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The new coupling between China and Africa

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Contents:

Much has been said of a “de-coupling” in the global economy between slow growth recessionary Western economies and relatively high growth Eastern economies. Slowdowns in growth in China, India and Southeast Asia show that in a global economy, the notion of de-coupling is invalid. A more accurate economic reality is an emerging trend of “new coupling” – coupled economic growth destinies of China and Africa. According to the International Monetary Fund (IMF), Africa‘s GDP grew at 5.2% in 2008. This is robust by any standard and was largely achievable due to buoyant commodity prices and strong demand from the Chinese economy. In recent years China’s demand for resources has underwritten African growth.

From the other perspective, for China to continue to achieve high rates of GDP growth into the future, its manufacturing economy requires key commodities and energy imports. Considering China‘s growing investment presence and influence on the continent, Africa will increasingly be the supplier of these resources. Chinese roll out of infrastructure in Africa is partly designed to facilitate this process - to alleviate supply side transportation constraints. Thus China‘s growth prospects will increasingly become more dependent upon African economies abilities to supply raw materials. This is the new coupling where China and Africa‘s growth trajectories become intertwined.

Stimulus to boost economy

China‘s post Olympics slowdown is of global concern. In October, China‘s

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industrial growth slowed quite dramatically dropping 9.7% year-on-year from 2007. The reason for the drop is attributed to cancelled orders for Chinese manufactured exports. The drop in demand for Chinese manufactured goods has been sudden. In October, Chinese exports of steel fell over 31% from the previous month. Already over-capacitated, many smaller steel manufacturers will be facing closure in the coming months as supply far exceeds demand. This painful process will force much needed consolidation and increased competitiveness for the steel sector.

With Western economies heading toward recession, China is the only major economy that continues to grow at a decent figure. To reinvigorate slackening growth, the PRC Government has announced a large RMB4 trillion (US$586 billion) stimulus package. The stimulus will boost spending by 1-1.5% of GDP with most of the spending not new but will be focused on accelerating spending on existing projects. Most spending will come from provincial rather than central government funds.

The challenge lies not in a lack of capital but in the implementation of the infrastructure projects. As the increased spend comes on line from March next year, it will begin to boost metals demand in China. But it is arguable whether the increased infrastructure spending will offset loses being suffered by China‘s export oriented sector. It is to be expected that Chinese firms will seek to offset their declining exports to traditional western markets by seeking new export destinations in the growing emerging economies, including Africa.

Declining African growth

The IMF has recently downgraded the growth prospects of Africa for 2009 to 3.4%. In light of plunging commodity and energy prices, this figure may be reduced further in the coming quarter. Reflective of the lack of ability to beneficiate its resources, approximately 80% of Africa‘s exports to China are just four commodities – oil, iron ore, wood and diamonds.

It is expected that global demand for metals will reach its trough in the first quarter of 2009 and begin to pick up thereafter. An effective role out of the stimulus package will begin to boost commodity prices and lead to China being the primary driver of global growth – perhaps accounting for over one-third. The global economy is looking to China to once again kick start growth both through infrastructure and consumer spending.

A trend that may emerge in 2009 could be the counter-cyclical practice of Chinese mining firms to make acquisitions in Africa‘s mining sector. Ignoring suppressed commodity prices and taking a longer term view of investment in the sector, Chinese mining firms backed by sovereign wealth fund capital may be more bullish to acquire African mining assets in the coming year. These investments could centre around the special economic zones that the Chinese government is establishing in conjunction with African economies on the continent.

Chinese state-owned mining firms could well increase their footprint in Africa over the short term.

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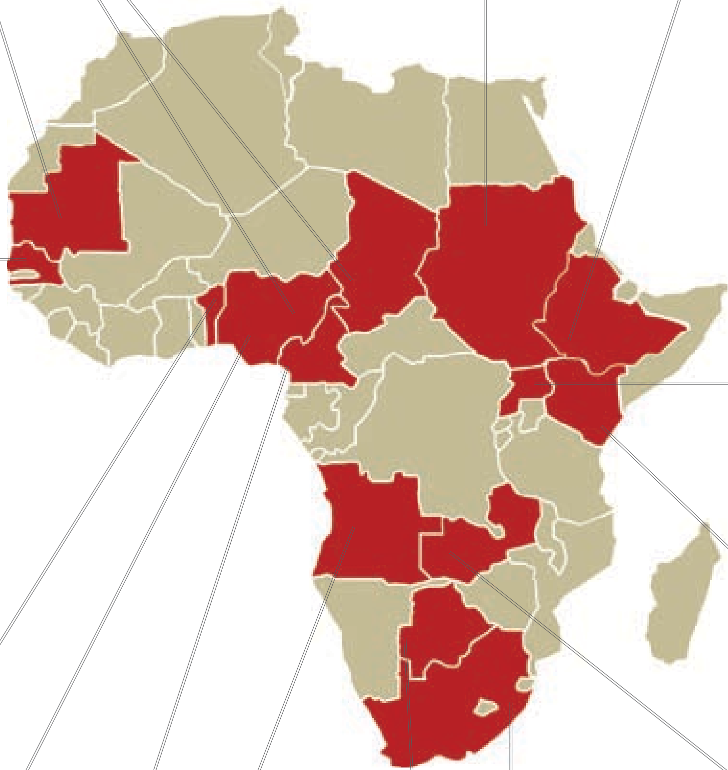
China in Africa Hotspots

Chad & Nigeria
China reveals plans to build oil refineries
The state-owned China National Petroleum Corporation (CNPC) signed a US$5bn deal with Niger's government to build the country's first refinery, and to pump oil from the Agadem block and build a 2000km pipeline to export it. In neighbouring Chad the CNPC will establish a refinery in N'Djamena. Both refineries are expected to refine 20 000bpd within the next three years.

Sudan
Sinohydro nets US$300mn contract in Sudan
Stated-owned Sinohydro Corp, the largest hydropower engineering and construction company in China, has gained a US$300mn order in Sudan to construct 486km of roads in the country, according to a statement posted on the website of the State-owned Assets Supervision and Administration Commission (SASAC).

Ethiopia
Chinese telecoms gear maker agrees to build national network
Ethiopia Telecommunications Corp (ETC) plans to boost mobile subscribers to 15 million in two years using US$1.5bn from China's ZTE Corp. ZTE Corp is building a US$5.2mn plant in northern Ethiopia to make handsets, and industry sources say it will also set up a CDMA network with capacity for 2.4 million Ethiopian subscribers.

Mauritania
Chinese to invest in Nouakchott expansion
China is set to invest US$282mn in the expansion of the Mauritanian port of Nouakchott. The deal is expected to lead to a threefold increase in the port's capacity by constructing new quays.



Uganda
China to build free trade zone
Chinese company Paradise International Investment Ltd is investing US$1.5bn in the Lake Victoria Free Trade Zone in Uganda. The company has drafted a five-year plan to develop the area with around 40 companies interested in setting up there. Companies operating in this zone will be exempt from paying income custom, corporate income and value added taxes.

Senegal
China signs US$90mn Senegal deals
Visiting Chinese President Hu Jintao's delegation signed a loan and aid deals worth US$90mn with Senegal in February. The deals included a US$23.25mn loan to renovate Senegal's public buses and financing for a US$49.26mn secure government communications system.

Kenya
Kengen awards hydropower contract to Sinohydro Corp
Kenya Electricity Generating Company (Kengen) has awarded China's Sinohydro Corp a US$65mn contract to build a new 20MW hydropower plant in western Kenya.

Benin
China signs pact
China and Benin signed an economic and technological cooperation pact in December 2008, with China providing almost US$5.98mn in aid and assisting in the construction of a fly-over bridge at Cotonou and a research hospital in Pakarou.

Zambia
Zambia launches US$400mn Chinese-engineered power project
Zambia has launched a US$400mn power project on the Kariba North Bank which will add 360MW to the country's existing power generation capacity. The Kariba North Bank expansion is being constructed by China's Sinohydro Corp. China's EXIM Bank provided 85% of the funding, while the Development Bank of South Africa had provided the remaining 15% according to reports.

South Africa
CADFund opens SA office
In mid-March, the China-Africa Development Fund (CADFund) opened its first representative office on the continent in Johannesburg, South Africa. With an initial tranche of US$1bn, the fund has already invested about US$400mn in various projects on the continent.

Nigeria
Chinese firms sign US$16mn pact on vehicle plant
Nigeria's Matreach Logistics Limited and its Chinese partner, Monde have reached an agreement to establish an assembly plant for the production of three-wheel and four-wheel vehicles in Nigeria. The construction of the assembling plant is in the second phase of the agreement and it is expected to commence in 2010.

Angola
Angola wins new billion-dollar loan from China
Angola has secured another loan amounting to US$1bn from China, to be spent on developing its agricultural sector. The southern African country has already received at least US$5bn in credit from China to pay for its post-war reconstruction.

Botswana
Botswana Power Corporation signs deal with Chinese firms for development
Botswana's state-owned energy utility has signed a contract with China National Electric Equipment Corporation and Shenyang Blower Works Electro-Mechanics Import and Export Co. Ltd for the development of a 6000 MW power station. The coal-fired, air-cooled plant will have four 1500 MW units and will be constructed adjacent to the existing Morupule Power Station.

Cameroon
Chinese companies to build fertiliser plant and cement factory
China's Overseas Construction Group Co. Ltd (CGC) plans to build a fertiliser plant and a cement factory in Cameroon worth a combined 170bn CFA francs.

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China, Africa and the Global Recession

Carien Els, Analyst — Frontier Advisory

With all indicators pointing to a drawn-out global economic recession, concerned parties are wondering how severe the implications of the economic downturn will be for the developing world and Africa in particular. Countries on the African continent have become increasingly dependent on Chinese aid, trade, and investment, particularly in the infrastructure and extractive sectors in recent years, and any impact that the economic downturn will have on China is likely to be felt by Africa too.

China is a major trade and investment partner to Africa, with major investments across the continents in a wide-ranging scope of sectors including agriculture, mining, construction & engineering, tourism and energy. In the last decade, Sino-African trade has grown by an average of 30% per year, reaching a high of US$ 106.8 billion in 2008, surpassing the US$100 billion mark set for 2010 two years ahead of schedule.

Though initial reports speculated that developing countries would be substantially less affected by the financial crisis than their developed counterparts, the economies in the global South are starting to show signs of considerable economic stress. Chinese exports and imports contracted drastically in value terms in February and industrial production and consumer demand have witnessed a dramatic slump. The Economist Intelligence Unit has downgraded its growth forecasts for China, with real GDP forecasts for 2009 down to 6% from 2008's estimated 9%. This effectively would be China's slowest growth rate since 1990.

China's economic downturn preceded the global slump, with property markets slowing considerably in the third quarter of 2008 even before the impact was felt from export markets on the manufacturing industry. Further, experts predict a substantial cut in investment growth as well as plummeting private consumption fuelled by increasing unemployment. It is the same doom-and-gloom scenario that is being sketched throughout the world economy, except that China's economic performance has direct and possibly massive implications for many African economies.

Africa's growth is closely tied with China's

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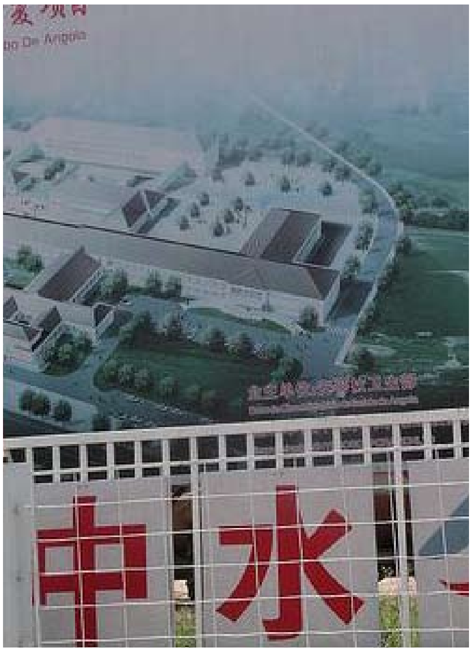

commodity demand and the predicted growth slowdown would undoubtedly have a negative effect on the demand for Africa's raw materials. In line with this thinking, the past three months have seen scores of Chinese mining companies pull out of Zambia and the Democratic Republic of the Congo. Several factories in the Congo and Guinea have also been closed with little expectation of them being reopened any time in the near future. Despite the widespread closing of both Western and smaller Chinese companies in Africa, the larger Chinese state-owned enterprises appear firmly established on the continent and are purportedly even eyeing deals that will facilitate their further expansion in, for example, the mining sector in Zambia.

Yet even if China's growth slows it will still far outstrip the growth rates of other major economies. Despite the ominous predictions of commentators, Beijing appears to be taking a long-term view and is pursuing strategic expansion into Africa, in line with the 2006 commitments made at the Forum on China-Africa Cooperation (FOCAC) Summit. Not only have Chinese companies pledged tens of billions of dollars of loans and investments to Africa, but on a recent visit to Angola Premier Wen Jiabao stated that the international financial crisis would not result in China reducing its assistance to Africa. He also reiterated the actions agreed upon at the Beijing FOCAC Summit in 2006, including China's pledge to double its financial assistance to Africa by 2009, as well as to provide US$ 3 billion of preferential loans and US$ 2 billion of preferential buyers' credits. During his visit to South Africa in mid-January, Chinese Foreign Minister Yang Jiechi emphasised that China would "continue to have a vigorous aid programme [in Africa] and Chinese companies will continue to invest as much as possible in Africa because it is a win-win solution".

Xing Houyan, the director of multinational business at China's Academy of International Trade and Economic Cooperation, explains that Chinese mining investment in Africa is large-scale and has a long-term focus. He states that the largest negative impact on investment is likely to only be on projects that are still in the planning phase where money has not been committed yet.

Beyond the rhetoric, whilst the exact impact of the global financial crisis on China's involvement in Africa will still have to play out, it is clear that increases in aid and investment spend by Beijing will not be at the rate originally hoped for. Commodity exports to China will still form an important component of Sino-Africa trade, but as the demand for commodities drops Africa is set to see a subsequent fall in export earnings, in line with lower commodity prices.

It is important to avoid making generalisations about the Sino-Africa economic relationship: though it appears that its long-term interests remain intact, China has a tendency to play its Africa hand shrewdly and will undoubtedly make strategic retreats where necessary.

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ABOUT US

Frontier Advisory (Pty) Ltd is a research and strategy company that assists clients to enter and operate in emerging market economies. We have worked with an array of multinational firms, small & medium enterprises as well as public sector clients and have assisted them to analyse, formulate and execute their business strategies in these new markets.

Frontier and emerging economies offer new investment opportunities for companies and are fast providing new markets for traditional market capital, technology and management expertise. These economies not only pose new challenges to business but also greater commercial potential. Our firm's professional services serve to offset the risk that is inherent in these countries – whether in the BRIC countries or second or third tier emerging markets.

Within the firm, there are four dedicated business units that include China Frontier Advisory, India Frontier Advisory, Africa Frontier Advisory and Latin America Frontier Advisory. Our diverse and international team is well positioned to serve clients' needs based upon their knowledge and operational experience and emerging markets.

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