Market Commentary

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Will Reshoring Create New Opportunities?

In 2020, as the COVID-19 pandemic came to global attention, international trade and production volumes declined drastically, similar to the Great Financial Crisis (GFC) of 2008/09 and World War II. In the case of the pandemic however, the speed of the decline and subsequent recovery was much quicker. Nevertheless, the damage was done, and both corporations and countries gained a new-found appreciation for secure and dependable supply chains.

We might think of globalization as a relatively recent phenomenon, as U.S. companies expanded their supply chains globally through the 1990s, pushing the value of imports from 10 per cent of GDP in 1991 to 14 per cent by 2000, and growing to over 17 per cent over the subsequent decade. Historically however, more significant changes in the way manufacturers managed supply chains can be traced back to the 19th century, as the U.K. drove globalization of textiles and industrial goods. Then of course globalization could depend on your perspective of the size and scope of the world, so with a little imagination, we can actually think of the origins of globalization in the first century B.C., as luxury (silk) goods from China started appearing at the other edge of the world, in Rome. The goods had traveled thousands of miles along what was dubbed the 'Silk Road'. This trade route thrived under protection of the empires of Rome and China, but after several centuries, the Silk Road closed, only to be revived under the protection of the Mongol Empire (in the 13th-14th centuries). Similarly, by the 9th century, Muslim traders dominated shipping through the Mediterranean and Indian Ocean, focusing on spices and transporting goods between Indonesia and Spain.

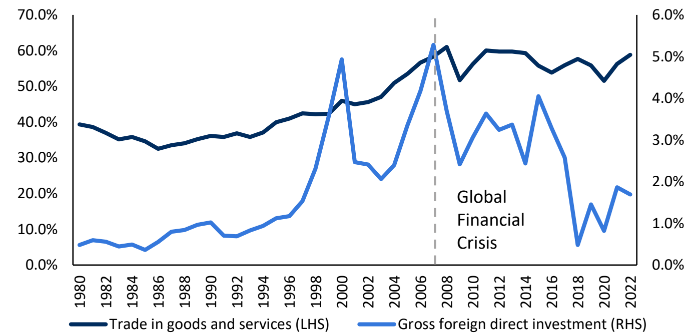
In 2013, China launched the ambitious Belt and Road Initiative (BRI), also sometimes dubbed the New Silk Road. Originally intended as infrastructure development and investment initiatives to link East Asia and Europe, the project has since expanded to Africa, Oceania, and Latin America. The investments so far in railways, highways, pipelines, ports, and other infrastructure has been estimated at over US$1 trillion, and is forecasted to reach as much at US$8 trillion.

Globalization can bring benefits by reducing manufacturing costs, expanding consumer choices, and more. Those of us residing in North America have undoubtedly enjoyed these advantages for years. However, following the GFC, there has been a prolonged slowdown in trade reform and a decline in political support for open trade amidst rising geopolitical tensions. In the U.S., over the last decade, imports have slowly declined to under 15 per cent of GDP. The International Monetary Fund (IMF) refers to this phenomenon as "slowbalization"[1]. This trend is somewhat subtle in terms of trade in goods and services, but more significant in terms of foreign direct investment (FDI) which reflects longer-term interests. The aftermath of the GFC, Brexit, and trade tensions between the U.S. and China collectively, led to a notable decrease in global FDI levels. As a percentage of global GDP, FDI dropped from 5.3 per cent in 2007 to a trough of 0.5 per cent in 2018. In recent years, the COVID-19 pandemic and escalating geopolitical tensions have further affected FDI, causing it to fluctuate around 1-2 per cent of global GDP, a level similar to that observed 25 years ago (Chart 1).

Key Takeaways

In the following pages, we look at the movement towards 'reshoring', 'nearshoring', or 'friend-shoring'. This was underway well before the pandemic hit, but has gained more attention as consumers still recall the pain of goods shortages on store shelves and inflation that is still front and centre of the current narrative. We look at how FDI is shifting between countries, and specifically away from China as the U.S. continues to de-risk its dependency on that country. In the short-term, rather than an immediate resurgence of U.S.-based manufacturing, we see more of a shifting of countries that the U.S. relies on. This will likely include benefits for countries like Canada, but also India and Poland. Mexico is already an important trading partner with the U.S., and so will likely continue to prosper, but in the same industries that it currently thrives in. Over the long-term, the U.S. aims to bring high-tech work back home, but the process will take time, offering future benefits.

Chart 1 - Trades and FDI As Percentage of GDP (Global)



Source: IMF staff calculations

Chart 2 - FDI Reallocation by Regions (% Chg in Number of FDIs)

Source Regions \ Destination Regions	United States	Americas excl. US	Advanced Europe	Emerging Europe	Asia excl. China	China	Rest of the world
Rest of the world	6.9	-12.4	-14.2	-8.1	-23.2	-44.2	-0.9
China	-41.6	-26.4	-37.3	-50.8	-63.8		-51.4
Asia excl. China	-22.7	-28.2	-31.2	-21.9	-43.2	-68.7	-23.9
Emerging Europe	8.1	-16.6	-9.6	-1.4	-41.8	-5.6	-31.0
Advanced Europe	-12.0	-31.2	-10.2	-20.4	-29.3	-39.2	-10.9
Americas excl. US	-0.9	7.8	-4.6	14.5	-13.6	-32.8	8.1
United States		-10.3	-18.9	-0.1	-17.2	-60.1	2.1

Source: fDi Markets; IMF staff calculations. Changes are computed using the number of greenfield FDI in 2Q20 - 4Q22 and average number in 1Q15 - 1Q20.

What Does Fdi Tell Us About Shifting Supply Chain Dependencies?

A closer look at the reallocation of FDI across regions reveals a growing fragmentation worldwide. FDI declined in the post-pandemic period from 2Q20 to 4Q22 by almost 20 per cent compared to the pre-pandemic average following the GFC[1]. However, this decline has been highly uneven. FDI flows to and from China experienced the most significant decrease, far worse than the aggregate change of a 19.5 per cent decline, particularly involving the U.S. and other Asian countries. Conversely, there has been an increase in FDI flows between the U.S. and emerging Europe, as well as between the U.S. and the rest of the world. This shift indicates that the U.S. is actively diversifying its supply chains away from countries like China towards countries deemed more geopolitically friendly. Additionally, there is a noticeable uptick in optimism regarding FDI from the Americas excluding the U.S., into other countries around the world, except China.

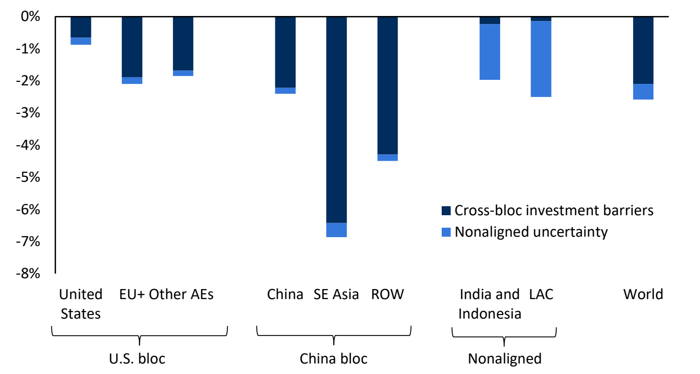
There is certainly a cost associated with the growing fragmentation as resources are allocated less optimally due to cross-bloc investment barriers (Chart 3). However, the impact on countries varies. According to the IMF's model-based quantification[1], in their baseline scenario, the U.S. is expected to suffer the least, while the EU, other advanced economies, and China may experience a ~2 per cent decline in long-term GDP losses, similar to the world average. Southeast Asia and the rest of the world (e.g., Central Asia, the Middle East, Russia, sub-Saharan Africa) are projected to face the largest negative impacts. For unaligned regions like India and Latin America, the impact on GDP heavily depends on their bargaining power, which is full of uncertainty.

Despite the potential long-term GDP losses, governments of major economies have underscored the strategic importance of supply chain resilience. In April 2022, U.S. Treasury Secretary Janet Yellen argued that firms should transition towards "friend-shoring" of supply chains. This call was influential as a growing number of larger, more profitable, and more knowledge-intensive firms expressed interest in reshoring during their earnings calls[1]. The U.S. government has enacted policies employing both 'sticks' and 'carrots' to achieve this goal. The 'carrots' include recent policy bills strongly tied to the industrial base, such as the Inflation Reduction Act (IRA), CHIPS and Science Act, and the Bipartisan Infrastructure Deal, while the 'sticks' consist of export controls and tariffs imposed on rival countries. The European Commission has also proposed the Net Zero Industry Act to counter U.S. IRA subsidies. Additionally, the French government has urged the EU to prioritize "Made in Europe" initiatives. In China, the government has provided substantial support, both financial and policy-based, to foster the growth of local advanced technology companies, aiming to reduce dependence on geopolitical rivals. It's noteworthy that many of these strategic policies are closely linked to the electrification theme we discussed back in January, emphasizing the importance of achieving electrification autonomously.

Investment Opportunities: Canada's Friend-Shoring Potential

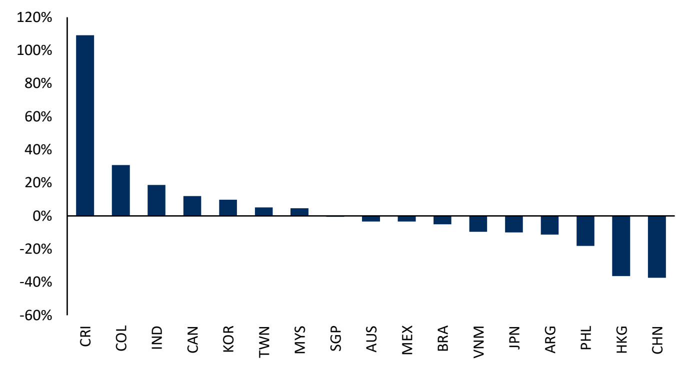
Given that Canada is the top trading partner of the U.S. and considering the longstanding binational supply chains between the two countries, any shift in the U.S. stance on geo-politics and industrial policy could significantly impact Canada as well. The U.S. is still a globalizing economy, but the "de-risking" of supply chains is ongoing. If we are going to see a push for U.S. companies to favour geographically convenient or politically secure partners and/or resurgence in manufacturing in the U.S., does Canada stand in an enviable position? Encouragingly, we have observed that Canada has been receiving more FDI from the U.S. in recent years, with geopolitical factors increasingly influencing decision-making processes. This suggests a long-term optimistic outlook for U.S.-Canada trade (Chart 4).

Chart 3 - Long-Term GDP Losses



Source: IMF staff calculations. AEs = advanced economies; EU+ = European Union and Switzerland; LAC = Latin America and the Caribbean; ROW = rest of the world; SE = Southeast.

Chart 4 - Change in Outward U.S. Foreign Direct Investment



Source: fDi Markets; IMF staff calculations. Changes are computed using the number of greenfield FDI in 2Q20 - 4Q22 and average number in 1Q15 - 1Q20. Labels on the x-axis use International Organization for Standardization country codes.

While we are still in the early phases of the reshoring trend, one thing that appears more certain is that the U.S. will prioritize friend-shoring strategic industries, particularly related to advanced technology such as electric vehicle (EV) batteries, stationary storage batteries, and semiconductor packaging[2]. These industries form a crucial component of the Canada-U.S. partnership, supported by robust binational government funding and policy initiatives. As previously mentioned, there is significant overlap between these industries and those discussed in our January piece on electrification. This is because one of the primary reasons for securing the supply chain is to facilitate a robust transition to clean energy.

On the manufacturing front, Canada and IBM have already joined forces to expand semiconductor packaging and testing capabilities at IBM's Bromont (QC) facility, creating jobs and economic activity in both countries. We also expect the U.S. and Canada to further partner with automakers, battery manufacturers, and organized labour to share training initiatives and cross-border credentials, addressing the rising demand for EVs in North America[2]. Canada's robust immigration system and highly skilled workforce will further bolster this friend-shoring trend.

Canada Has an Abundance of Critical Minerals

More importantly, Canada is one of the few Western nations that have an abundance of cobalt, graphite, lithium, and nickel — essential to creating stationary storage batteries and EVs. On top of that, Canada ranks as the world's second-largest producer of niobium, a vital metal for the aerospace sector, and is the fourth-largest producer of indium, a critical component in semiconductors and various materials essential for advanced vehicle manufacturing[3]. Therefore, we see the supply of critical minerals as a significant long-term opportunity (Chart 5). As tensions between the U.S. and China mount, there's a growing push in the U.S. to reduce reliance on Chinese imports of critical minerals. Currently, China is the leading supplier, providing the U.S. with the largest number (24) of non-fuel mineral commodities[4]. In response to this, the Canada-U.S. Joint Action Plan on Critical Minerals was announced on January 9, 2020, to advance bilateral interest in securing supply chains for the critical minerals needed in strategic manufacturing sectors. In 2020, bilateral mineral trade was valued at $95.6 billion, with 298 Canadian mining companies and a combined $40 billion in Canadian mining assets south of the border. Just two years later, in 2022, the bilateral mineral trade surged to $135.5 billion, reflecting a substantial increase of 41.7 per cent[5]. While certain minerals, like rare earths, require complex refining processes and mining projects can take 5 to 25 years to become operational, Canada's International Trade Minister Mary Ng affirms that “Canada wants to be a part of the solution”.

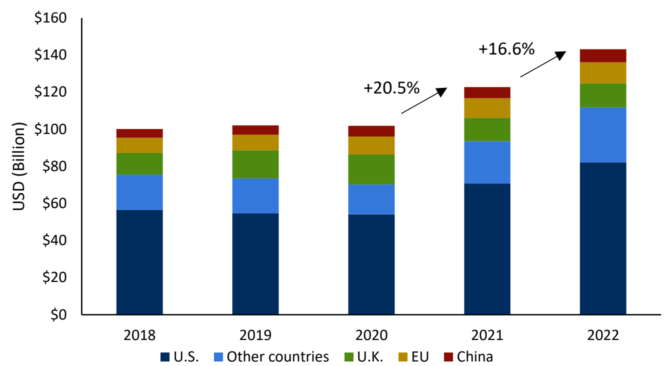
In addition to the U.S., Canada has also established partnerships with other allies concerning critical minerals. For instance, there's the Canada-EU Strategic Partnership on raw materials and the Canada-Japan sectoral working group on critical minerals. Over the past two years, we've seen several success stories in this area, including collaborations with global corporations. Two notable examples include LG Energy Solutions signing agreements to source battery minerals from three Canadian mining companies and Volkswagen's memorandum of understanding with Canada to secure a supply of battery minerals.

Investment Opportunities: Other Countries Around the World

Other countries set to benefit from the reshoring trend include India and Poland. India has a robust and cost-effective labour force, along with political stability for an extended period, making it highly attractive to multinational corporations and offering significant upside potential. For example, Apple is accelerating its shift to India to diversify its global production away from China. It's also evident that strengthening ties with India is now a top priority in U.S. foreign policy. Meanwhile, Poland, as part of emerging Europe, has experienced a rise in FDI from the Americas in recent years. According to BCI Global, over 60 per cent of European and U.S. companies anticipate reshoring some production activities from Asia back to Europe or the U.S. within the next three years. Poland emerges as one of the most favoured new production locations, thanks to its shorter delivery times, modern road infrastructure, and large warehouse stock[6]. As shown in Chart 6 below, Poland and other emerging European countries have seen significant growth in trade with the U.S. since the GFC. Although India's growth rate is slightly lower, it remains one of the fastest-growing countries, with a relatively large combined volume of exports and imports. Vietnam has also experienced impressive growth and has a significant combined trade volume. However, Vietnam faces higher non-aligned uncertainty due to its more balanced approach between the two great powers and its geographical location, which partly explains the decline in FDI from the U.S. in recent years, making its situation more complex.

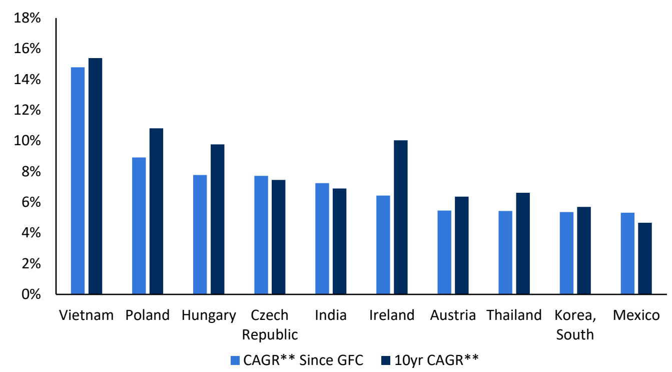
In summary, after years of increasing globalization, we are now observing a trend toward greater fragmentation globally. This shift is driven by major economies realizing the need for resilient supply chains and their strategic importance in achieving nationwide goals such as the clean energy transition. These developments mark the very beginning stages of reshoring. With changes in the U.S. stance on geopolitics and industrial policy, opportunities should arise for Canada in critical minerals and advanced technology manufacturing. Similarly, emerging Europe and India stand to benefit. Reshoring, akin to past offshore trends, is expected to remain a long-term theme for years to come.

Chart 5 - Canada: Exports for Mineral and Metal Products, Excluding Fuels



Source: Natural Resource Canada; Data as of November 15, 2023.

Chart 6 - Growth in Trade Activity* with the U.S. - Top Ten Countries



Source: United States Census Bureau; Raymond James Ltd.; Data as of December 31, 2023. *Trade Activity: exports and imports combined. **Compound annual growth rate.

[1]IMF (2023), Chapter 4 Geoeconomic Fragmentation and Foreign Direct Investment, IMF, https://www.elibrary.imf.org/display/book/9798400224119/CH004.xml

[2]The White House (2023), FACT SHEET: Strengthening the United States-Canada Partnership, The White House, https://www.whitehouse.gov/briefing-room/statements-releases/2023/03/24/fact-sheet-strengthening-the-united-states-canada-partnership/

[3]Government of Canada (2023), The Canadian Critical Minerals Strategy, Government of Canada, https://www.canada.ca/en/campaign/critical-minerals-in-canada/canadian-critical-minerals-strategy.html

[4]U.S. Geological Survey (2024), Mineral Commodity Summaries 2024, USGS, https://tableau.usgs.gov/views/MCSDashboardWorkbook_2024-01-30/MCSDashboard?%3Aembed=y&%3AisGuestRedirectFromVizportal=y#7

[5]Natural Resources Canada (2023), Mineral Trade, Government of Canada, https://natural-resources.canada.ca/maps-tools-and-publications/publications/minerals-mining-publications/mineral-trade/19310

[6]BCI Global, Reshoring Production Back to Europe and the US Is on the Rise, Particularly for Critical Parts and Final Production Processes, BCI Global, https://bciglobal.com/en/reshoring-production-back-to-europe-and-the-us-is-on-the-rise-particularly-for-critical-parts-and-final-production-processes

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