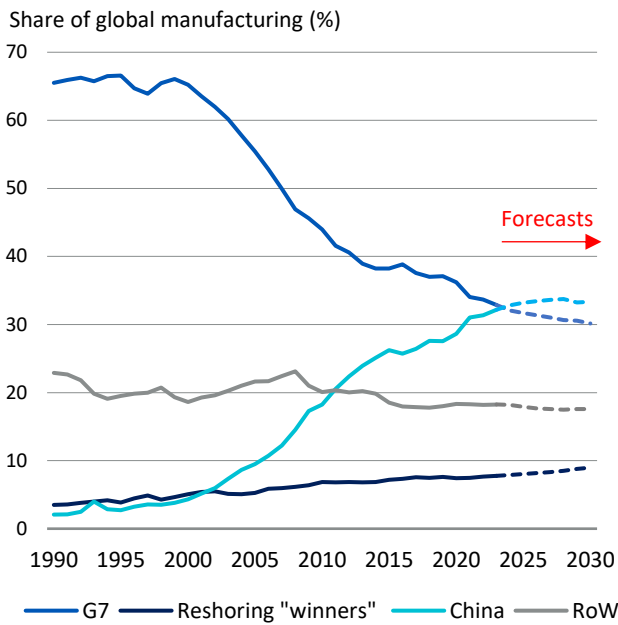
US and EU policy is attempting to encourage a degree of onshoring, specifically for semiconductors. But outside of the ‘small yard, high fence’ strategy (in which the US allows most trade and economic relations with China to continue, outside of specific products, technologies and services tied to US national security), it seems unlikely that policy support for onshoring will be forceful enough to lead to a revival of DM manufacturing (see Figure 8).

The ‘China shock’ is still more likely to morph into an ‘EM shock’ rather than reverse the fall in the DM manufacturing share. Substantial wage differentials and deep supply chains across APAC create a substantial competitive edge that policy or technology are unlikely to overturn.

Indeed, outside of Mexico and India, we judge that the other potential reshoring ‘winners’ will be dominated by Asian economies, specifically: Indonesia, Bangladesh, Malaysia and Vietnam, which should see their share of global manufacturing increase, potentially at the expense of China but certainly in place of G7 countries (again, see Figure 8).



Figure 8: From 'China shock' to 'EM shock'?



Source: UNIDO, Haver, Oxford Economics, abrdn, November 2023. Note: Reshoring "winners" = Bangladesh, India, Indonesia, Malaysia, Mexico, Vietnam.

That said, there is some risk that climate policy pushes manufacturing closer to DMs. Carbon border adjustment taxes could potentially become a major force shaping firms production location decisions in a way that it has not been thus far.

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Moreover, there is a risk that trade policy becomes even more hostile, especially should President Trump win reelection. Trump has threatened to implement tariffs across a much broader range of trade partners. China could potentially face 60% tariffs while countries with large bilateral trade surpluses like Vietnam could also be targets.

Conclusion

Ultimately, evidence of reshoring to date is mixed. While there are strong reasons to expect that the rise of national security considerations will spur some relocation, it is uncertain how strong this force will be and exactly who will benefit. Moreover, the nature and aggressiveness of the policy backdrop is highly uncertain, and we will consider what different US election results might mean for reshoring and the broader policy backdrop in an upcoming research note.

Mexico's strong rates of investment and larger share of US imports suggest it is most likely already benefiting from US-China tensions, while India has had some success in boosting its exports of electrical goods and appears well placed to benefit from geopolitical tensions going forward.

A broader shift in global supply chains is not yet evident, but other EMs within APAC are plausible winners.

APAC's centrality within the global trade network confers a strong starting advantage, while there is no need for these manufacturers to 'nearshore' to gain access to one of the fastest growing consumer markets in the world: that of China and Asia.



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