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STELLENBOSCH · SOUTH AFRICA

China's economic slowdown: assessment and implications for Africa

Three decades of average double digit growth has helped propel China into the world's second largest economy with global economies increasingly reliant on China to drive economic growth. As China transits from an investment-based economy to a consumer-based economy, its demand for raw materials is declining, affecting commodity prices, impacting on commodity sellers and exerting pressure on currencies around the world. With China's position as Africa's biggest trading partner, fears persist that the economic slowdown in China is being widely felt in Africa due to the huge trade volume between China and Africa, thus exposing African economies to spillages from the Chinese economy. This policy brief examines the current state of the Chinese economy and its impact on African economic growth and recommends a blend of policy measures aimed at curtailing the impact of the Chinese slowdown on Africa's economy.

State of the Chinese economy

China's rapid economic growth and subsequent emergence as an economic power in global economic development was based on its decision to open up its economy and institute economic reform policies in 1979. Three main factors were responsible for China's rapid growth: investment in soft and hard infrastructure, low wages and rapid productivity growth. The Chinese economy, which has had an average growth rate of ten per cent since its transition into a market-oriented economy in 1979, has been experiencing a steady decline in growth rate since 2011. Its growth rate fell from 10.6 per cent in 2010 to 7.3 per cent in 2014 and further dropped to 6.9 per cent in 2015. In 2011, China's policy-makers mindful that double digit growth is unsustainable in the long run commenced implementation measures to alter its growth structure towards a more sustainable model. China's 12th Five-Year policy plan (2011-2015) started looking inwards for growth, placing strong emphasis on promoting consumer demand, addressing income disparity, boosting energy efficiency, reducing massive carbon emission and deepening economic reforms.

Certain factors are responsible for the deceleration in China's economic growth. Firstly, growth at double digit level is unsustainable when a country attains a certain level of Gross Domestic Product (GDP) and a certain level of GDP per capita.

Singapore, Taiwan and Korea all experienced single digit growth of 6-6.3 per cent when their GDP per capita reached US\$ 7,000 (Lin, 2016). Thus, China with a GDP of about US\$ 10 trillion and a GDP per capita of almost US\$ 7,000 is expected to experience a similar process of deceleration in its quest to transit to a developed economy, but to sustain its growth, investments in innovation and research is required. Also, weak recovery in global growth in the aftermath of the 2007-2009 recession and instability in the economic and financial situation in Europe, Russia and Brazil has led to a slowdown in international trade growth as global export growth rate fell to 6.1 per cent in 2014 and to -1.8 per cent in 2015 (Lin, 2016). The global demand for Chinese goods has been so weak that Beijing expects little contribution from exports in 2016 (Beijing AP, 2015), hence deciding that domestic demand will be the driver of future growth (Lin, 2016).

Structural changes in the labour market are another factor responsible for the deceleration. Low wages was the fulcrum of China's economic success which allowed China to undercut firms in developed economies. China's aging population has however, brought challenges to the Chinese labour market and exemplifies the notion that limits exist to the rate in which labour can contribute to the economy. China's population is getting older at a rapid pace and a government think tank

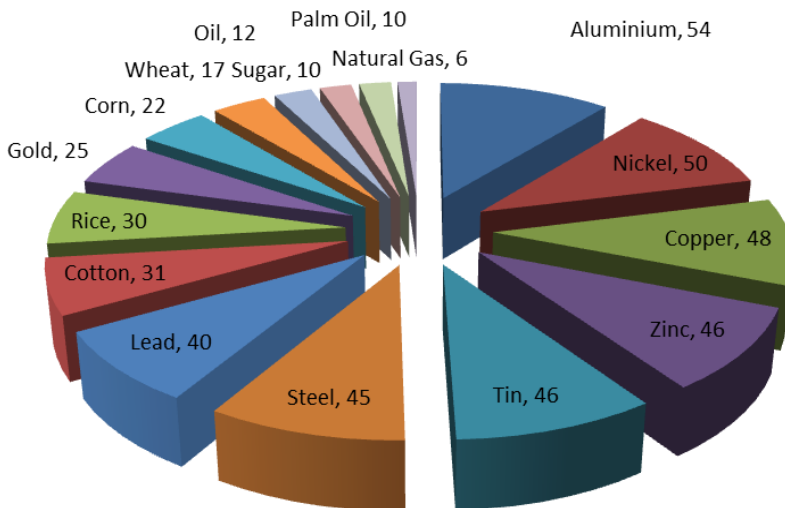


Figure 1. China's share of global consumption (UNCTAD, 2015)

in key sectors of the economy.

To economists, China's structural deceleration is inevitable. It signals the change in China's growth model caused by narrowing the technological gap with developed economies, thus, necessitating a shift into the service sector. With China accounting for approximately 17 per cent of global economic activities (BBC, 2015) - see figure 1, a percentage fall in Chinese growth will result in a 0.5 per cent fall in global growth (Independent, 2015). This can lead to a significant spill-over effect on the global economy by disrupting global trade and hindering growth, especially in developing economies.

China's impact on Africa

report forecasted 25.9 per cent of the total population will be aged 65 or above in 2050 (East Asia Forum, 2013). China's one-child policy which initially created an economic boost has contributed to the falling birth rate, created a lopsided demography, and a shrinking workforce with the labour market projected to decline by 30 per cent in 2050 (CNBC, 2012). The consequence is an increase in average wage cost with the minimum wage rising by 10.37 per cent in 2013 and 11 per cent in 2014 (Bloomberg, 2014). This is rendering Chinese firms to be less competitive in low value, labour intensive industries such as the textile and plastic industry and requiring a shift towards an innovation-led economy.

The deceleration of China's economic growth is also caused by Beijing's attempt to control China's excessive investment rate which was becoming unsustainable. China's investment ratio as a percentage of GDP stood at over 48 per cent in 2014 (Economist, 2014) as an initial high investment rate was required by China in its attempt to bridge infrastructural gaps needed to spur economic growth. Recent investment and stimulus programmes undertaken in the wake of the 2008 recession have been less productive due to the infrastructural gap been filled. An International Monetary Fund (IMF) 2015 report estimated that China may have been over-investing in recent years by around 10 per cent of its GDP, with the cost falling squarely on households. China's excessive investment now tends to channel scarce resources to commercially unviable sectors and away from household consumers leading to waste and creating asset bubbles. A case in point is the slowing property market which, with the exception of Beijing and Shanghai, has been experiencing a fall of approximately 26 per cent in prices in surrounding cities leaving tens of millions of empty apartments termed "ghost cities" as investment with nobody wanting to or able to afford them (Zero hedge, 2016). The Chinese government is now attempting to regulate investments so as to avoid slumps

The sixth Forum on China Africa Cooperation (FOCAC) barely masked the reality of China's economic slowdown and its impact on Africa's economies. As China's economy transits, its demand for commodities is falling, dragging down prices and affecting commodity sellers worldwide - see figure 2. Also, to smoothen out its transition process, China is allowing its currency to decline in value, so it can sell more goods to foreign economies and solve its overcapacity problem. In 2009, China surpassed the United States (US) as Africa's major trading partner with bi-lateral trade between China and Africa valued at US\$ 210 billion in 2013, up from US\$ 10.6 billion in 2000 (The hill, 2014). Such trade volume has made Africa's economies increasingly reliant on the Chinese economy to power its growth. China's insatiable demand for commodities have driven African export and growth over the past two decades enabling Africa's GDP to grow an average of 5.5 per cent in the past decade (Economist, 2013); as well as offer a buffer to African economies from export volatility during the global economic crises of 2008 and 2009 when there was a decline in commodity importation from developed economies. Concurrently, cheap Chinese imports from clothing to cell phones and computers have also led to improved standards of living and helped reduce inflation in Africa by exerting downward pressure on global prices. Africa will, however be impacted through the following:

Currency devaluation

The decision by the People's Bank of China on 11 August 2015 to devalue the renminbi by about two per cent against the US dollar is having immense repercussions in African countries from diversified economies like Egypt and South Africa to single export economies like Gabon and Angola. This monetary policy which was an attempt by Beijing to shift growth momentum back to China "devaluing its currency to boost exports and investments" is having a tremendous impact on the trade relationship and the current account balance between Africa and China. The

devaluation makes Chinese exports relatively cheaper to import to Africa, and Africa's exports more expensive to import in China since most international trade is conducted in the US dollar. This will be beneficial to African consumers as they will have access to an array of cheaper Chinese goods and machinery. Following China's renminbi devaluation, economies in Africa with strong export ties to China especially the region's top ten commodity exporters are feeling fiscal pressures to devalue their national currencies as growth concerns and currency stability trumps inflation fears. The Egyptian dollar, the Zambian kwacha and the South African rand all lost 13, 13, and 10 per cent of their respective value (Securities Africa, 2016; Bloomberg, 2015). The devaluation will also impair or act as a disincentive to outward direct investment as domestic wages and salaries become relatively more costly for private Chinese firms looking to invest in mining and manufacturing sectors such as textiles, steel and glass industries.

Aid/loans and investments

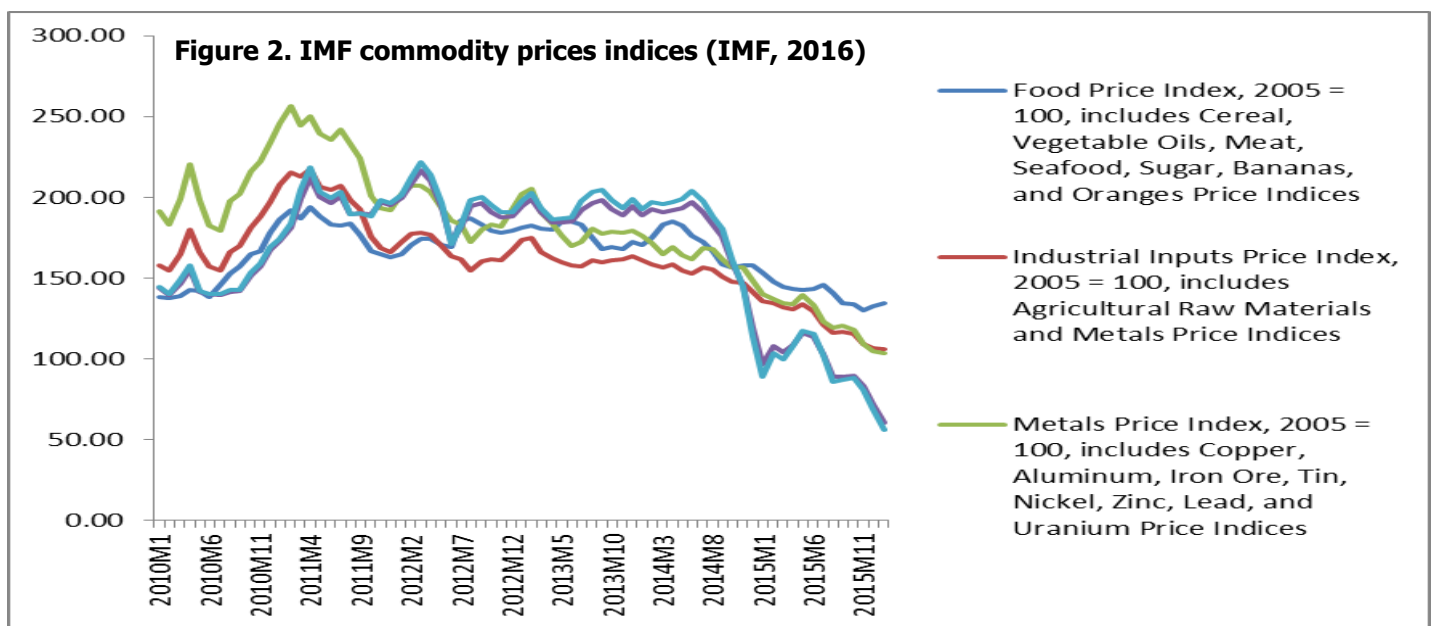
China has been an important source of funding and loans for infrastructural development in Africa. A quarter of Chinese engineering contracts globally were undertaken in sub-Saharan Africa (IMF, 2015). China's state-owned enterprises (SOEs) have undertaken massive road, railway, power plants and airport constructions across Africa and China's loan as a percentage of Africa's total debt rose from two per cent in 2005 to approximately 15 per cent in 2012 (IMF, 2015). China's economic slowdown, however, is making borrowing cost and debt servicing higher for developing economies as Chinese reserves channelled into loans to finance infrastructural development in Africa are increasingly becoming more expensive for African economies to service in the face of dwindling revenue from commodity sales. Also, the SOEs faced with fewer funds for investment purposes are renegotiating or

putting on hold investment and infrastructural contracts as the Chinese government tries to bolster its reserves. The Financial Times (2015) reported a contraction of 84 per cent in Chinese Greenfield investments and existing project expansion in Africa, while spokesmen at China's Ministry of Commerce (MOFCOM) on 17 November 2015 reported a 40 per cent fall in total investment to Africa in the first half of the year compared to the same period last year. This does not bode well for infrastructural development as well as job creation in Africa.

Commodities and commodity prices

China's position as the fastest growing economy in the past decade was based on a growth model of investment and export and this led to increased demand for commodities. China consumes 20 per cent of non-renewable resources, 40 per cent of base metals and 23 per cent of agricultural produce globally (IMF, 2012). Export dependent economies are usually more susceptible to commodities and commodity price fluctuations which are felt more in their current account balance and on their economic growth rate since a country's commodity basket and its trade partner usually determine the level of susceptibility.

China's economic transition implies less production of goods leading to less demand for African commodities. This creates an artificial global surplus, thus, pushing down commodity prices. The IMF commodity market reported an 8.1 per cent fall in commodity prices stretching price losses to eight months. Ore and metal prices decline reached their lowest figures since 2005 while mining sectors across Africa are expected to embark on labour cuts due to reduced commodity demand and revenue from China. The fall in copper prices in Zambia is leading to closures of mines and workers retrenchment while in South Africa, it is estimated that 19,000 jobs in the mining sector are



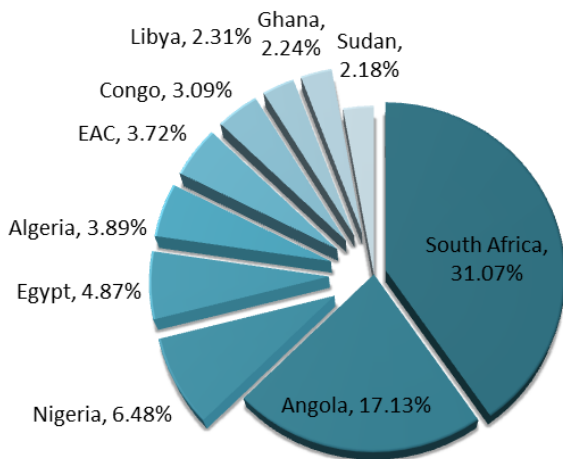


Figure 3. China's Africa top trading partner (UNComtrade, 2015)

at risk due to the Chinese slowdown (SCMP, 2015). Also, royalties and mining taxes accruing to the country are expected to fall leading to cuts in public spending. The impact of the downturn will differ substantially amongst countries based on the commodity exported, its quality and quantity, the percentage share of GDP that is exported to China and administrative policies taken by decision makers to ameliorate the impact of the slowdown. African economies with higher export ratio as a percentage of their GDP to China such as Angola, Sierra Leone and Zambia as well as countries with less diversified economies like Gambia and Mauritania will be more vulnerable to the Chinese slowdown – see figure 3. However, non-commodity exporting economies particularly in East Africa like Rwanda, Ethiopia and Kenya that were forced to engage in export diversification due to a shortage of minerals will continue to experience economic growth.

Conclusion and recommendations

Given the demographic estimation of Africa's population growth, with a projected estimate of the labour force (20-65 years) exceeding the rest of the world combined by 2035 (Bloomberg, 2015), China's economic slowdown can create opportunities for African economies with its comparative labour advantage and abundant resources if properly addressed. Africa's destiny is dependent on its economic structure and more importantly, how it readjusts to China's shift towards a new regime. To ameliorate the impact of the slowdown, the following measures are suggested:

- Africa's policy-makers should undertake and implement deep structural reforms for the transformation needed for

increased productivity and growth in all sectors of the economy with particular emphasis on agriculture.

- Africa can be a major beneficiary of China's outsourcing if it undertakes reforms and invest in infrastructure. In Ethiopia, Chinese investment is creating a new global hub in the leather and shoes sector due to cheap labour, availability of raw materials and favourable government policies.
- Africa can take advantage of China's transition by selling goods and services to China such as the Western Cape provincial government's "Project Khulisa" strategy of promoting the province's wine and fruits to new markets like China.
- African economies can consider engaging in currency devaluation as suggested by the IMF. A weaker currency will have the effect of reducing demand for import goods in favour of domestically produced goods, and boost exports, which in turn will reduce unemployment and set in motion economic growth. Devaluation, however, has inflationary tendencies.
- African economies should move towards diversification from primary commodities to accelerate economic growth. Botswana's decline in diamond sales and the government's response in creating a number of economic hubs in education, innovation and agriculture to diversify the economy away from diamonds is helping to mitigate commodity shocks and enhancing economic growth.
- Finally, African economies should undertake energy subsidy reforms by cutting fuel subsidies to align domestic prices with international prices. Fuel subsidies have been noted to divest an economy of scarce resources critical to other priority sectors and delay the adoption of energy efficient technologies.

Dr Emmanuel Igbino
Research Fellow
Centre for Chinese Studies
Stellenbosch University



Contact Us

Centre for Chinese Studies
 Stellenbosch University
 Private Bag X1
 Matieland 7602
 South Africa

Tel: +27 21 808 2840
 Fax: +27 21 808 2841
 Email: ccsinfo@sun.ac.za
 Web: www.sun.ac.za/ccs
 Twitter: CCS_STELL

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