China’s trade and investment slowdown could hamper developing Asia

A growth slowdown in the People’s Republic of China causing a decline in trade would be felt across Asia, with commodity exporters and trade partners closest to the country hit hardest.

Although the region’s dependence on trade with China has been expanding fast, the effects of such a slowdown would not be catastrophic, says a new book published by the Asian Development Bank Institute.

Peter Morgan, co-chair of ADBI’s Research Department and one of the editors of *Slowdown in the People’s Republic of China, Structural Factors and the Implications for Asia* explains:

> China’s emergence as a major economic power brings to the regional economies both opportunities and challenges. An immediate risk faced by China’s Asian neighbors is the potential spillover effects of its economic slowdown. However, our model-based analysis suggests that the adverse impacts of this slowdown on regional economies would be relatively modest.

The study only considered the effects of a slowdown on trade, setting aside any repercussions for growth woes to be spread through financial markets or other avenues.

Trade underscores growth within Asia, although the nature of trade flows complicates calculations about its effects, Morgan says.

> China has outpaced the US, the European Union, and Japan as the largest trade partner of most Asian developing economies. Because a substantial part of Asia’s exports to China is composed of intermediate goods that will be processed and re-exported overseas, China’s import growth reflects the rise in both domestic demand and external demand from outside the region. As a

result, the role of China's demand in supporting regional growth may be exaggerated by the amount of total trade.

The nature of China's growth has been making its domestic economy increasingly important to trade partners, says Morgan.

First, China has been rapidly increasing the domestic content and value-added of its exports in global value chains. Second, China's domestic demand has been increasingly contributing to the value added of its trading partners. This suggests a larger impact of China's demand shock on its trading partners.

The study, which considered the effects of a drop in China's investment growth of 3 percentage points a year between 2016 and 2020, found an overall slowing of growth in developing Asia of 0.26 percentage points in annual growth over the 5 years. The biggest effects would be felt on commodity exporters and the countries most entwined with China's production chains.

Given its geographical proximity and the large size of its economy, China is the dominant destination for commodity exports of most Asian emerging economies. Shrinking import demand for coal and other minerals from China would hit developing Asia's exports in these sectors hard. Besides these commodity sectors, machinery exports of Hong Kong, China; Taipei,China; and the Republic of Korea, and electronics exports of the Philippines would be significantly affected as well, largely due to the high participation of these sectors in China-centered Asian production chains.

Morgan and his co-editors note the need for Asian economies to strengthen coordination as their growth becomes increasingly tied to China in the years ahead.

They say future shocks could be minimized by a greater focus on domestic demand.

Over the past 7 years since the global financial crisis, there have been some favorable signs that show the strengthening role of domestic consumption in regional economies. Further policy reforms to improve income distribution, strengthen social safety nets and develop domestic financial markets are necessary to promote a structural shift toward domestic demand.

That was Peter Morgan, co-chair of ADBI's Research Department, talking about a study he did with Fan Zhai, the former managing director of the China Investment Corporation. Morgan edited *Slowdown in the People's Republic of China, Structural Factors and the Implications for Asia* with Justin Yi-fu Lin, director of the Center for New Structural Economics, Peking University, China, and Guanghua Wan, director of the Institute of World Economy, Fudan University, China. This is part five of a five-part podcast series on the book.

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