China Leads Global Manufacturing Output

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In 2010, China was the world's largest manufacturer and stands to maintain this in 2011. Low labour costs and economic growth have allowed China to become the destination of choice for global businesses looking to offshore manufacturing.

Consumers have benefitted from the resulting competition for production costs.

However, China's one-child policy and rising wages are restricting manufacturing and labour growth, while the country has earned the unwanted tag as the world's low-quality producer.

~ China's total manufacturing production expanded by 107.9% in real terms over 2005-2010, amounting to US$10.2 trillion, the largest total worldwide, more than double that of second-placed USA. The country's large manufacturing base has been key in attracting foreign businesses and boosting the domestic labour market, while Chinese consumers have benefited from lower prices on locally produced goods;

~ Nonetheless, high rates of inflation, growing wages and a shift in government policy are beginning to erode China's manufacturing edge, with businesses increasingly turning to cheaper Asia Pacific producers. With manufacturing making up 29.5% of GDP in 2010, one of the highest ratios in the world, China remains vulnerable to external demand shocks.

Implications
Consumers and businesses continue to benefit from China's manufacturing base, despite socioeconomic challenges threatening the country's competitiveness:

~ China benefits from advanced infrastructure compared to other Asia Pacific nations, with infrastructure bottlenecks in India, for instance, a major obstacle for businesses. China ranked 91st out of 183 nations in the World Bank's Ease of Doing Business index in 2011, considerably higher than its regional low-cost competitors such as Indonesia and India;

~ Strong growth in manufacturing production allowed China to overtake Japan as the world's second-largest economy in 2009 in US$ terms, as well as remain the leading exporter in the world with exports of US$1.6 trillion. However, China's image has suffered from the “made in China” tag, which has become a byword for low-cost and low-quality among international consumers;

~ Relatively low labour costs, a large workforce and strong economies of scale attract major international brands to Chinese manufacturers, especially in the textile and electronics sectors. Consumers worldwide have also benefited from the manufacturing shift to China, as savings made by international companies are reflected in the prices of goods. The Chinese consumer market has also been boosted by the availability of a wide array of locally produced products;

~ However, China is losing its advantage as a low cost environment for labour. The country's one-child policy is resulting in shortages of labour, permitting workers the leverage to demand better wages. Rapid population ageing is narrowing the labour pool, while high inflation is increasing export and transportation costs. Wages per hour in manufacturing increased by 63.1% in real terms over 2005-2010;

~ As a result, businesses can now find lower labour costs in Indonesia and Bangladesh, for example, especially in the production of clothing and footwear. To remain competitive, much of Chinese manufacturing has migrated westwards to cheaper Chinese provinces;

~ With China responsible for over a quarter of the world's total manufacturing production and manufacturing employing 13.6% of the employed Chinese population in 2010, China remains vulnerable to external demand shocks, should global economic conditions worsen.

Prospects
~ With the USA experiencing difficult economic conditions and stagnating manufacturing levels throughout 2011 , the production capacity gap between China and its closest competitors will likely increase further in 2012 and beyond. However, Chinese manufacturers may be affected by falling demand as a result of the eurozone sovereign debt crisis. China is expected to see annual real GDP growth of 9.4% in 2011 slowing to an estimated 8.7% in 2012;

~ Rising living standards, greater demand for urban office jobs and increasing wages are all factors that may stunt manufacturing expansion in China. Continued increases in the old-age dependency ratio (the percentage of persons older than 65 per persons aged 15-64), which is expected to rise from 13.0% in 2010 to 18.2% by 2020, will also restrict the labour pool for manufacturing sector employers;

~ The country's 12th Five-Year Plan (2011-2015) looks to move China away from being a cheap goods producer and into a more design-based global role. Businesses involved in the production of budget products in China may have to rethink their strategy over the longer term, while there are strong opportunities for investors in high-tech segments.

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