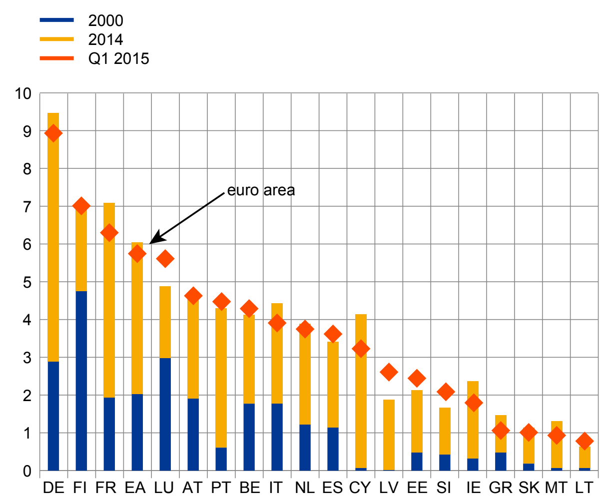
Box 1
Trade links between the euro area and China

Over recent decades, China's role in global trade has grown significantly. With several economic reforms starting in the late 1970s, it has grown rapidly and become an increasingly important player in the global economy. In 1980 Chinese imports accounted for just over 6% of GDP, but by 2014, they had increased to 19% as a result of trade liberalisation, the country's accession to the World Trade Organization in 2001 and rapid investment growth in the Chinese economy. In addition to traditional trade, China also plays a central role in global supply chains, processing intermediate inputs for subsequent re-export to a third destination. Since 2011, however, the country's growth prospects have weakened, as the economy is undergoing a rebalancing from investment-driven growth towards a path of more balanced economic growth.

Chart A
Exports to China

(percentage share of total extra-euro area exports)



Source: IMF Direction of Trade Statistics.
Note: Extra-euro area exports exclude trade flows between euro area countries.

China accounts for a relatively limited share of euro area exports, although this share has risen over time. Exports to China have rapidly increased across all euro area economies over the past 15 years, rising from 2% of total extra-euro area exports of goods to 6% at the end of 2014. Germany, France and Finland account for the largest shares of exports to China, while other countries' shares range from close to 6% in Luxembourg to 1% in Lithuania (see Chart A). China's share of extra-euro area exports is comparable to that of Switzerland and less than half that of the United States or the United Kingdom.

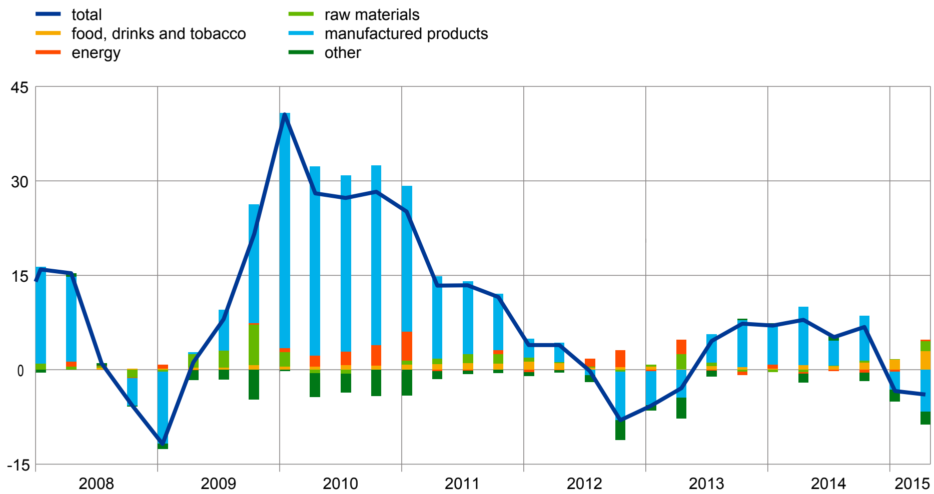
The slowing of growth in China since the beginning of 2015 has reduced euro area exports, in particular exports of machinery and transport equipment. This has had adverse repercussions for, in particular, exporters of manufactured goods (see Chart B), which account for almost 90% of goods exports to China. Conversely, exports of food, drink and tobacco and raw materials have been holding up, signalling that consumption and intermediate goods exports are still buoyant. These recent developments are consistent with China's role in processing intermediate inputs for final consumption and with the rebalancing of the Chinese economy towards consumption and away from investment-driven growth.

The fall in euro area goods exports to China has partly been offset by increasing exports to other advanced economies. While exports to China have declined rapidly and provided negative contributions to euro area export growth, demand in other advanced economies, such as the United States and European

Chart B

Euro area exports of goods to China by product category

(annual percentage change; percentage point contributions)



Sources: Eurostat and ECB calculations.
Note: The product categories are defined according to the Standard International Trade Classifications.

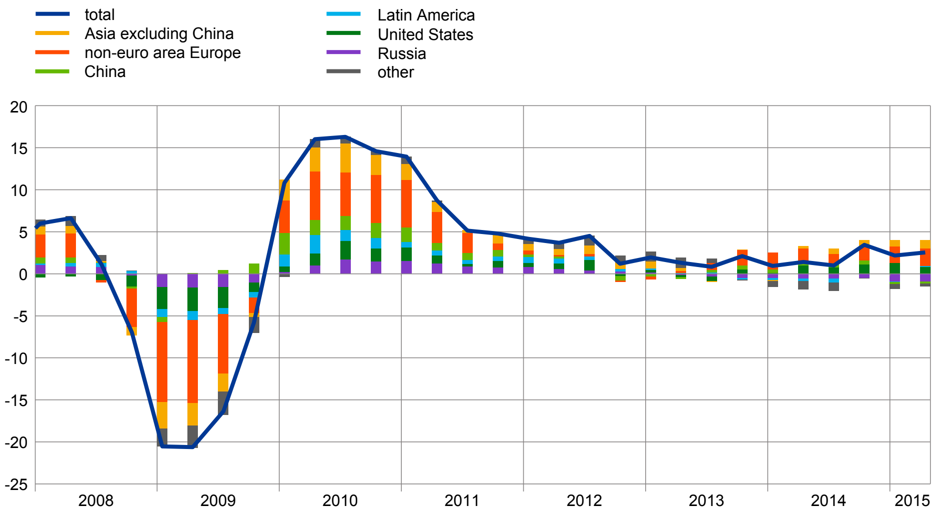
countries outside the euro area, has increased and provided an impetus to euro area export growth, demonstrating the renewed importance of advanced economies for global trade growth in 2015 amid slowing emerging market economies (see Chart C).

Indirect trade spillovers from China to the euro area are likely to be small and mainly concern other Asian countries. While direct trade links between the euro area and China remain limited, there could be adverse trade spillovers whereby important export destinations for the euro area, which are also large trading partners for China, experience slowdowns. The largest export destinations of the euro area,

Chart C

Extra-euro area exports of goods and country contributions

(annual percentage change; percentage point contributions)

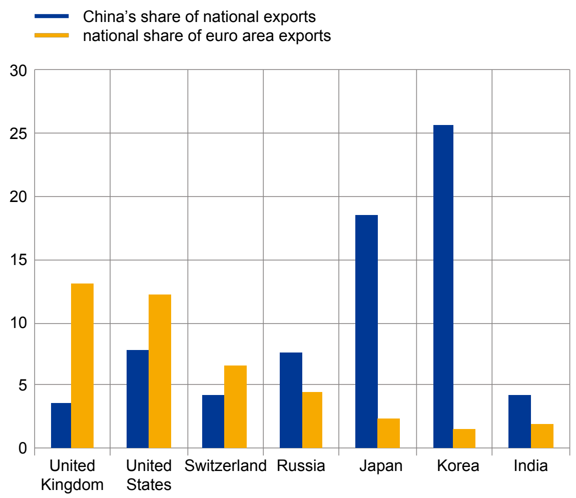


Sources: Eurostat and ECB calculations.

Chart D

Trade exposure to China

(percentages)



Source: ECB calculations.

excluding China, are the United States, the United Kingdom and Switzerland. These countries, in turn, have relatively small export exposures to China and are unlikely to be severely impacted by a slowdown in Chinese activity (see Chart D). The countries that are most likely to be affected by a domestic slowdown in China are neighbouring economies in Asia, which, when taken as a whole, account for a relatively large share of euro area export demand (around 21%). Overall, however, available estimates suggest that the direct and indirect trade effects from a 1 percentage point slowdown in Chinese real GDP are relatively muted, and amount to a decline of around 0.1 to 0.15 percentage points in euro area activity after two to three years.

China's role in global production chains may limit the transmission of negative developments to the euro area. Exports of intermediate goods to China have become increasingly important over time; their share increased from 53% in 1995 to 59% in 2011. This relatively large share highlights China's prominent role in global value chains, whereby products are shipped to China for further processing or assembly and then re-exported to another destination for final consumption. In this context, and with the latest available data being from 2011, at least 8% of euro area exports to China are not directly linked to developments there, but rather reflect demand developments elsewhere. Arguably, some exports of final goods could also be involved in global production networks, supporting the production of goods to be sent to a third destination and thereby reflecting final demand elsewhere. Hence, a slowing of Chinese activity is likely to have less of an impact than would be suggested by gross trade flows.

While trade spillovers from a continued slowdown of economic activity in China are likely to have only a modest impact on euro area GDP, other spillover channels can potentially be important. The size of the Chinese economy means it has had a significant effect on oil prices, although its relevance has waned in recent years as growth has continued to decline. Therefore, the impact of a slowdown in China on oil prices may be limited, although it crucially depends on whether growth in other emerging market economies slows as well. While China would also affect some commodity-producing emerging markets via lower metal imports, major exporters of metals account for a fairly small share of euro area trade. Another possible channel for transmitting negative shocks to the euro area is confidence effects, where, for instance, capital outflows can be triggered by adverse confidence shocks, leading to a tightening of financial conditions in emerging markets and a further slowdown of euro area foreign demand. Moreover, capital outflows from China, if not counterbalanced by other private or official flows, could trigger a depreciation of the Chinese currency and, in its wake, exchange rate depreciations of other emerging market currencies. Finally, a rise in global uncertainty could directly affect the confidence of euro area households and firms, hampering consumption and delaying investment decisions. Therefore, the impact on the euro area of a potential further slowdown in China ultimately hinges on the extent to which this slowdown spills over to other emerging markets more generally, and the degree to which the resulting loss of confidence affects global financial markets as well as global trade.