Global Economic **Outlook 2020**

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G10 outlook for 2020

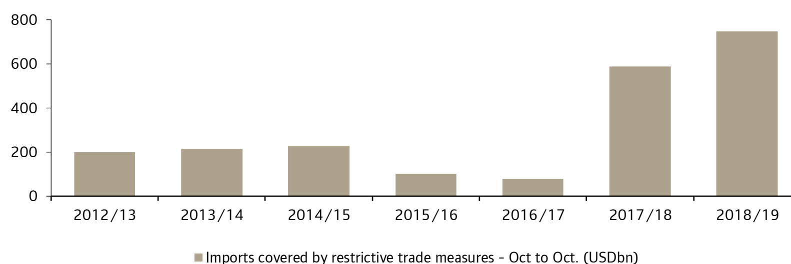
Caution is advised

The global economy has been hit hard by the trade war between the US and China. Trade tensions have eased but the process of economic recovery is not as simple as turning off the trade protectionism switch.

Slow healing

For last year, we predicted that global growth would be weaker than most estimates; probably somewhere in a 3%-3.5% range. It seems as if the outturn will be at the very bottom end of this range, and we doubt that 2020 will be much better. A slide to below 2.5% would be seen by many as a recession, albeit a fairly modest one. While we err to the view that recession can be avoided, we'd expect it to be a close shave. The dislocation of global trade patterns by protectionism has been a crucial part of the global economic slowdown. There might be some hopes that the late-2019 Phase One trade agreement between the US and China will usher in a trade environment that's more conducive to growth in 2020. However, we have to remember that while this accord spared China the imminent imposition of tariffs on around USD160bn of goods exports to the US, the world has still seen some USD747bn of import-restrictive trade measures in the year to October 2019; an increase of almost tenfold from the year prior to President Trump's election win (Figure 1).

Figure 1: Protectionism surges

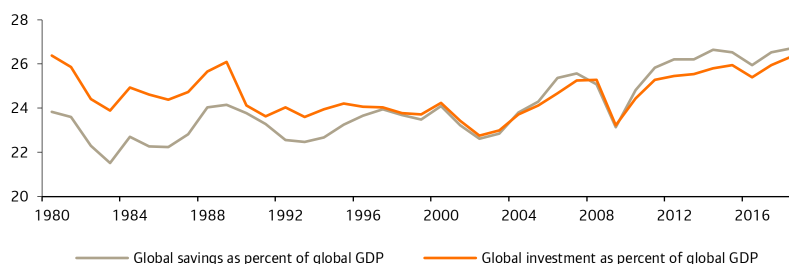


Source: World Trade Organisation

Much depends on whether incremental improvements in US/China trade relations can lift business confidence and whether the policy easing that central banks and governments have put in place to counteract the trade tensions can bear fruit. We are sceptical about both. We doubt any further US/China trade deals will be agreed in 2020, partly because the US election will take up more political time for the Trump administration and partly because the Phase One deal covers only the low-hanging fruit. Future trade deals will be harder to achieve and continued tensions with others, such as the EU over autos and aircrafts, could still leave the US administration on a collision course with many of the worlds large trade-surplus countries. There are some signs that the trade-inspired damage to global manufacturing might have come to an end. Purchasing manager surveys, for instance, have stabilised. However, we have to remember that the manufacturing sector is only around 15% of global value added and the much bigger services sector is showing few signs of improvement. Generally speaking, employment levels in developed countries remain very high and wage growth is improving. But these trends mask the real problem, which is poor productivity. Real economic prosperity can only come through rising productivity. The strength in employment and improving wages merely reflect the fact that investment has been poor and, with it, productivity growth. This weakness in global investment not only hurts productivity, it has also led to a global savings surplus (Figure 2). Excess savings relative to investment not only accounts for the very low level of global bond yields and policy rates; it also leads to strong inflows into 'riskier' financial investments, such as equities.

This helps explain why **global stock markets have generally remained quite elevated even as the global economy has stalled**.

Figure 2: Excess savings



Source: IMF

More help needed

Central banks and some governments have put policy in place to counteract the deterioration in economic fortunes. Lower policy rates could aid investment but a rebound in investment is more an issue dictated by global trade-related confidence, not borrowing costs. We believe that the bias for global monetary policy will still be towards further easing in 2020 even if, for many, **the scope to ease policy is limited**. Those with very low policy rates, such as the ECB and BoJ fear that the so-called 'reversal rate' might be close at hand. That's the point where rate cuts are a net drain on the economy, primarily through their adverse impact on commercial banks. Hence, these central banks will probably err towards asset purchases and away from rate cuts. We could also find that some central banks that have not undertaken quantitative easing before start to do so, such as the Reserve Bank of Australia. The Federal Reserve still has room to ease policy after its three "insurance" rate cuts of 2019. We suspect that more insurance will be needed this year, with at least one more cut anticipated.

While many central banks will be trying to scrape out the last dregs of monetary easing, **the pressure on fiscal policymakers to act in tandem to ease policy will only grow**. The US administration has already shown that fiscal easing can shore up growth without the cost of higher inflation and higher yields and it seems that some other governments around the world need to follow suit. Some, such as the UK and Japanese governments, appear to have heeded the message but fiscal expansion in the euro zone, and Germany, in particular, appears insufficient. Given the euro zone debt crisis between 2010 and 2012 we might understand some of this reticence. But today we are talking about budget expansion in countries with large current account surpluses (Germany), not large budget deficits in countries with weak trade positions, as we saw back in 2010/12. The combination of large budget deficits and large trade deficits saw yields in countries such as Greece soar during the 2010/12 crisis. Budget stimulation by Germany and other strong-trade countries today is not going to have the same cost in terms of much higher bond yields. The ECB is certainly putting pressure on the German coalition government to ease fiscal policy and, within the coalition the junior SPD partner is putting the same pressure on the dominant CDU partner. We feel that the fiscal response of Germany, and many other euro zone and non-eurozone countries in 2020 could hold the key to economic recovery just as an easing of trade tensions seems to be a prerequisite for stronger growth.

The political dimension

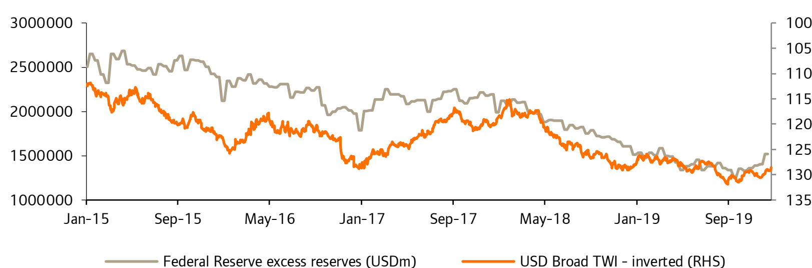
The politics of US/China trade negotiations and the politics of Brexit were the two driving forces for 2019. In 2020 Brexit will remain a hot topic as the UK and the EU try to negotiate a trade deal in what seems an impossibly short amount of time (the deadline is 31 December 2020). Political factors in the US will shift from external trade tensions to internal election uncertainties. As this shift occurs, the Trump administration

could dial down some of the trade tensions with other countries for fear of alienating many core Republican voters, such as those from farming communities. But equally, a desire to look tough on trade could see the administration go after different countries and different sectors, such as European car manufacturers. Whatever happens ahead of the 3 November election, we don't doubt that the president will pull out all the stops to keep the economy and the stock market strong, even if this means heaping even more pressure on the Fed to cut rates further. The outcome of the election is a tough call, not least because the identity of Trump's Democratic opponent is not yet known. Should more progressive/left-leaning candidates such as Bernie Sanders or Elizabeth Warren win the Democratic nomination, the stark contrast with Trump could unnerve the market in the same sort of way that the UK election did in late 2019. But provided the economy holds up and Trump's alleged indiscretions, such as those that resulted in impeachment proceedings, don't undermine support, **he may prove a hard president to unseat**, just as most first-term presidents have been in the recent past.

Dollar in decline

President Trump might have been able to achieve a number of things, such as a phase-one trade deal with China, but his complaint that the dollar is significantly overvalued has fallen on deaf ears. The dollar ended 2019 just about where it started in broad trade-weighted terms. Provided 2020 sees some easing of trade-related tensions and the Fed continues to re-build its balance sheet, the dollar seems more likely to give some ground, albeit not at the sort of pace that might appease President Trump. The re-building of the Fed's balance sheet could prove a key factor in weakening the dollar. The history of the past few years suggests that the provision of dollar liquidity, however it has been measured, is a key determinant of the dollar's value (Figure 3).

Figure 3: Fed's balance-sheet rebuilding to weigh on the dollar



Source: Federal Reserve

Some other central banks have also called a halt to the decline in their balance sheet. The most notable of these has been the ECB which re-started quantitative easing last year. In theory this could prevent the Fed's easing from lowering the dollar against the euro. However, evidence tends to suggest that, because the dollar has such a dominant role in the provision of global liquidity, it is the action of the Fed that is key, not that of other central banks. Hence, unless the US economy rebounds strongly in 2020 and the Fed starts to tighten again (which we doubt) the dollar seems likely to undergo a modest decline which we'd suggest will be in the 5%-10% range against other developed currencies. For euro/dollar, this implies a level just below 1.20 at the end of 2020.

Brexit has rendered the pound as one of the more volatile currencies in recent years and it could maintain this dubious accolade in 2020 thanks to continued Brexit negotiations and the continued existence of a possible cliff-edge exit from the EU on 31 December 2020 if no trade deal can be agreed between the UK and EU. But, while **the risk of a sterling collapse still exists**, we doubt that things will turn out this way. Trade discussions may have to be extended beyond the deadline, but this should not stop the **pound rising**, very possibly towards 1.45 against the dollar and 0.80 against the euro during the course of the year.

Risk return

In theory, at least 2020 could be set to be a good year for risk assets. From a carry-trade perspective, many funding currencies such as the euro, yen, Swiss franc and even the US dollar still have very low money market rates and volatility amongst the major currencies is some of the lowest we have seen. Figure 4 shows what we call a Global Hazard Index (GHI) which combines implied FX volatility across major currencies to provide a guide to currency risk. It is currently the lowest it has been since the euro came into being in 1999.

Figure 4: Low FX volatility

Source: Reuters datastream

High FX volatility is the enemy of the carry trade given that surges in volatility are usually associated with a rapid strengthening of the funding currency. In contrast, low volatility – and low funding rates – work to the benefit of carry trades. We could add to this hopes that the global economy is turning the corner as trade fears dissipate, that the dollar will slide, and that many risk assets, such as emerging market stocks, have underperformed developed markets and hence appear relatively cheap. But, of course, there are also counter-arguments. For a start, the global economy has enjoyed a long expansion, especially the US, that might be looking both long in the tooth and responsible for a rally in risk assets, such as stocks, that leaves many developed markets overbought and in need of a decent correction. Political factors could still cause havoc in major nations, especially Brexit and the US election. Inflation could make an, unwelcome, return and push central banks back towards tighter monetary policy again. While we could add more reasons for caution, **we think that the odds slightly favour some degree of outperformance from riskier assets**. As we mentioned at the start, global growth may still underwhelm in 2020 but the compensation should come from the persistence – and extension – of easier monetary policy and possibly easier fiscal policy as well. **Returns in risk assets** might not live up to the stellar performance we saw from most assets last year, but **we do anticipate gains**, not losses, for 2020.

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China's outlook, and the implications for Africa and South Africa specifically

An economic stabilization in China likely to be short-lived; GDP growth likely slipping to a three-decade low; a range of material downside risks still testing the agility of policymakers in Beijing and requiring careful navigation; further breakdown in relations with the US; the Phase One trade deal overcommitting China and detracting from China's other trading partners. All this comes against the backdrop of an ongoing structural slowdown, and the restructuring and rebalancing of China's economy.

Welcome to 2020, the year of the rat. We are sceptical of economic growth improving in 2020 for developed countries, and risk assets that are supported by abundant liquidity may tumble due to high asset-price valuations, rising global debt, or whatever the shocks may be.

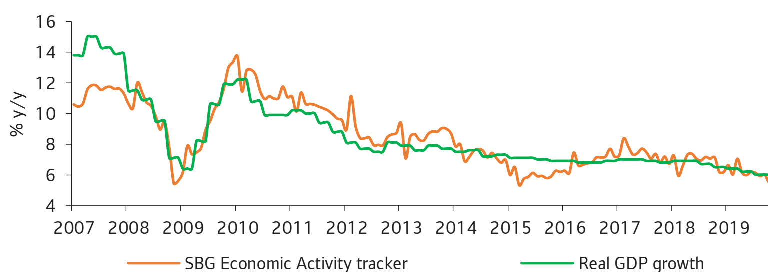
Faced with all this, **African nations have doubled down on regional integration, thereby creating a continental free trade area. This could make African markets more alluring to China** – Africa's most consequential commercial partner but one whose internal adjustments are still yet to be fully metabolized by African countries.

We argue that **the next phase of ties between China and South Africa specifically** must more forcefully and single-mindedly prioritize tactics for further industrialization, job creation, and technology transfer through Chinese investment in manufacturing. To this end, they must shape ties to support South African growth and development, and position South Africa as an engine for intra-Africa trade. **South Africa therefore must make good on its commitment to improving the ease of doing business** in SA as well as its competitiveness.

A China perspective

We aren't convinced the Chinese economy has bottomed out. Granted, the data is much improved since October 2019, with a plethora of monthly macroeconomic data implying that momentum loss seems suspended. Nevertheless, economic growth in the world's second-largest economy is still likely to drop below 6% in 2020, which would be the first time since 1990. That's down from 6.1% in 2019 and 6.6% in 2018, marking a third straight annual slowdown. And, of course, GDP growth could fall lower in a worst-case scenario: think trade talks break down again; the ongoing liquidity challenges facing smaller banks fail to be ring-fenced; a large enough share of corporates struggle to meet their debt obligations; and so on.

Figure 1: Momentum loss ongoing – real GDP growth slowing



Source: CEIC and SBR

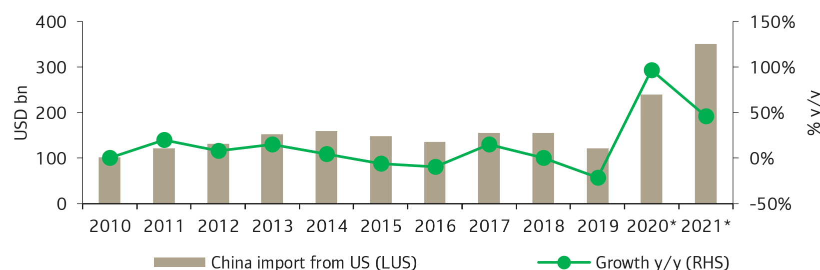
China is amid a profound long-term economic transition that could see growth trend towards 3-4% by 2025. Hence, its performance should be seen in the context of cyclical movements around a decelerating trend: upswings will be shorter than before, and downswings longer.

Nevertheless, the now signed Phase One trade deal will boost global sentiment and financial markets. Whilst China's cyclical slowdown has been driven primarily by domestic forces and policy priorities – specifically tight financial conditions, de-risking the financial sector, weak local government investment and soft domestic demand, the trade war has not helped. Consider that China's exports to the United States tend to grow at a similar rate to China's overall exports. Hence, without a trade war, China's exports may have fallen by 2% y/y in 2019 in dollar terms. That 20 percentage point negative swing, largely owing to trade tensions, probably reduced overall Chinese export growth by about 3-4 percentage points, shaving off 0.8-1.2pp of China's nominal GDP growth in 2019. **The Chinese economy will therefore certainly benefit from removing this particular headwind in 2020.**

Still, **China's near-term trajectory will be determined by Beijing's policy choices**. Even though talk of better use of counter-cyclical tools for macro policy has ramped up in recent months, for now though the goal remains to merely ameliorate some of the most challenged parts of the economy, not reverse the slowing trend. The still relatively weak credit impulse means that if the economy has stabilized, the growth recovery will likely be muted. And, just like last year, the Financial Stability and Development Commission (FSDC), the People's Bank of China (PBoC), and China Banking and Insurance Regulator (CBIRC) have made it clear already that they would press on with the de-risking campaign, defusing financial risks, improve and expand the scope of its macro-prudential regulation, further dismantle the shadow banking industry, prevent real-estate speculation, and work with local governments to reform state-owned enterprises and clear hidden debt. **None of this seems to be broadcasting news of an imminent China economic rebound.**

As for the trade deal, a further breakdown in relations seems more likely rather than a genuine resolution. First, the more difficult issues have yet to be addressed, and China has virtually no room to make any concessions regarding the remaining, far more stubborn and entrenched, issues. Second, **the Phase One deal gives China very little** besides the US pledging to reduce the 15% tariffs on USD120bn worth of Chinese goods to 7.5% and suspend plans for other tariffs. Resentment will no doubt build. Third, China has overcommitted, agreeing to purchase a staggering USD200bn in goods and services from the US by the end of 2021 – an increase of 100% y/y in 2019 and 45% y/y in 2021. If so, third countries from both the developed and developing world would need to be prepared. These targets force China to shift purchases of oil seeds, for example, away from Brazil, Argentina, Ethiopia, Tanzania and others. The same applies to fish and lobster away from Russia and Canada; cars from the EU or Japan; industrial machinery at the expense of the EU, Japan, and Korea; and pharmaceuticals away from Switzerland.

Figure 2: China's import targets from the US in 2020 and 2021

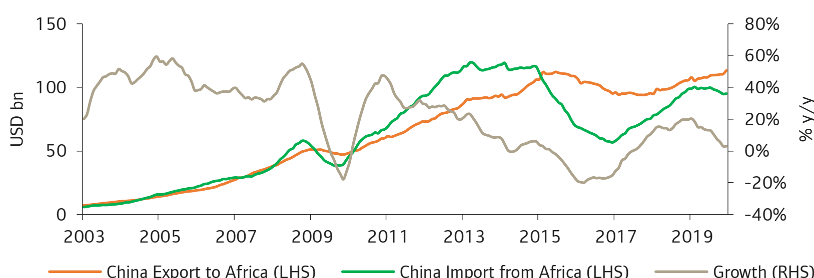


Source: PIIE, CEIC, Standard Bank Research

Implications for Africa

Africa should take heed. China-Africa trade may appear to be an unstoppable multi-billion-dollar juggernaut — but it would be foolish to ring-fence Africa's relations from the current developments underway inside the Mainland. China-Africa trade growth plummeted from 20% y/y in 2018 – the fastest since 2011 – to just 2% y/y in 2019, a bi-directional total of USD208bn. China's connection to Africa has been changing, with the broader China-African relations seeing a more selective and focused engagement from China. China's "new normal" matters: its slowdown, rebalancing, de-risking of the financial system, and emphasis on the Belt and Road initiative, along with the distraction of the trade war, all have **conspired to divert China's attention away from Africa.**

Figure 3: China-Africa bi-directional trade growth (annualised)



Source: China's General Administration of Customs, CEIC, Standard Bank Research

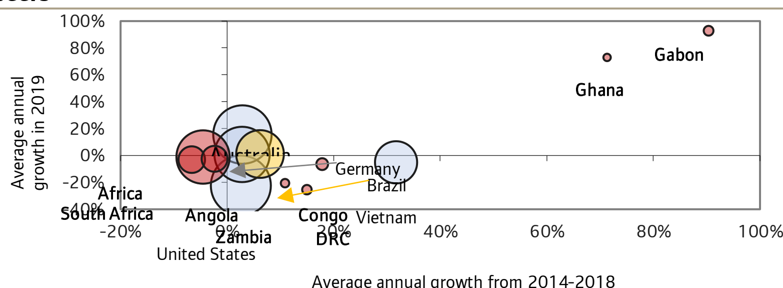
African exports to China contracted 3.7% y/y in 2019, having rebounded 31% y/y in 2018 largely due to lofty commodity prices. Given the rich representation of Africa across the spectrum of global commodities, it is no surprise that Africa is sensitive to changes in China. Drummond & Liu (2013:5) estimated that a one percentage point decrease in China's domestic investment growth is associated with an average 0.6 percentage point decrease in Africa's export growth. The World Bank (2015) estimated that **a one percentage point reduction in China's growth results in a 0.37 percentage point decline in output growth in specifically South Africa.**

China accounts for the largest proportion of global imports of the natural resources Africa exports. But, China's role in global commodity markets is changing now as it undertakes a transition from a growth pattern that is highly intensive in its use of natural resources, driven by investment and the development of heavy industry, to **a more sustainable path that uses these resources less intensively** (Mi et al, 2018:1007 and Roberts et al., 2016:147). China's lower growth rate and changing demand composition are already **affecting commodity prices**, with a particularly strong impact on global mineral markets (Pigato and Tang, 2015:10).

The trade data bears this out: South Africa's exports to China, for example, peaked at USD48bn in 2013 and has averaged USD25bn each year over the past three years (USD26bn in 2019). **Worryingly, South Africa is also falling down the pecking order in China's hierarchy of trade partners**: in 2013 South Africa was China's 12th largest source of goods and has since fallen outside the top 20 – and its share of China's imports has halved. Meanwhile, several other emerging markets, like Brazil, Malaysia, Thailand and Vietnam have seen sales to China increase rapidly over the past decade. **Worse still, the next two years will be rough, muddied by trade tensions between the US and China, which may, to some extent catch certain African nations in the crosshairs**. China committed to purchase a staggering USD200bn in goods and services from the US by the end of 2021 – an increase of 100% y/y in 2019 and 45% y/y in 2021. If these are to be met, it will cannibalise China's purchases from elsewhere, like oil seeds away from Brazil, Argentina, Ethiopia, Tanzania and others.

Over the next five years, **we expect Chinese import growth from Africa to expand just moderately**, to around USD150bn by 2025. China's largest impact on global commodity markets will come from supply-side structural reform and environment policy tilt rather than from ever-growing demand for raw materials.

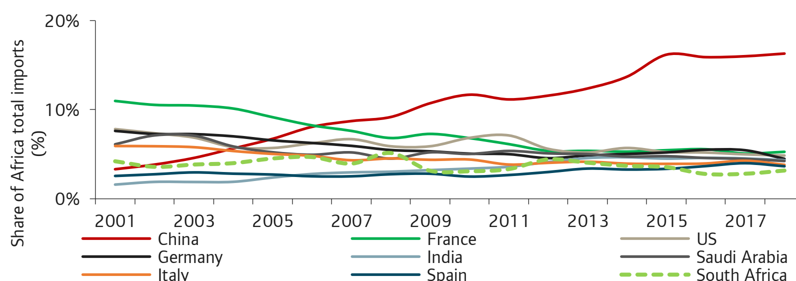
Figure 4: South Africa/Africa exports size and growth to China relative to peers



Source: MOFCOM

Meanwhile, Chinese exporters continue to diversify towards emerging markets, and tapping into Africa's fast-growing consumer markets is likely to continue unabated. Africa is now the destination for 4.5% of China's total exports – double that of a decade ago, and more than Africa's share of global GDP of 2.8% in 2018. Across Africa, Chinese goods have penetrated markets deeply, increasing from 3.7% of Africa's total imports in 2001 to 19.0% in 2019. Around two-thirds of African countries list China as their largest source of goods. In contrast to China's growing penetration, Africa's traditionally large trading partners, such as France, the United Kingdom and the US, have seen their market hare decline. Similarly, **South Africa's share of Africa's total imports peaked in 2003 at 8.0% but has slipped to 4.6% in 2018.** Granted, South Africa is still the largest trading partner of countries such as Namibia, Mozambique, Zambia and Zimbabwe but its foothold is being diminished. **We expect Chinese exporters to tighten their hold on Africa's consumer markets**. Last year China's exports to Africa expanded by 7.2% y/y, from USD105bn in 2018 to USD113bn in 2019. By 2025, exports to Africa could surpass USD200bn, expanding 10% p.a. over the period as Chinese exporters diversify their target markets, with Africa being their focus.

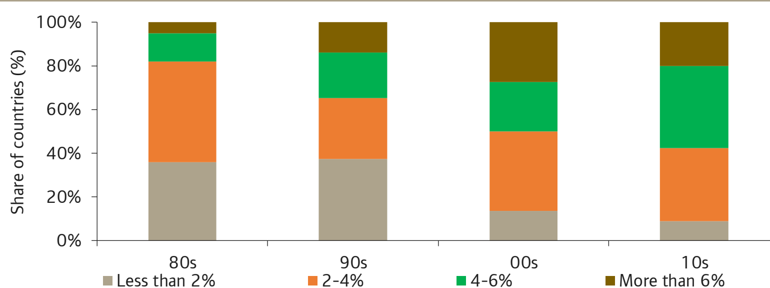
Figure 5: Rising penetration of Chinese exports in Africa



Source: ITC, CEIC, Standard Bank Research

Our view is underpinned by a relatively constructive cyclical and structural outlook for Africa led by relatively robust economic growth in some key economies such as Ethiopia, Ivory Coast, Tanzania, Mozambique and Ghana. In addition, over half of Africa's economies will likely expand by at least 5.0% in the next five years, whereas less than one-third have done so in the past five years. This improved cyclical story weds neatly to the structural forces, like favourable demographics, urbanization and industrialization, and rising incomes and a growing middle class, which remain intact and continue to play out across many African economies. It is well understood in China **that African economies present a host of compelling opportunities for trade and investment.**

Figure 6: Distribution of GDP growth in Africa



Source: IMF

The case for a manufacturing focus

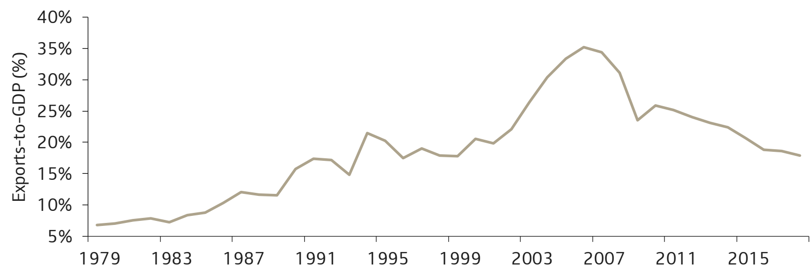
Unlike the rapidly growing Asian economies whose rising incomes have been associated with structural shifts from agriculture to industry, **African countries have tended to bypass manufacturing**, shifting from agriculture to services, with relatively sluggish industrial employment growth (Kumar and Bergtrom, 2013:54). The share of African manufacturing in GDP rose from 6.3% in 1970 to a peak of 15.3% in 1990 and has since significantly declined, to around 10% last year. **Growth without industrialization has meant that Africa's growth has not been sufficiently labour-absorptive** to allow for upward income migration of the population. In addition, African manufacturing is not only small in size, but it is dominated by firms in the informal sector not on the same escalator as modern firms with access to technology, markets, and finance.

The divergent path between Asia and Africa is glaring in Africa's poor intra-regional trade relations. A mere 13.5% of Africa's total trade occurs amongst African nations, which is considerably lower than Asia (58%) – and Latin America for that matter. Herein lies the rub: **the overlap between African demand and supply is negligible**. Instead, China has increased exports to Africa twelvefold since 2001. Worryingly, for the first time, China's overall trade with Africa surpassed total intra-Africa trade in 2018. Intra-Africa trade peaked at USD182bn in 2013 and subsequently fell to a low of USD125bn in 2016. Since then, intra-Africa trade has increased by 9% y/y and 5% y/y in 2017 and 2018 respectively, tallying USD144bn in 2018.

China-Africa ties and partnership must now single-mindedly prioritize tactics for further industrialization, job creation, and technology transfer through Chinese investment in manufacturing industries, led by the private sector, in a manner that supports African growth, development and intra-Africa trade. Attracting greater Chinese engagement and investment in African manufacturing, which includes not only the transfer of capital, but crucially the movement of firm-specific assets such as technology, managerial ability, corporate governance and access to the network connecting markets, must be the overarching objective.

Chinese firms have developed the experience and know-how. China has emerged as the largest manufacturer in the world – known as "the world's factory". The countries own recent history suggests Chinese policymakers are familiar with the nature of the goal. In addition, the Chinese economy is in the process of transformation – expanding more slowly and is less factor – and investment-driven, shifting towards a pattern of growth driven by services and consumption; propelled by innovation and with market forces determining the allocation of resources. Accelerating real wage growth and rising unit labour costs in China from the mid-2000s has raised the possibility of relocation of production and jobs from export-oriented labour-intensive – especially light manufacturing industries to low-income countries. For the time being, the preferred respond to the challenges of rising costs and tighter demand by means of adjustments in existing operations – upgrading technology, controlling costs, expanding markets or product ranges – rather than by establishing production operations in a new location.

Figure 7: Exports as a share of total GFP



Source: General Administration of Customs & SBR

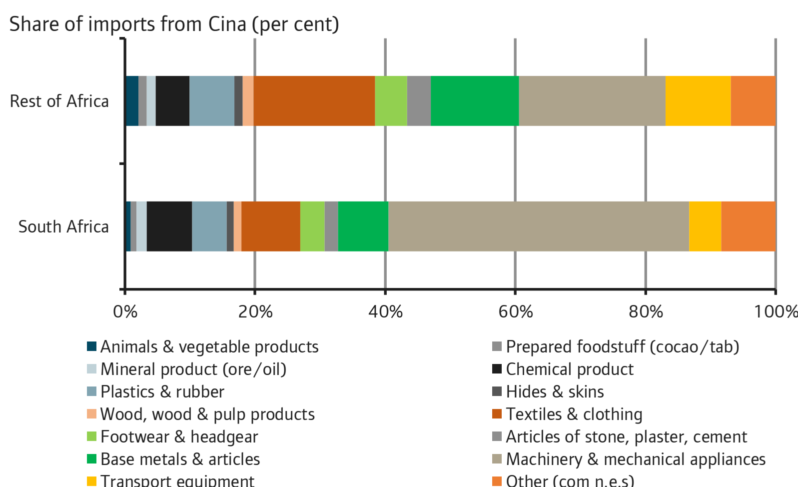
Looking ahead though, as wage rates in China continue to rise, Africa should be exploit emerging opportunities for investment in export-oriented manufacturing (Pigato and Tang, 2015:5). It is a logical progression that outbound investment in manufacturing is most likely to follow Chinese sales, and some of China's fastest growing export markets are in Africa. China's exports to Africa expanded by 10% y/y and 7% y/y in 2018 and 2019, respectively. **This is exactly what South African corporates should be leveraging, thinking of ways to collaborate with Chinese firms in Africa** — especially as industrial restructuring in coastal China forces some labour-intensive firms to relocate to other parts of the developing world, including Africa. Importantly, the Africa Continental Free Trade Area (AfCFTA) fits many criteria to indeed be the catalyst for China-Africa ties.

Potentially, **inside Africa's more open economies will be opportunities in consumer-facing industries** such as retail, telecommunications and banking; infrastructure-related industries; across the agriculture-related value chain; and in resource-related industries. The AfCFTA is an important medium- to long-term opportunity for Africa, potentially attracting manufacturing business migrating from China. In many respects, whether the AfCFTA will succeed as a driver for African development will largely depend on its impact on regional integration, buttressing trade and developing nodes of growth. Even more powerful benefits will come if the dismantling of tariff barriers occur in conjunction with improving the efficiency of customs, tackle bureaucratic delays and reduce opportunities for corruption; and improving the management of economic corridors and invest in physical infrastructure and logistics networks (De Soyres et al., 2018:33).

South Africa's position

South Africa plausibly has the most to lose from greater competition with China on the African continent. South Africa has a relatively developed industrial sector – certainly the most scalable in Africa – accounting for one-third of Africa's manufacturing capacity. With an estimated USD16.5bn in imports from China in 2019, **South Africa is the largest consumer of Chinese products in Africa** – ahead of even Nigeria and Egypt. South Africa purchases around 14.9% of all the goods China sells to Africa.

Figure 8: Distribution of GDP growth in Africa



Source: IMF

Much like in other emerging markets with nascent manufacturing sectors, **the inflow of Chinese products has had a profound impact on a host of domestic industries in South Africa**. Granted, South Africa's own particular political and socio-economic difficulties have also served as headwinds (Naude, 2018:147). However, Edwards and Jenkins (2014:454) conclude that Chinese penetration of the South African displaced imports from other countries — but declines in domestic production accounted for the bulk of the increase. Losses in sales are particularly high in textiles and clothing, footwear and leather, electrical and electronic products and some types of machinery. Bongo-Bongo and Biyase (2018:11), find that imports from China have harmed both employment and value added of the manufacturing sector in South Africa over the past decade. The impacts have been seen not only in textiles, but also clothing, toys and household appliances (Morris & Einhorn, 2008:370), and, more recently, high-technology and machinery equipment (Edward & Jenkins, 2014:4). In short, imports from China do provide headwinds to employment, prices, inflation and wage growth (Sandrey and Jensen, 2007). It is clear that in the face of increased competition from imports, domestic firms were unable to defensively innovate by upgrading capital stock and upgrading skills.

South Africa's manufacturing sector not being dynamic is seen as a key factor explaining slow growth and high unemployment in South Africa (Rodrik, 2008). Since 2008, 3.5 million people have entered the labour force, but only 1.6 million additional jobs have been created. The unemployment rate has risen from 22.5% in 2008 to 29.1% in 2019. Nearly 6.2 million people are unemployed, or 9.3 million if those who have stopped looking for work are included. Including these discouraged workers, South Africa's unemployment rate is actually 38.5%. Of those looking for employment, as around 60% have not worked in the past five years – more than twice the number of just a decade ago. The manufacturing sector has the potential to absorb a notable share of the labour force. Consider, for example, Ethiopia where China's investments in manufacturing have been robust: employment levels grew from just about one million workers in 2004 to more than 5.6 million workers by 2015 (Naude, 2018:145).

Most important, failure to get the partnership right may marginalise South Africa from intra-Africa trade. Chinese goods have eroded the competitiveness of South African exports to its neighbours (Renard 2011:24). Being crowded out from Africa's growing consumption and rising middle-class is an acute concern. The risk is real as it is in South Africa's exports to Africa where Chinese competition is already fierce (Edwards & Jenkins, 2014:8). Yet, South Africa's long-term growth prospects (and perhaps relevance to China) is wedded to South Africa's relevance to Africa. Therefore, the

manner in which South Africa coordinates its industrial and trade policy, and infrastructure, with other leading African economies, has become critically important.

For now, South Africa is often considered a preferred partner for Chinese firms. As such, **China's commercial footprint in South Africa is weighty, wide-ranging and multifaceted**. South Africa is China's largest export destination in Africa (Nigeria is close behind) and the largest source of imports from Africa (having usurped Angola in 2011). South Africa hosts the most outbound foreign direct investment (FDI) from China into Africa, even when China's largest investment in Africa – the sizable USD5.8bn purchase by the Industrial and Commercial Bank of China's (ICBC) purchase of 20% of Standard Bank Group – is excluded. South Africa has also amassed the largest share of China's greenfield investment in Africa (tallying nearly twice the size of its nearest rival on the continent cumulatively since 2001) – investments made by nearly 100 different Chinese firms across a range of sectors. Using this base as a platform, the next phase of China-South Africa ties and partnership must more forcefully and single-mindedly prioritize tactics for further industrialization, job creation and technology. **Attracting greater Chinese engagement and investment in South African manufacturing**, which includes not only the transfer of capital, but crucially the movement of firm-specific assets such as technology, managerial ability, corporate governance and access to the network connecting markets, **should be the overarching objective.**

Nevertheless, **boding well for the outlook for greater investment by China in South African manufacturing is private firms having driven China's commercial footprint in South Africa**, responding to economic incentives most swiftly – especially since 2013. Importantly, there is a material difference in the sector distributions of private- and state-led investments in Africa. First, private firms preferably invest in high-income and middle-income countries. Second, private firms tend to invest in manufacturing and services industries whilst SOEs are more likely to invest in construction and mining (Lu et al, 2011:224). Third, private firms are attracted to host-country strategic assets and are averse to economic and political risks when choosing investment locations abroad, whilst, state-owned enterprises follow the strategic needs of their home country and invest more in natural resource sectors, being largely indifferent to the political and economic conditions in the host countries (Amighini et al., 2012:20). Private companies are not creating establishments in government-sponsored special economic zones (SEZs), which are in fact struggling to survive (Pigato and Tang, 2015:8).

This is somewhat unique to South Africa. By and large, elsewhere in Africa, Chinese banks – specifically China Development Bank and the Export Import Bank of China – offer loans to African countries and SOEs to build infrastructure projects such as roads, dams, railways or industrial plants built by Chinese companies, manifesting in imports of related equipment and machinery, wide trade deficits; and gradual repayment of interest and sometimes principal's on loans back to China. However, Chinese loans to South Africa are relatively marginal – accounting for 2.3% of Chinese loans to SSA from 2000 through 2017 (Atkins et al., 2018). Rather, across South Africa private firms have already established operations in a diverse range of sectors including agriculture, autos, consumer electronics, industrial machinery and equipment, finance, metals and many more. On aggregate, their foray into South Africa is a sea-change from the path of Chinese firms interests in other parts of Africa, which has been weighted towards commodity acquisitions and largescale government-to-government negotiated construction contracts. The private-led footprint reinforces broader global trends and reflects both the relative wealth of South Africa and the maturity of South Africa's economy, institutions, corporates and depth of financial markets.

Even though African countries are relatively open to Chinese investment, which has been identified by Beijing as an important consideration in assessing total outward investment strategies, **the business environment in Africa remains challenging.** According to a survey of attractiveness for outbound investment, each of the seven

African nations assessed—Tunisia (48), South Africa (49), Egypt (51), Algeria (61), Kenya (65), Nigeria (66) and Angola (67)—ranked in the bottom third, out of 67 countries. Another survey, the Global Foreign Direct Investment Country Attractiveness Index, reported that South Africa's rank had deteriorated from 43 in 2013 to 48 in 2019. In particular, South African manufacturing, like across much of Africa, faces several stubborn obstacles. These issues include: access to finance, access to trade finance, complexity of tax system, customs and trade regulations, corruption, availability of qualified labour, labour regulations, employee health, reliable electricity supply, cost of electricity, transport costs, loss due to transport (breakage, theft, delays), physical infrastructure, ability to own land/premises, and physical crime (Kumar and Bergstrom, 2013:58).

South Africa has advantages. First, labour costs; for instance: the average wage in South Africa masks the country's high wage inequality. And, more than 5 million workers currently earn the minimum wage. Second, South Africa has an abundance of natural resources, essential inputs in production such as skins for footwear, timber for the furniture industry and land for agribusiness. Third, South Africa has an already substantial domestic market. Fourth, South Africa has favourable access to the region – a region which is experiencing rapid growth in their consumer markets, urbanising rapidly and enveloped in favourable demographics.

To fortify its current position, South Africa must make good on its commitment for improvements in the ease of doing business and competitiveness to create a better climate for partnerships. Improving the transparency of business regulations and the legal framework are important institutional factors that encourages Chinese outbound investment (McGregor, 2013:580). One of the specific targets set by South African President Cyril Ramaphosa as part of government's economic reform agenda, is **to improve the country's rank in the World Bank's annual global Ease of Doing Business survey to top 50**, from 82 in the latest assessment. Interestingly, China too has made tremendous progress in these areas, especially in the past three years. Over the past year, China ranked among the top 10 performers in implementation of reforms, improving 15 positions to rank 31 out of 190 economies. Improvement to the environment for doing business matters as many African countries are defiantly testing environments, and, as such, many Chinese firms prefer to business in South Africa.

Conclusion

Chinese firms have acquired both experience and expertise in its journey as "the world's factory", with Chinese policymakers right alongside. The Chinese economy is in a process of profound transformation by expanding more slowly and less factor- and investment-driven, rather shifting towards a pattern of growth driven by services and consumption; propelled by innovation; and with market forces determining the allocation of resources.

Ring-fencing China's South African engagements from China's trends would be impossible. South Africa must construct its policy framework to both ameliorate the more harmful impacts of China's internal adjustment as well as to benefit from developments underway in China. At the same time, Africa's promising structural drivers and the launch of the continental free trade area are alluring. Already some of China's fastest growing export markets are in Africa; from 2009-2015 nine of China's 15-fastest growing export markets were in Sub-Saharan Africa. Setting up production facilities – even if the starting point is on lower value-added assembly operations in the host nation – is a logical consideration for many Chinese firms.

A number of regionally minded hubs would be required to service Africa's internal demand. South Africa must position itself to this end and align diplomacy and concomitant metrics to a win-win bilateral partnership with China. South Africa has plenty to lose should Chinese firms choose to set up operations elsewhere – in Asia or

Africa – further eroding South Africa's position in intra-Africa trade. South Africa has already seen its manufacturing sector shrink as a share of GDP over the past decades. Instead, nearly 20% of South Africa's imports come from China, displacing imports from other countries, and at the expense of local production.

Turning this around will be critical for South Africa's commercial relevance in Africa, and for much-needed job creation and skills development in South Africa.

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