

China Economic Update

by NAB Group Economics

2 April 2015



Australia's relationship with China needs to mature as its growth model evolves

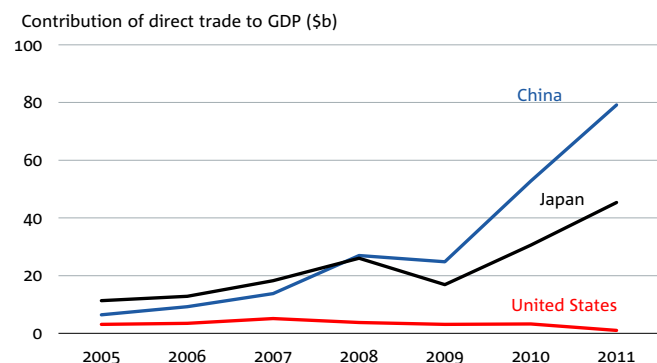
China's rapid industrialisation over the past few decades has provided considerable economic benefit for Australia – as a strong increase in trade and investment has increased the integration between the two countries, even before the recently negotiated free trade agreement.

A [new report](#), co-produced by the Australia China Business Council (ACBC) and the University of Sydney, sponsored by National Australia Bank, highlights the significant benefits to Australian households and businesses from the closer relationship with China.

China's rising impact on Australian economic growth

In the past, there have been a range of estimates that have attempted to calculate the contribution of Australia-China trade to Australia's economic growth. The University of Sydney's analysis in the ACBC report utilises the World Input-Output Database (WIOD), which provides a stronger quantitative basis to determine the contribution. Between 1995 and 2011 (the current range of the database), the contribution of direct trade with China rose continuously, contributing in excess of 5.5% of Australian GDP in 2011.

China the leading contributor to GDP among our major trading partners

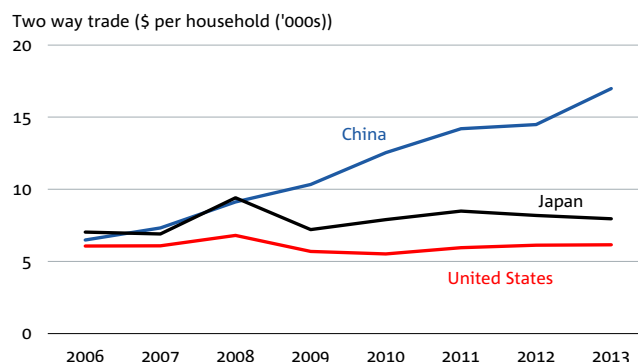


Sources: ABS, DFAT, ACBC, NAB Economics

Australia-China trade and its impact on employment

The ACBC report shows that Australia's two-way trade (imports and exports) with China rose by 17% in 2013, to almost \$17000 per household – making China by far Australia's largest trading partner. In comparison, two-way trade per household with Japan was almost \$8000 and the United States totalled just over \$6000 in 2013.

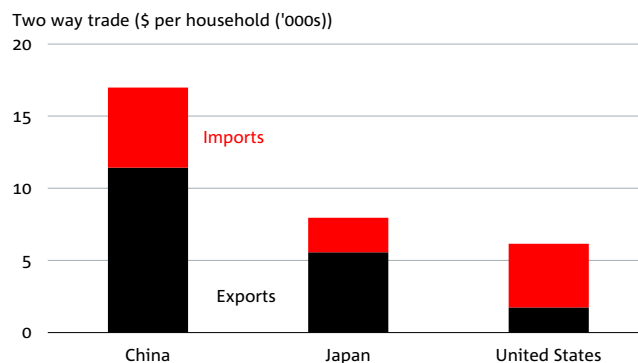
China has become an increasingly important export market, while the US and Japan have remained stable



Sources: ABS, DFAT, ACBC, NAB Economics

The majority of Australia's two-way trade with China has been exports – accounting for over two-thirds of the total. This trend reflects both China's increasing demand for Australia's resources – particularly iron ore and metallurgical coal – but also the comparatively strong prices for these commodities, a trend that has reversed considerably across 2014 and early 2015, as conditions in China's industrial sector have slowed.

Australia's two-way trade dominated by exports for China and Japan, but imports from the US

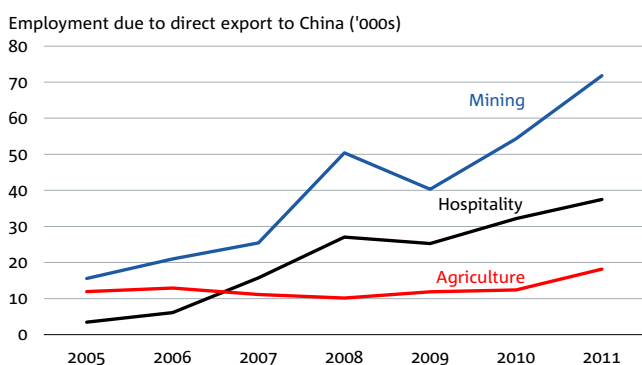


Sources: University of Sydney, ACBC, NAB Economics

The WIOD was also used to measure the impact of China trade on Australian employment levels. The ACBC report shows that almost 200 000 Australian jobs were supported by exports to China in 2011 – double the level of 2007. The 2011 level was equivalent to around one in fifty-eight workplaces being supported by direct export to China – double the level of 2007 and four times the level in 2001.

China's impact on employment by industry varies considerably – reflecting both the direct links to trade with China as well as the labour intensity of each sector. The three industries with the largest employment gains related to trade with China are mining, the broad hospitality sector and agriculture, forestry and fishing.

Mining employment the key beneficiary of trade with China (selected industries only shown)



Sources: University of Sydney, WIOD, ACBC

That said, this analysis only considers direct impacts of trade on employment, whereas there are also some spill over effects to related industries. For example, the ACBC report notes that international students provide indirect benefits via accommodation and goods & services purchases that are almost equal to the value of their education expenses.

China's economic evolution and the impact on trade

China's model of growth is beginning to change, with the government keen to shift the economy away from the investment and export led model (which has run out of momentum) and towards one centred around consumption (as is the case in advanced economies). This has raised some concerns in Australia – given the rapid growth of resources exports over the past decade, which were closely related to the investment led growth.

However, China's evolution, driven in part by rising incomes and wealth in the emerging middle class, also provides significant opportunities for Australian businesses – particularly in areas like food (both in terms of quality and security), tourism and education. The ACBC report notes that only around five per cent of Australia's exports to China are directed to consumer markets, a ratio that is well below other trading partners. The report also notes that despite the opportunities for growth, reaching these potential customers will require new approaches and engagement with Chinese business partners.

More to Australia-China trade than iron ore and coal (selected industries only shown)



Sources: University of Sydney, WIOD, ACBC

While resources, particularly iron ore and metallurgical coal, have dominated Australia's trade with China in recent years, there has also been significant growth outside the resources sector. For example, there has been a steady increase in food exports, manufacturing (particularly basic and fabricated metals, machinery, chemicals, electrical & optical equipment and transport equipment) as well as services. This growth has meant that China has become the most important destination for a wide range of non-resource exports.

In agriculture there has been a significant shift in the profile of exports to China. Traditionally, fibres (such as wool and cotton) have dominated Australia-China agricultural trade, but in 2013 there was considerable growth in beef, oilseeds and other meat, reflecting in part the changing dietary patterns in China (switching towards a more Western style diet).

That said, the ACBC report highlights the superior position that New Zealand currently holds in Chinese trade. New Zealand has greater penetration into Chinese consumer markets, particularly for higher value consumption, with a larger share of Australian exports heading to the comparatively lower value food and beverage processing sector (around 45%, compared with just 25% for New Zealand).

New Zealand's agriculture industry has made greater inroads into higher value consumer sectors

Export sector	Chinese industrial sector (Share of exports)		
		Food, Beverages & Tobacco	Final consumption
Agriculture, Forestry & Fishing	Australia	45%	3%
	New Zealand	25%	24%
Food, Beverages & Tobacco	Australia	14%	62%
	New Zealand	5%	79%

Source: University of Sydney, ACBC

Conclusions

The evolution of China's growth model means a less resources-intensive export profile for Australia in the longer term. Among other recommendations, the ACBC urge Australian businesses to become more deeply engaged with China's consumer markets and contribute to China's value chains as well as partnering with Chinese firms to expand opportunities in services.

This view is supported by NAB's [Australia-Asia Business Engagement Index](#), which highlights the fact that many Australian firms – particularly in the SME space – engage narrowly with Asia, seeking to benefit from lower cost product imports, rather than a broader trade relationship.

For more information, please contact

Gerard Burg +613 8634 2788

Group Economics

Alan Oster
Group Chief Economist
+61 3 8634 2927

Jacqui Brand
Personal Assistant
+61 3 8634 2181

Australian Economics and Commodities

James Glenn
Senior Economist – Australia
+(61 3) 9208 8129

Vyanne Lai
Economist – Australia
+(61 3) 8634 0198

Phin Ziebell
Economist – Australia
+61 (0) 4 55051024

Industry Analysis

Dean Pearson
Head of Industry Analysis
+(61 3) 8634 2331

Robert De lure
Senior Economist – Industry Analysis
+(61 3) 8634 4611

Brien McDonald
Senior Economist – Industry Analysis
+(61 3) 8634 3837

Amy Li
Economist – Industry Analysis
+(61 3) 8634 1563

Karla Bulauan
Economist – Industry Analysis
+(61 3) 86414028

International Economics

Tom Taylor
Head of Economics, International
+61 3 8634 1883

Tony Kelly
Senior Economist – International
+(61 3) 9208 5049

Gerard Burg
Senior Economist – Asia
+(61 3) 8634 2788

John Sharma
Economist – Sovereign Risk
+(61 3) 8634 4514

Global Markets Research

Peter Jolly
Global Head of Research
+61 2 9237 1406

Australia

Economics

Ivan Colhoun
Chief Economist, Markets
+61 2 9237 1836

David de Garis
Senior Economist
+61 3 8641 3045

FX Strategy

Ray Attrill
Global Co-Head of FX Strategy
+61 2 9237 1848

Emma Lawson
Senior Currency Strategist
+61 2 9237 8154

Distribution

Barbara Leong
Research Production Manager
+61 2 9237 8151

Interest Rate Strategy

Skye Masters
Head of Interest Rate Strategy
+61 2 9295 1196

Rodrigo Catril
Interest Rate Strategist
+61 2 9293 7109

Credit Research

Michael Bush
Head of Credit Research
+61 3 8641 0575

Simon Fletcher
Senior Credit Analyst – FI
+61 29237 1076

Equities

Peter Cashmore
Senior Real Estate Equity Analyst
+61 2 9237 8156

New Zealand

Stephen Toplis
Head of Research, NZ
+64 4 474 6905

Craig Ebert
Senior Economist
+64 4 474 6799

Doug Steel
Senior Economist
+64 4 474 6923

Kymerly Martin
Senior Market Strategist
+64 4 924 7654

Raiko Shareef
Currency Strategist
+64 4 924 7652

Yvonne Liew
Publications & Web Administrator
+64 4 474 9771

UK/Europe

Nick Parsons
Head of Research, UK/Europe,
and Global Co-Head of FX Strategy
+44207710 2993

Gavin Friend
Senior Markets Strategist
+44 207 710 2155

Derek Allassani
Research Production Manager
+44 207 710 1532

Asia

Christy Tan
Head of Markets
Strategy/Research, Asia
+852 2822 5350

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