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China Sneezes: Could Africans benefit from a devalued yuan?

Article By:

Ashwin Kaja

When ***China*** sneezes, does all of ***Africa*** catch a cold? Slower Chinese growth and a recently devalued currency will certainly impact Africa, whose largest trading partner is China. However, the impact of China's recent currency devaluation will largely depend on country-specific factors.

The Chinese government likely devalued its currency in August in part to combat a perceived downward trend in economic growth. This trend was recently reflected in the August data for the Caixin China Manufacturing Purchasing Managers' Index ("Caixin PMI"). The Caixin PMI, which indicates overall trends in Chinese manufacturing activity, fell to a 77 month low in August. The recent drop in the Shanghai Composite Index is believed to reflect fears that these Caixin PMI numbers indicate a faster than expected decline in China's economic output. The Shanghai Composite dropped 42 percent in value since June 12, 2015, eliminating all gains made this year.

An initial devaluation of 2 percent occurred on August 11, followed by a subsequent 1.5 percent devaluation on August 12, 2015. In addition to these devaluation activities, Beijing has recently attempted other methods to prevent further losses to the stock market. These additional measures include permitting pension funds to invest in the Chinese stock market. In addition, on Tuesday August 25, 2015, The People's Bank of China injected 150 billion yuan (23.4 billion dollars) into the financial system through a reverse repo agreement.

For investors with a stake in Africa, this economic data cannot be ignored. Indeed, Africa has developed strong economic ties to China in recent years. When Africa is treated as a single country, China is its largest trading partner. In 2014, trade between Africa and China exceeded 220 billion. This is almost three times the value of trade between the United States and Africa for the same year. China is also a major investor in African infrastructure. As recently as 2014, when Chinese Premier Le Keqiang visited the African Union headquarters, Beijing indicated a desire to increase direct investment to 100 billion by 2020. Naturally, a weakened yuan will require an even greater increase in Chinese investment to achieve the originally intended effect. Further, a weakened yuan could result in decreased exports of African goods to China and increased imports of Chinese goods in Africa.

Despite this potential downside, some African countries, particularly those that import Chinese capital goods, may benefit from a weakened yuan. In recent years, a number of East-African countries, including Ethiopia, Kenya, and Mozambique all experienced large trade deficits, due at least in part to the relatively high cost of Chinese capital goods such as Chinese-made bulldozers and electrical lines. In Kenya, the trade deficit widened at the beginning of the year due at least in part to the construction industry's demand for construction goods. The recent devaluation of the yuan may help to reverse this trend. At least for the construction industry, a cheaper yuan will likely result in reduced input costs. The same might be true for the construction industries in other African countries that also rely on Chinese imports. These same countries may also benefit from lower-cost Chinese consumer goods.

Complicating matters further, most African countries use U.S. dollars instead of yuan when trading with China. This makes it more difficult to determine the impact of a devaluation on Africa-China trade. As a result of recent market turmoil, the value of some African currencies have also decreased. For example, during the same period of August that China's yuan dropped 3 percent in value compared to the U.S. dollar, the South African rand dropped nearly 2 percent relative to the dollar, largely blunting the impact of the yuan's devaluation. Recent data indicates that the rand fell even lower on August 24, which may have altogether eliminated any impact of the yuan's devaluation on South African consumers. The value of other African currencies also dropped in August; Zambia's currency shed more than 3.4 percent of its value and the value of the Nigerian and Angolan currencies are also expected to decrease. In short, whether the yuan actually devalues relative to other African countries will depend on a country-by-country analysis because the U.S. dollar is the currency used when trading.

Thus, the actual impact a devalued yuan will have on Africa's economy remains unclear. A devalued yuan could benefit some African countries while concurrently damaging others: the result will largely depend on the circumstances of each individual country. A web of other factors, including the global price of oil and a potential rise in the United States interest rate could further complicate matters.

Although China might have sneezed, it remains too early to determine whether the illness is contagious. Of greater concern for African investors should be the overall economic health of Africa's largest trading partner. Some worry that China's growth may have dropped below Beijing's seven percent target for 2015. If China's economy is indeed shrinking at a faster rate than previously expected, Africa and the entire global economy will undoubtedly catch a cold.

James Damon is co-author of this article.

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