China’s economic troubles ripple worldwide

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As the Chinese economy continues to falter……

………the spillover is expected to impact exposed economies around the world. Many Asian economies are dependent on Chinese trade and are likely to be the hardest hit, but countries in Europe, Africa and Latin America could also face significant impacts.

The country’s economic woes are fuelled by a long-term property market slump, with new home prices falling by the fastest rate in a decade last month. Consumer and business confidence remains low, while youth unemployment is worryingly high.

China's economy is also feeling the impact of deeper societal changes, with a falling birth rate and ageing population adding to the sense of stagnation.

China struggles to respond

The seriousness of the situation is perhaps best exemplified by Beijing’s response. In September, China’s central bank announced a raft of measures, which largely focused on monetary policy. Lower interest rates, cheaper mortgages and extra money for local investment projects were part of the package.

While these measures were initially welcomed by investors, many economists fear that the package may be too little, too late. While there may be some welcome short-term relief, they argue that the package fails to address wider structural problems in the Chinese economy.

The biggest weakness of the stimulus so far is that it will do little to improve demand. Consumer confidence is low, partly because of the damage the housing crisis has done to household wealth. Despite looser mortgage rates and downpayment rules, consumers are staying away from new homebuilding projects. Positive incentives at the micro level would be needed, such as financing unfinished projects. In addition, more direct fiscal support to households to stimulate spending would help. Further fiscal measures have been announced, but it remains to be seen whether they will be enough to support the real estate sector and domestic demand.

In other words, nobody is expecting a quick fix to this enduring China crisis. With that in mind, economies and sectors with strong ties to China are being advised to brace for impact.

Asian economies most at risk

China is the world’s second largest economy. It accounts for around 10% of world trade, 16% of world (nominal) GDP and 17% of world oil demand. Nobody is entirely immune from the effects of China’s economic woes.

But in the league table of risk, Asia-Pacific economies occupy the top positions. In terms of trade, regional neighbours like Taiwan, Singapore, Australia, Malaysia, Vietnam and South Korea are highly exposed. In all these countries, value-added exports to China are 5%-10% of GDP.

The Chinese economic revolution pulled millions of citizens into the middle class and created unprecedented demand for goods that businesses across Asia were happy to fill. That middle class is now experiencing a prolonged crisis of confidence, and the ripples are being felt across the entire Asia-Pacific region.

Europe and Africa have reasons to be fearful

Anxiety is also being felt further afield, albeit for different reasons. For example, China is the top provider of Foreign Critical Inputs (FCIs) to the EU’s industries, making Europe vulnerable to any disruption in supply.

Many of these FCIs are essential to European manufacturing and not readily available elsewhere. They include microchips, turbine parts, the chemicals required for drugs and electric batteries, and hundreds more.

In 2022 a third of FCIs imported by the EU from extra-EU countries came from China. Research described in a European Central Bank (ECB) blog found that a halving of that supply would result in a drop in manufacturing value added of between 2% and 3.1% across five EU economies.

At the same time, China is sub-Saharan Africa’s largest single country trading partner. According to the International Monetary Fund (IMF), a one percentage point fall in Chinese GDP could result in an average 0.25 percentage point decline in growth across the region. African countries that export oil to China may be impacted most of all.

Sector impacts

Commodities feel the pinch

In terms of sectors, commodities are already feeling the impacts of China’s property crisis and manufacturing slump and have been for some time. When countries build less, they slash their imports of aggregates, chemicals and iron ore, among many others. Struggling industries need less fuel and raw materials. Squeezed consumers buy less coffee. We could go on. Russia, Chile, South Africa, Brazil and Australia, as well as commodity-exporting Asian neighbours like Malaysia and Indonesia, are likely to lose out most if the Chinese downturn continues.

Electrical equipment squeezed on two sides

The electrical goods sector is impacted in two ways. With fewer homes being built and bought - and consumers wary of big ticket spending - exports of electrical goods into China inevitably fall. “At the same time, the supply risk grows considerably,” says Kyle Kong, ICT specialist at Atradius. “Imports of FCIs into electrical goods manufacturing in Europe and Asia may be disrupted, as the economic slowdown leads to insolvencies in China and a reduction of the number of suppliers. An enduring slowdown would be bad news for overseas manufacturers who rely on components from Chinese factories, and doubly so for those who then export finished products back into the Chinese market.”

The ECB research into the impact of a Chinese slowdown on five EU economies, which assumes a halving of supply, found that the electrical equipment sector would experience a median value-added decline of around 7%.

Machinery falls silent

Last year, US building site machinery manufacturer Caterpillar warned that demand from Chinese construction companies was worse than originally thought. A year on, little has changed. “The Chinese property sector remains in a serious slump, though we will have to wait and see if the recent government stimulus package has an impact,” says Dimitri Pelckmans, Head of Risk Services Belgium and Luxemburg at Atradius. “When companies aren’t constructing buildings, they don’t need construction machinery, creating problems for manufacturers in the US and Europe.”

In addition, Chinese factory activity shrunk for the fifth straight month in September This reduces investment and, with it, the demand for new manufacturing machinery. It also puts the flow of components into foreign factories at risk.

Chemicals, base metals and electronics are other sectors that could be hit hard by a prolonged Chinese slowdown.

The global impact of China’s struggles

Against this backdrop, many business leaders and economists are wondering how bad it might get.

Modelling by Oxford Economics suggests that, in the worst-case scenario, the GDP of countries with deep trade links to China would suffer a 1% fall by 2026. Those countries include South Korea, Taiwan and Vietnam. In the same scenario, the GDP of commodity exporting countries like Russia, Brazil and South Africa falls by 0.5%. Australia is among a small group of nations that face risk on both sides.

But this fallout might be reduced by a strong policy response from the Chinese government, and in particular a fiscal stimulus package that targets tax cuts, subsidies or direct cash transfers. This has yet to happen, but the research suggests the worst global impacts might be avoided if Beijing prioritised fiscal intervention alongside the monetary measures already announced.

At the moment, the best policy for interlinked economies is to hope for the best but prepare for the worst. Our own research forecasts a 23% increase in insolvencies in the Asia-Pacific region in 2024, largely driven by China’s growth slowdown.

Countries with low trade and financial exposure to China - the US is one - are likely to be less directly impacted. Nevertheless, China’s position at the heart of global trade and international supply chains means a return to stronger growth would provide a welcome boost to economic prospects around the world.