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# *Zeitenwende* in German-Chinese Trade Relations? Evidence from German Firms

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## Key Messages

- In February 2024, the ifo Institute conducted a representative firm survey on import relations with China. The survey results suggest significant changes compared to a previous survey conducted immediately before the outbreak of the war in February 2022.
- The share of German manufacturing firms that rely on important inputs from China has fallen from 46 percent in February 2022 to 37 percent in February 2024. Similar declines can be observed in wholesale (2024: 35 percent, 2022: 44 percent) and retail trade (2024: 36 percent, 2022: 43 percent).
- The share of firms that plan to reduce their imports from China has also fallen considerably and is at 38 percent in manufacturing (2022: 45 percent).
- Increasing political uncertainty has become one of the main reasons for plans to reduce imports from China (65 percent), alongside firms' general diversification efforts (80 percent).

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# *Zeitenwende* in German-Chinese Trade Relations? Evidence from German Firms

*Andreas Baur and Lisandra Flach**

The Russian attack on Ukraine in February 2022 marked not only a turning point (*Zeitenwende)* for German security policy but also for German foreign economic policy. From a European standpoint, the war served as a painful reminder of how economic dependencies can be used as political leverage, bringing the geopolitical dimension of trade relations and economic interdependencies into public focus. In particular, economic ties with the People's Republic of China are increasingly being scrutinized. The ifo Institute conducted a representative survey with German firms in February 2024 to assess changes in their reliance on Chinese inputs since the outbreak of the war and firms' plans regarding their supply relationships with China. The 2024 survey is comparable to a previous survey conducted in February 2022, just before the outbreak of the war in Ukraine (Baur and Flach 2022). This report presents the survey results, encompassing approximately 4,000 companies from the manufacturing sector as well as wholesale and retail trade.

## Fewer Firms Rely on Products From China

In the survey, companies were first asked whether they currently rely on key inputs (manufacturing) or products (retail) from China. Compared to the survey from 2022, it is noticeable that in both manufacturing and wholesale and retail trade the share of firms that rely on important intermediate inputs or products from China has fallen significantly (see Fig. 1). The corresponding share in the manufacturing sector fell by 9 percentage points from around 46 percent in February 2022 to 37 percent in February 2024. Similarly, about 35 percent of wholesale firms and 36 percent of retail firms indicate a dependence on important goods from China. Here, too, there has been a decline compared to February 2022.

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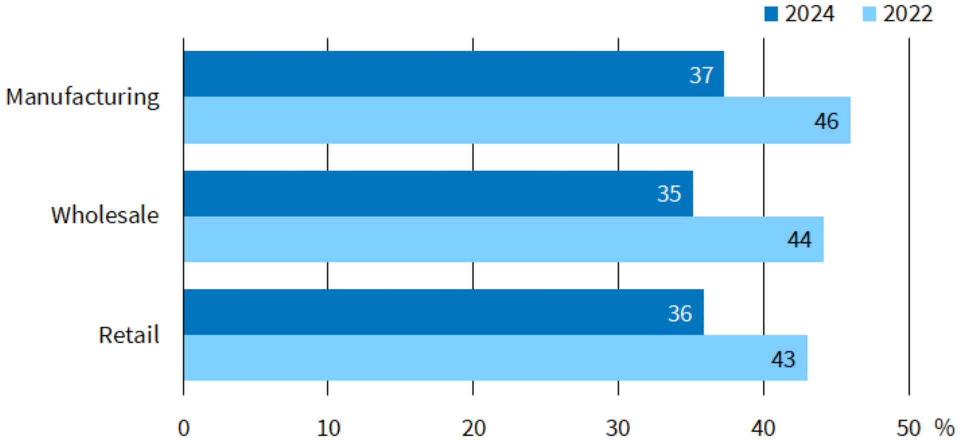
**Figure 1:**

**Important Intermediate Inputs or Products From China**

Share of firms




Source: ifo Business Survey, February 2024.

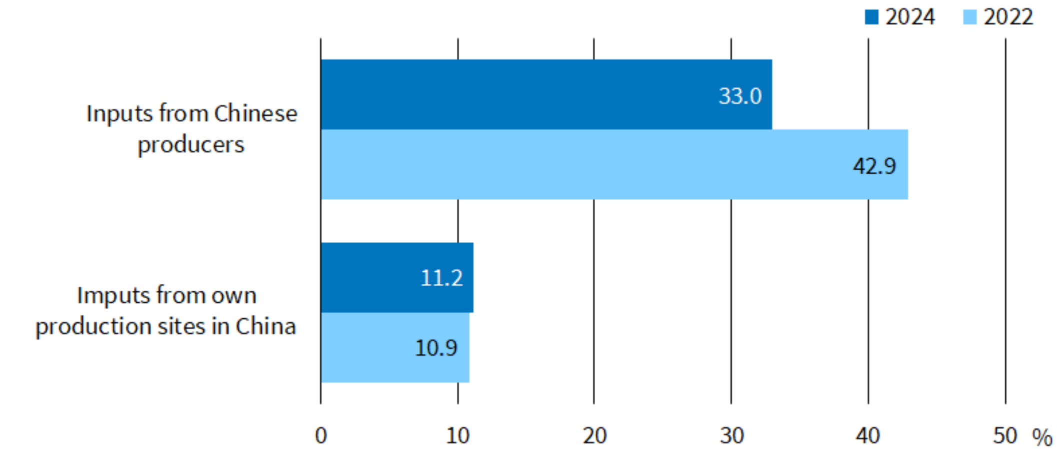


In the manufacturing sector, this decline can be explained almost entirely by the fact that fewer industrial firms are dependent on inputs from Chinese producers (see Fig. 2). This share fell from 43 percent to 33 percent. In contrast, the share of firms that source important inputs from their own production facilities in China has remained virtually unchanged and was around 11.2 percent in the current survey (2022: 10.9 percent). This clearly shows that a company's import strategy is often closely tied to its investment decisions abroad. Since setting up production facilities abroad is often associated with high fixed costs, the resulting import flows can be relatively persistent ("sticky") (Antràs 2020). This offers an explanation why the share of companies sourcing inputs from their own production facilities in China has remained almost unchanged.

**Figure 2:**

**Important Intermediate Inputs From China**

Share of manufacturing firms




Source: ifo Business Survey, February 2024.

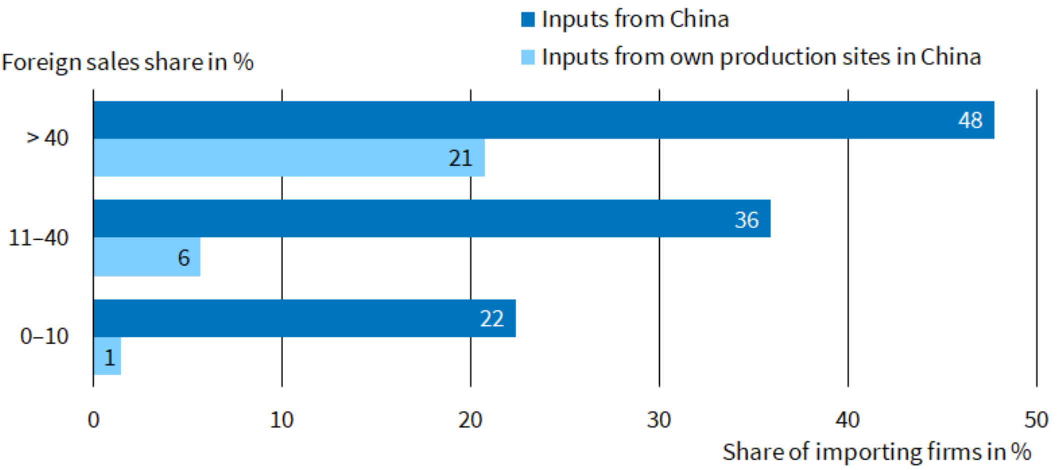


Figure 3 demonstrates the close linkage between firms' import and export activities. In particular, it is the *export-oriented* firms with high sales shares abroad that are often reliant on inputs from China. While, for example, only around 22 percent of companies that generate no more than 10 percent of their sales abroad resort to Chinese intermediate inputs, the corresponding share for companies with an export quota of over 40 percent is nearly 50 percent. In addition, for the latter group the share of companies that source inputs from their own production facilities in China is particularly high at around 20 percent.

**Figure 3:**

**Foreign Sales Share and Imported Intermediate Inputs**

Manufacturing



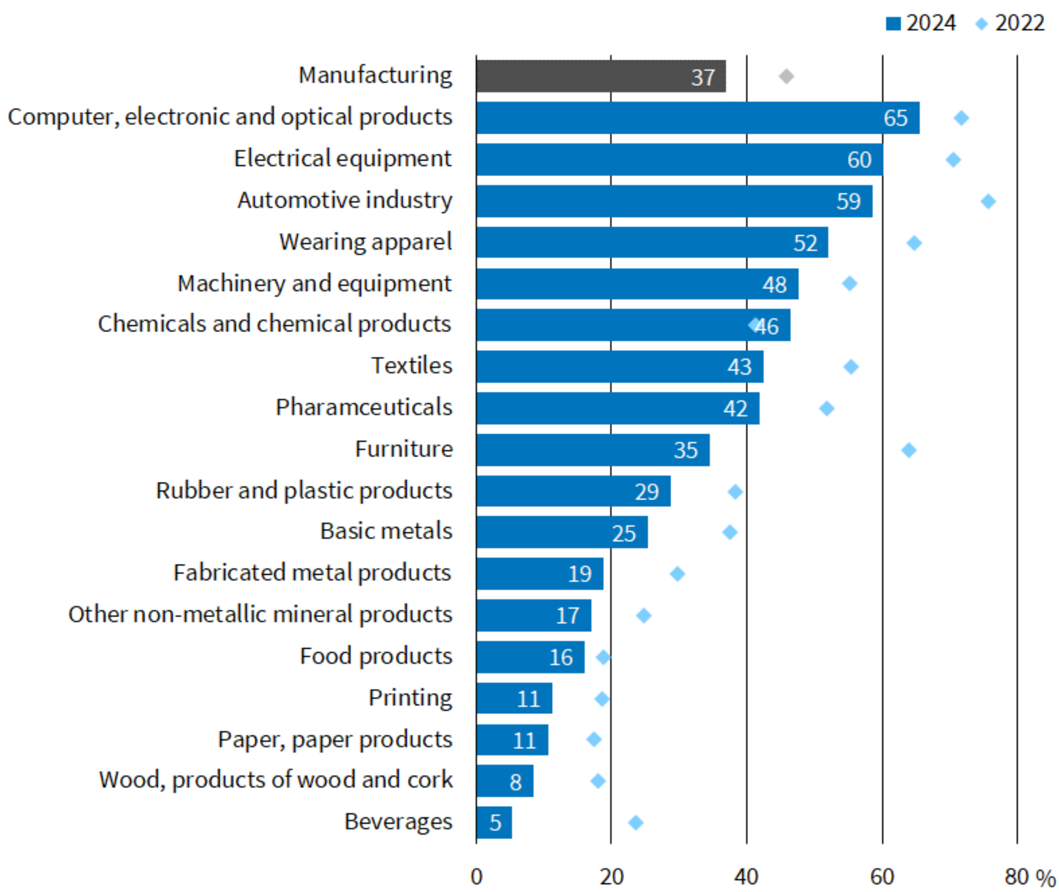

Source: ifo Business Survey, February 2024.

Due to the strong link between the export and import side, it is not surprising that companies in manufacturing industries with a strong export orientation are most frequently reliant on Chinese inputs (see Fig. 4). Manufacturers of data processing equipment, electronic and optical products (65 percent), producers of electrical equipment (60 percent) and companies in the automotive industry (59 percent) often report that they are sourcing key inputs from China. By contrast, in industries that only generate a small turnover abroad, such as beverage manufacturers or paper producers, less than 10 percent of companies report sourcing inputs from China. Compared to the 2022 survey, the share of firms that source important intermediate products from China has fallen in all manufacturing industries except for the chemical industry. The respective decline was particularly pronounced among furniture manufacturers (-29 percentage points) and in the automotive industry (-17 percentage points).

**Figure 4:**

**Important Intermediate Inputs From China**

Share of firms




Source: ifo Business Survey, February 2024.

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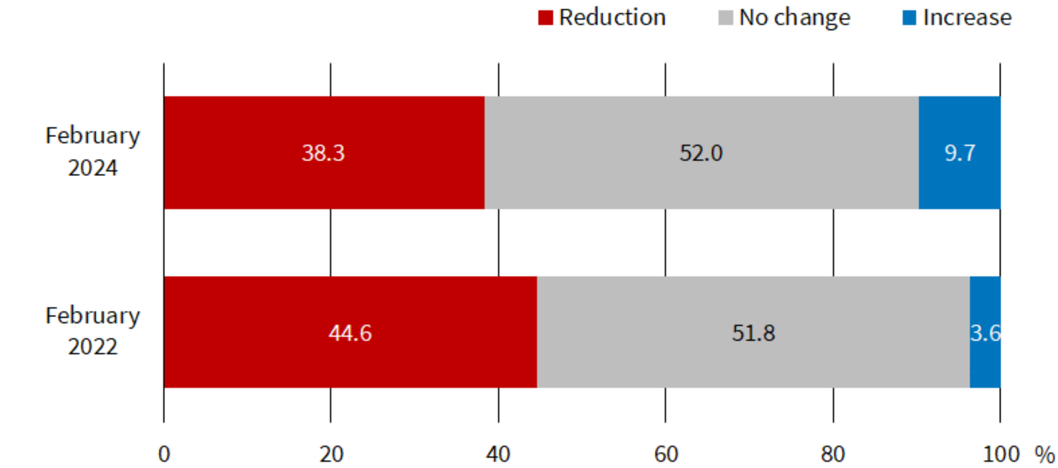
# Fewer Firms Plan to Reduce Imports From China

What plans do German companies have with regard to their future sourcing of intermediate inputs and products from China? Figure 5 shows that around 38 percent of German manufacturing firms want to reduce their imports of Chinese intermediate inputs in the future. In the previous survey in February 2022, this figure was still almost 45 percent, which corresponds to a decrease of around 6 percentage points. In contrast, the share of firms considering an increase in imports of Chinese intermediate goods has risen significantly: While in February 2022, less than 4 percent of all manufacturing firms planned to import more from China in the future, almost 10 percent indicated such plans in the current survey. In contrast, there was hardly any change in the share of companies planning neither an increase nor a reduction in imports from China: As in the previous survey, this applied to around one in two companies surveyed. Similar to the manufacturing sector, the share of companies in the trade sector that intend to import fewer goods from China has also fallen significantly (see Fig. 6). In wholesale, just under 36 percent of firms reported such plans - a decrease of around 8 percentage points (2022: 44 percent). In retail, this share fell by 16 percentage points to around 39 percent (2022: 55 percent).

**Figure 5:**

**Plan for Future Imports From China**

Share of manufacturing firms




Source: ifo Business Survey, Februar 2024.

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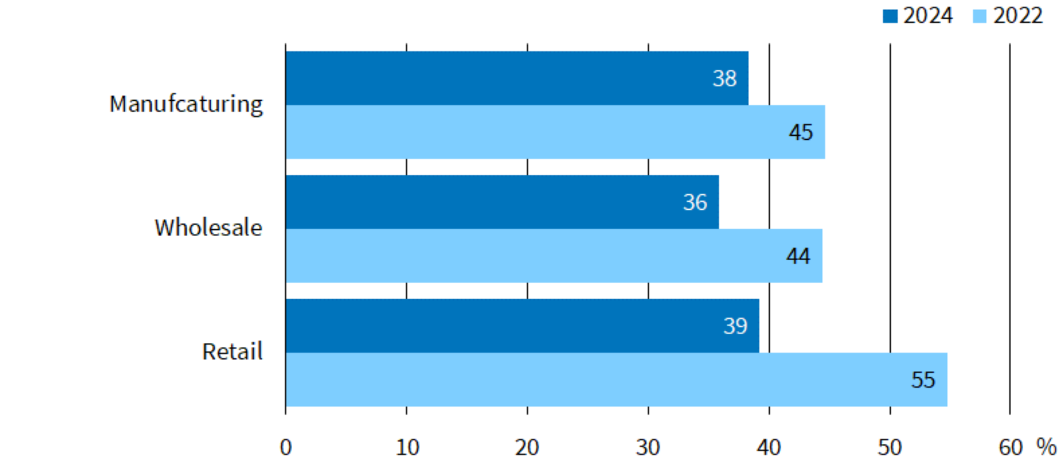
**Figure 6:**

**Planned Reduction of Imports From China**

Share of firms



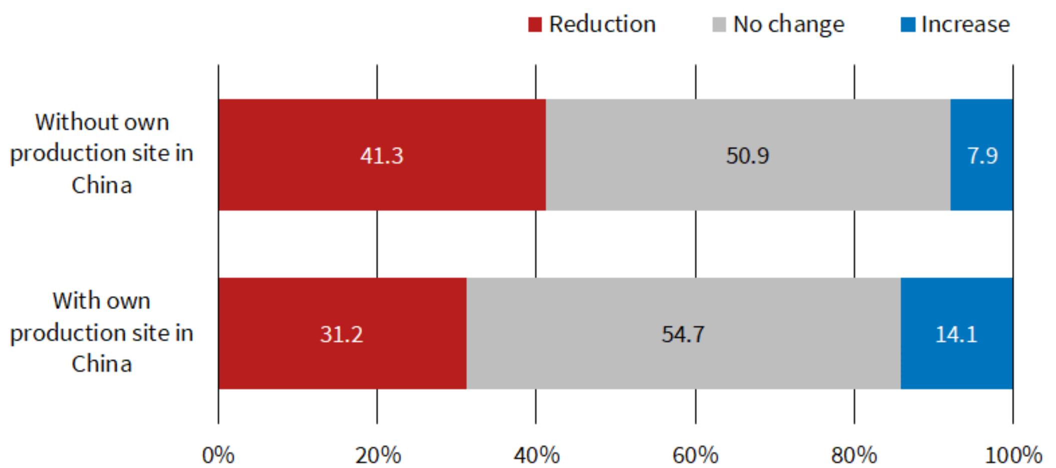

Source: ifo Business Survey, February 2024 © ifo Institute

It is noticeable that firms with their own production facilities in China are particularly keen to intensify their sourcing of Chinese imports in the future than firm without any production site in China (see Fig. 7). More than 41 percent of companies that source Chinese inputs exclusively from external firms want to reduce their imports from China, while only 31 percent of companies with their own production site in China plan to do so. Instead, companies with Chinese production facilities are significantly more likely to increase imports from China (14 percent) than companies that do not produce in China (8 percent).

**Figure 7:**

**Plan for Future Imports From China**

Share of firms




Source: ifo Business Survey, February 2024. © ifo Institute

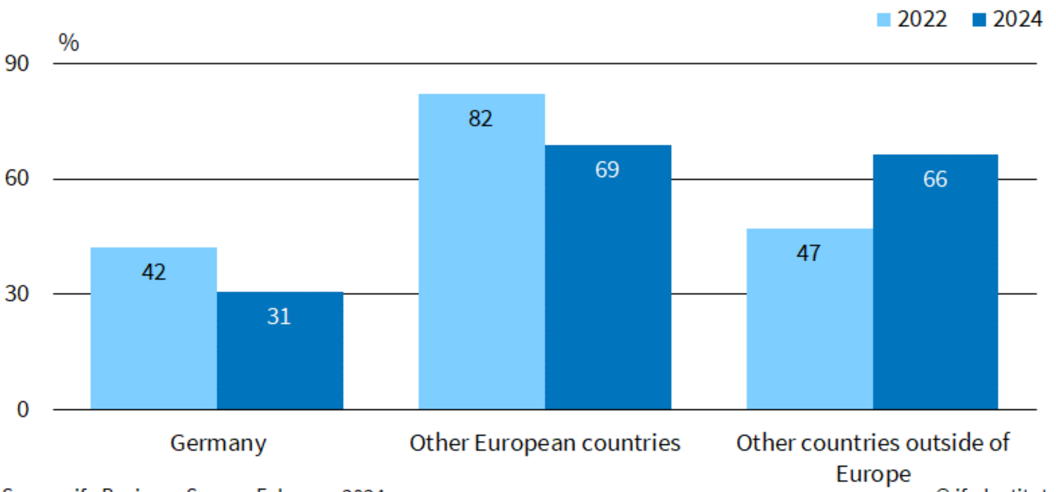
# Non-European Alternatives Gain Importance

Firms that reported plans to reduce their sourcing of Chinese intermediate inputs also indicated how they intend to replace the corresponding Chinese inputs in the future (multiple answers were possible). Compared to the survey results from 2022, it is striking that significantly more companies are now considering non-European alternatives (see Fig. 8). At the same time, fewer companies focus on imports from Germany and other European countries compared to 2022. Two out of three manufacturing firms that plan to reduce their imports of Chinese intermediate goods in the future are planning to source more intermediate goods from non-European countries in return. In 2022, this was not even half of all firms. The share of firms that plan to rely more heavily on inputs from other European countries in the context of a reduction in Chinese imports has fallen by around 13 percentage points compared to 2022 and was around 69 percent in the current survey. The share of firms that intend to replace Chinese with German inputs has also fallen by more than 10 percentage points to around 31 percent. Only 6 percent of all firms state that they would exclusively rely on more German inputs when reducing sourcing from China.

**Figure 8:**

**Planned Reduction of Imports From China, Instead Imports From...**

Share of manufacturing firms (Multiple answers possible)




Source: ifo Business Survey, February 2024.

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# Political Uncertainty One of the Main Reasons for Planned Reduction of Imports from China

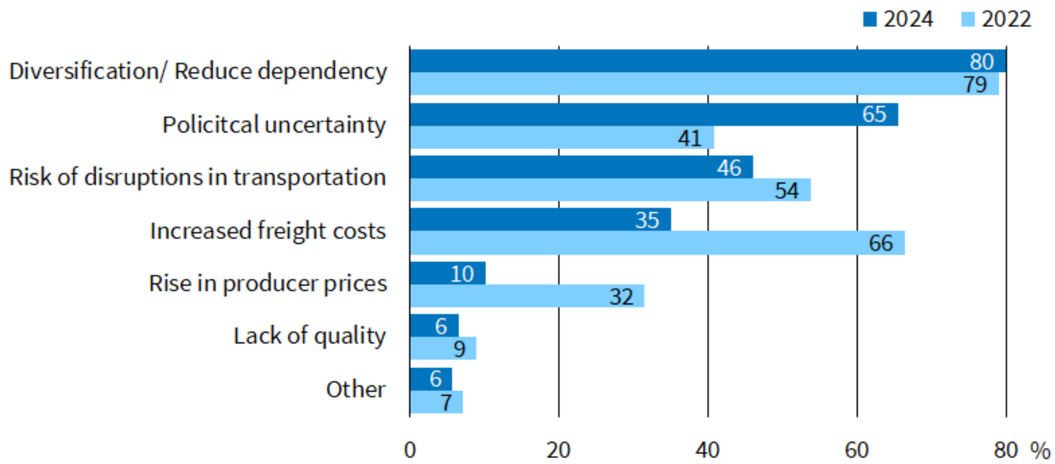
Reducing dependencies and diversifying supply chains is still the main reason why firms want to reduce their imports from Chin, as shown in Figure 9. Around 80 percent of companies cite this as a reason, almost as many as in 2022, when the corresponding figure was 79 percent. An important driver for companies' diversification efforts and the planned reduction in imports from China in general is political uncertainty: For 65 percent of the surveyed companies, this plays an important role in their plans to reduce their purchases of Chinese inputs in the future. In spring 2022, this share was still significantly lower at 41 percent. The fact that now significantly more firms want to reduce their imports from China due to political uncertainty seems plausible in connection with the Russian attack on Ukraine, which broke out immediately after the conclusion of the previous survey in February 2022. Thus, the Russian aggression seems to have also significantly raised companies' awareness of the geopolitical risks with regard to China.

The transportation of products from China is still an important issue for companies. Although increased freight costs play a significantly less important role than they did two years ago, when two out of three companies cited this as a reason for a planned import reduction, transport disruptions are still a reason for almost half of the companies to want to obtain fewer Chinese intermediate goods in the future. The importance of increased producer prices has fallen significantly compared to 2022, from 32 percent to 10 percent, which is not too surprising given the deflationary tendencies of the Chinese economy. Moreover, only 6 percent of all firms report that the lack of quality of inputs is a reason for them to reduce Chinese imports in the future.

Figure 9:

**Reasons for Planned Reduction of Imports From China**

Share of manufacturing firms, multiple answers possible




Source: ifo Business Survey, February 2024.

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# Conclusion and Outlook

Since the beginning of the Russian attack on Ukraine, German-Chinese trade relations have gained even more public attention. This new survey with German firms on their import relations with China shows clear differences compared to the first survey conducted immediately before the outbreak of the war in Ukraine. The results reveal that the share of German firms relying on important inputs or products from China has fallen in both manufacturing and retail. In manufacturing, this decline is mainly driven by fewer firms being reliant on inputs from Chinese producers. In contract, the share of firms reliant on inputs from their own production facilities in China has hardly changed. This result emphasizes the stickiness of foreign investment decisions of multinational firms. Compared to 2022, the share of firms that plan to reduce their imports from China has also fallen in manufacturing and trade and is now just under 40 percent. In this context, the importance of non-European sources of supply to replace Chinese inputs has increased for the surveyed firms, while domestic and intra-European alternatives are less frequently considered compared to 2022. Unsurprisingly, increasing political uncertainty has become one of the main reasons for plans to reduce imports from China, alongside firms' general diversification efforts. Compared to 2022, transport disruptions and freight costs are cited much less frequently by the firms surveyed as a reason for reducing imports, but still play a non-negligible role overall.

The survey results presented in this report suggest two main implications for German and European foreign economic policy. First, both surveys show that the diversification of supply chains remains an important strategic goal for many German firms, also regarding China. As firms are increasingly looking at non-European alternatives to replace Chinese inputs and goods, the expansion and deepening of the network of EU trade agreements is gaining in importance. The survey results also highlight that direct investments by German firms in China are an important factor for German imports from China and are characterized by a relatively high degree of persistence. Government support for trade diversification should therefore also focus on the role of foreign investment. The overhaul of state investment guarantees undertaken 2023 with the aim of avoiding an excessive concentration of investment guarantees in one country is therefore to be welcomed in terms of better supply chain diversification.

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