Global Insights

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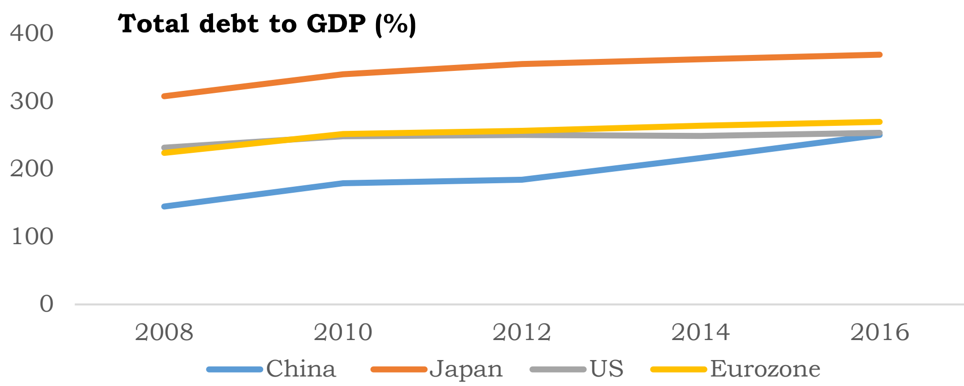
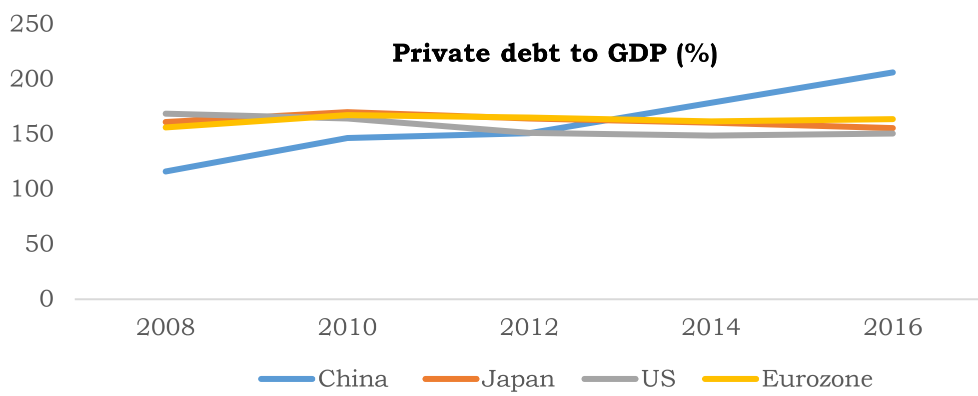
China's surging debt; a gloomy future? Implications for Rwanda

The Bank of International Settlements in its recent report warned that the growing debt in China is a key risk to the global economy. According to the IMF August report, the debt situation in China is "dangerous unless the country can bring its continual increases in debt under control". In 2017, China's overall debt is around 256% of GDP, higher than that of the US, although still lower than Japan which remains the world's most indebted country. High debt to GDP ratios are not necessarily a problem, in China however, the pace at which debt has grown as well as a surging private debt poses a risk.



Corporate and household debt in China has grown sharply than all major economies, which poses a greater risk – in case of any economic downturn; this could be a source of trouble.



Sustainable growth?

China has had consistent strong growth for years. However, most of this growth has been due to extensions of credit to companies by banks and the state. After falling exports following the financial crisis, China thought to offset this impact by boosting infrastructure spending which led to an explosion of lending. The ongoing transition from an investment based to a consumer led economy in China has also created a boom in consumer debt as banks lent money to fuel spending. Currently, the state, commercial banks, consumers, state and private companies possess high and increasing debt levels. Although China has in the past reported strong growth, structural changes in the economy have affected this trend. Within 10 years, China's growth has halved from 14.2% in 2007 to 6.7% in 2016, the worst growth rate in almost 27 years, this therefore means that the growing debt hasn't been productive. According to Deutsche Bank, China's banks have never experienced a consumer credit cycle and therefore an increase in non-performing loans would be a challenge. According to the IMF, non-financial sector debt will reach 300% of GDP by 2022.

Possible impact on Rwanda

China is the world's second largest economy, the world's largest consumer of raw materials and the world's top exporter. Any economic downturn due to increasing debt would undoubtedly have a negative effect to the global economy as well as Rwanda.

Rwanda relies on China for imports. In 2016, Chinese imports to Rwanda were 11% of the total imports. Chinese goods are cheaper relative to other major countries, this helps to lower the import costs for Rwanda. Foreign direct investments from China also help to support the local economy while a sufficient demand for raw materials, especially minerals in China helps Rwanda's export receipts. A downturn in China would therefore have a direct negative impact on Rwanda because it would lead to a decline in demand for minerals, leading to low prices for Rwandan exports. It would shrink FDI and financial inflows such as remittances and aid from China to Rwanda while a decline in Chinese output would lead to an increase in import prices, putting pressures on Rwanda's reserves and exchange rate.

An impending crisis?

The increasing debt in an economy that is slowing is indeed a dangerous situation. China's economy has been slowing year on year while debt has been rapidly growing. China's growth decelerated to 6.7% in 2016 down from 6.9% in 2015. It is forecast to stabilize at 6.7% in 2017 but decline to 6.4% in 2018. Does this mean an impending global crisis led by China? Probably not soon!

A crisis in China would, only unfold if the Chinese economy is heading for a hard landing. Considering current developments, this worst-case scenario is unlikely to play out and therefore an impending crisis is unlikely. Although China's economy has declined, the IMF forecast growth to average at 6.4% through to 2020. Although modest, this growth should continue to support Chinese demand and output. Indeed, recent reforms by state owned enterprises have helped debt to equity ratios for China's largest non-financial firms to drop to the lowest levels since 2010, which should support a healthy private sector.

China's government has also showed efforts to control the debt problem. By maintaining capital controls, the government has prevented financial outflows that could cause deterioration in financial markets. The People's Bank of China (PBOC) is also working with financial institutions to reduce growth of bad consumer loans. China has little overseas debt, and a high domestic savings rate. Most of the debt is state owned because state-controlled banks loaned funds to state-controlled firms – which gives the government the ability to manage the situation. Current estimates show that state assets are $19 trillion, about 1.8 times total GDP, which makes the debt, less risky in the immediate term.

A crisis in China is therefore unlikely in the near term, but it remains a development to watch.