Australian exports to East Asia – lower commodity prices mask improved trade integration

by NAB Group Economics

29 April 2016

National Australia Bank

- NAB surveyed Australian business integration with East Asia in September 2014 and China in December 2015. Recent headline trade data indicate a reversal in the decades-long process of growing integration with our region as exports have declined.
- However, as the series of product line case studies presented here shows, the headline export numbers give an unduly gloomy picture. As the stimulus of record export prices inevitably passed, commodity revenues fell. This masked ongoing progress in lifting commodity export volumes, diversifying the commodity base and lifting earnings in services trade. The fall in the $A (from above US dollar parity) that accompanied falling commodity prices has lifted our competitiveness in manufactures and services, helping support trade volumes.
- Paradoxically, therefore, long term fundamentals for increased integration have improved at the time export earnings have shrunk. The lower $A is boosting market opportunities in key sectors like agribusiness and tourism, already facing favourable prospects as income growth across East Asia changes dietary and leisure patterns. There is still work to be done on removing market access restrictions, despite free trade agreements, improving our efficiency to out-compete low cost rival suppliers and diversifying our product and market export profile in East Asia to limit reliance on a limited range of markets and products.
- The bottom line: Export revenues have been hit by the withdrawal of the sugar hit of the commodity price boom but the deeper process of integration continues.

Links

NAB ACRI Australia-China Business Engagement Index

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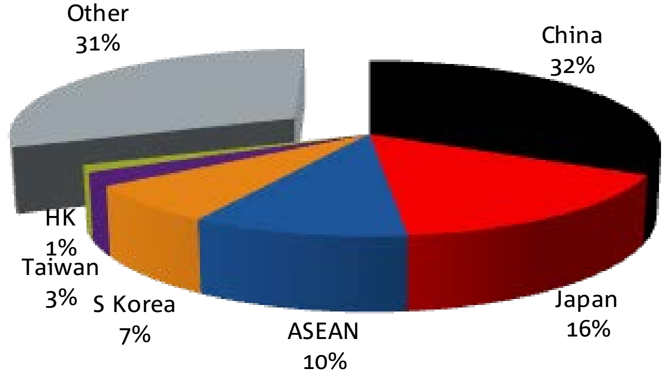
The big picture

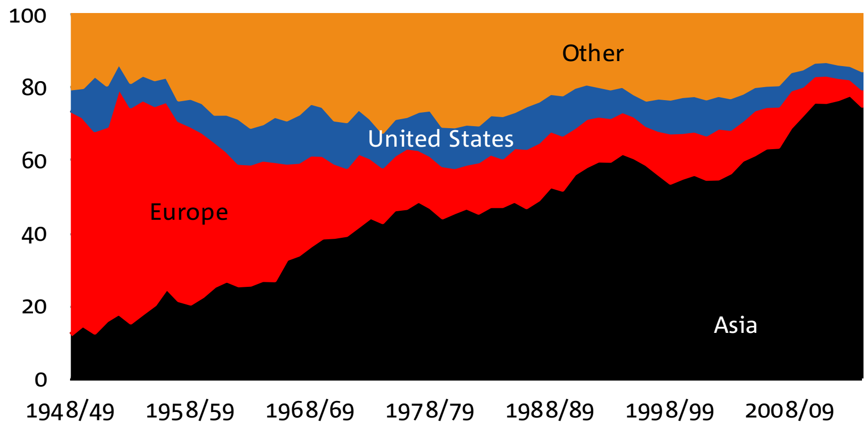
East Asia – easily the biggest market for Australian exports

East Asia buys two-thirds of Australian merchandise exports – China the major player



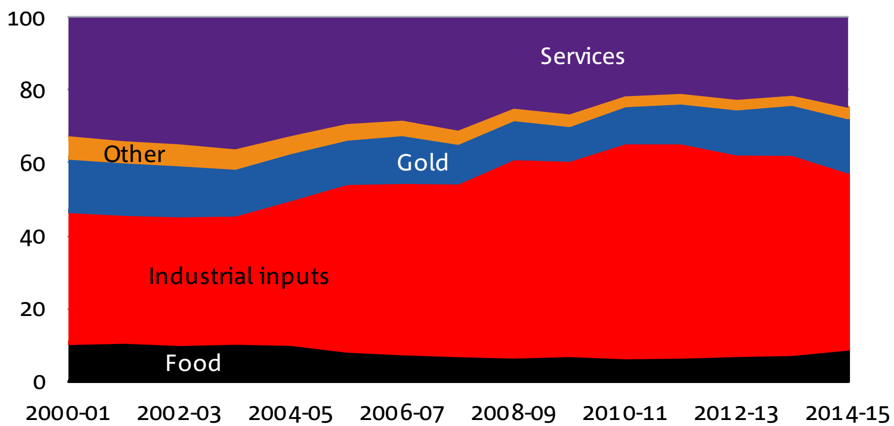
Sources: ABS, NAB Economics

The shift towards Asia has been a long term trend – reflects shifting balance of global economic power



Sources: RBA, ABS, NAB Economics

Industrial inputs have dominated trade but diversity now rising in export mix

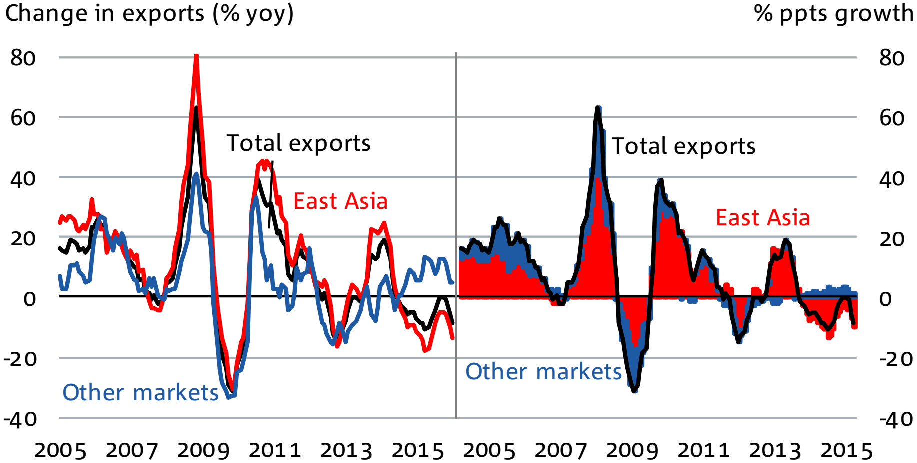


Sources: RBA, ABS, NAB Economics

- One-eighth of everything produced in Australia is sold into East Asia, representing around $210 billion in exports of goods and services in 2014/15 out of $1.6 trillion in GDP.
- East Asia is easily our biggest export market, buying over two-thirds of all goods exported in 2014/15 and 40% of service exports. This dominant export market position has gradually evolved with the rise of China displacing Japan from its previous number one ranking in regional export markets. In 2015, the $80 billion in shipments to China was twice that to Japan.
- China's rise to predominance initially mirrored the growing preponderance of its heavy industry in global production. This pulled in huge volumes of resource inputs like iron ore, coal and non-ferrous ores and metals – reflected in the rising share of industrial inputs in our export mix to the region. Recently the export mix has begun to diversify as a result of solid growth in services sectors (like education) as well as agribusiness trade.

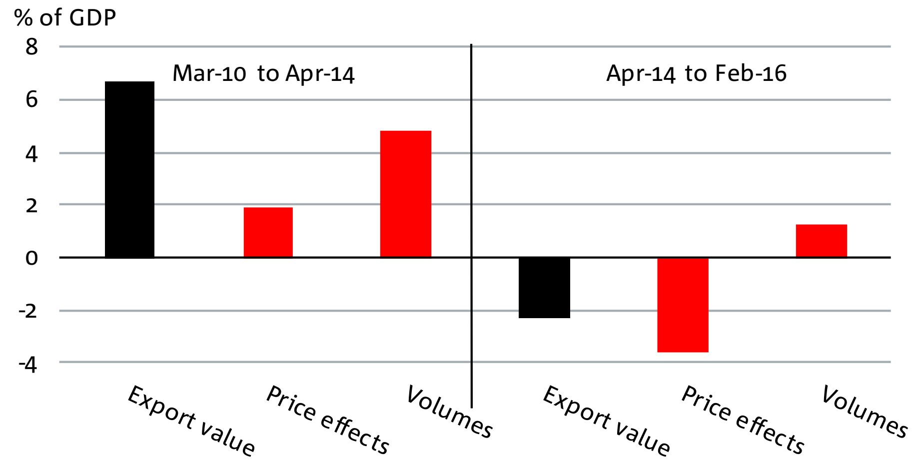
Australian exports hit hard by price slide in East Asian commodity trade

Export values to East Asia have fallen, other areas holding up better



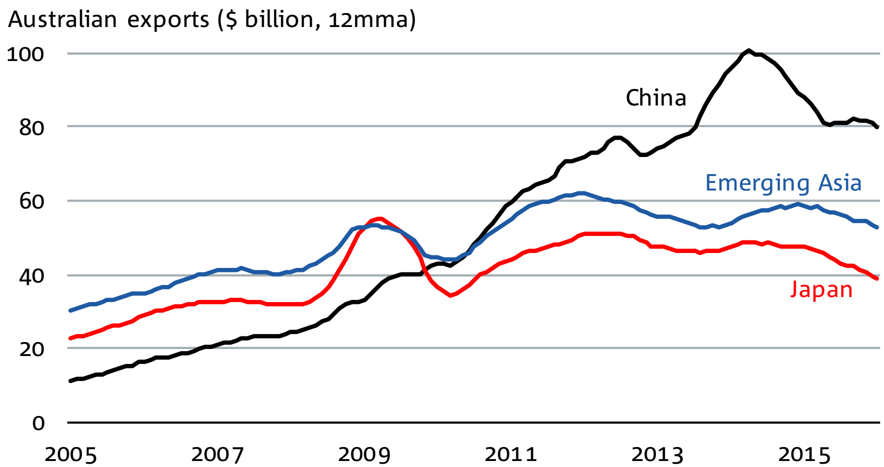
Sources: ABS, NAB Economics

Lower commodity prices to East Asia slice almost 4 % of Australian $ GDP, higher volumes offset 1.5% of the loss



Sources: ABS, NAB Economics

Export earnings fallen across all major markets as prices have come away from peaks



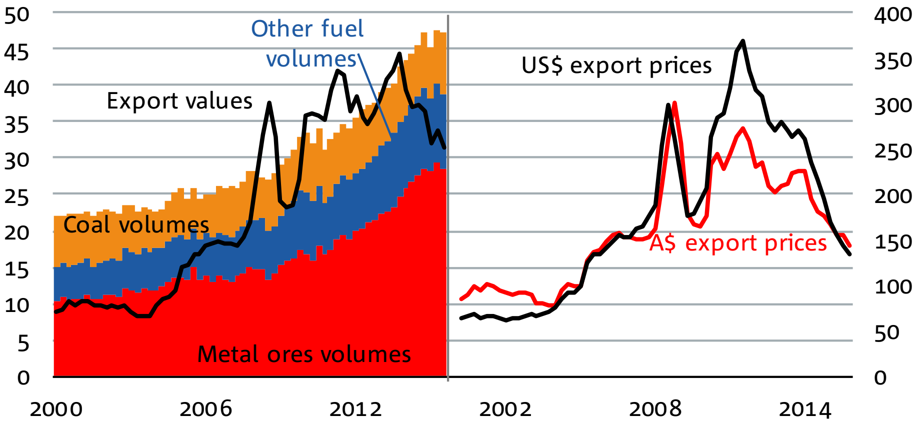
Sources: ABS, NAB Economics

- Australian exports to East Asia have turned down since 2014 as global commodity prices slumped. By late 2015/early 2016 the value of exports was down by around 15% yoy and the loss in goods revenue since April 2014 was equal to around 2½ percentage points of current dollar GDP – a sizeable shock.
- Higher export volumes have offset some of the downturn in commodity prices as increased shipment of resources and services lifted earnings.
- The downturn in exports to East Asia has been broad based with trend declines in shipment values to Japan, China and the emerging market economies of East Asia – a reflection of the tough trading environment facing commodity suppliers to a region experiencing sluggish growth (by its historical standards), little expansion in trade volumes and paying falling prices for the goods it imports.

Upside - Lower prices mask strong commodity export volumes

Decline in commodities exports is price driven, with volumes generally trending higher

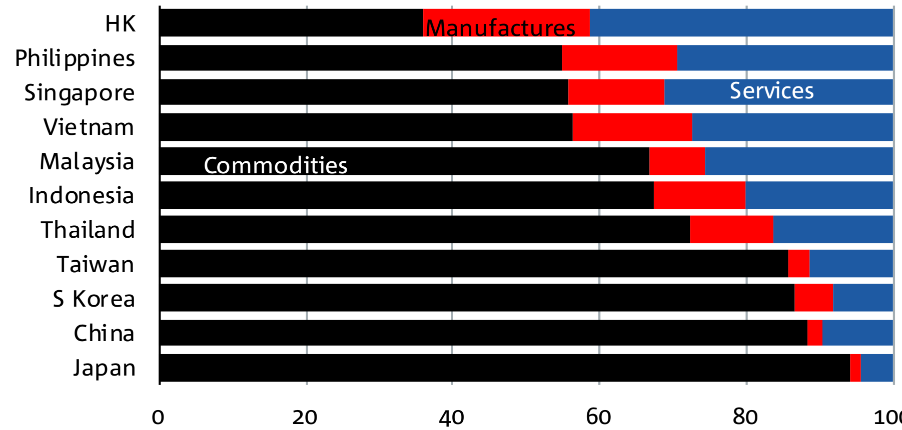
Australian resource exports ($ billion, volumes) Price index (Q1 2005 = 100)



Sources: ABS, RBA, NAB Economics

Australian export mix to Asia differs considerably between countries

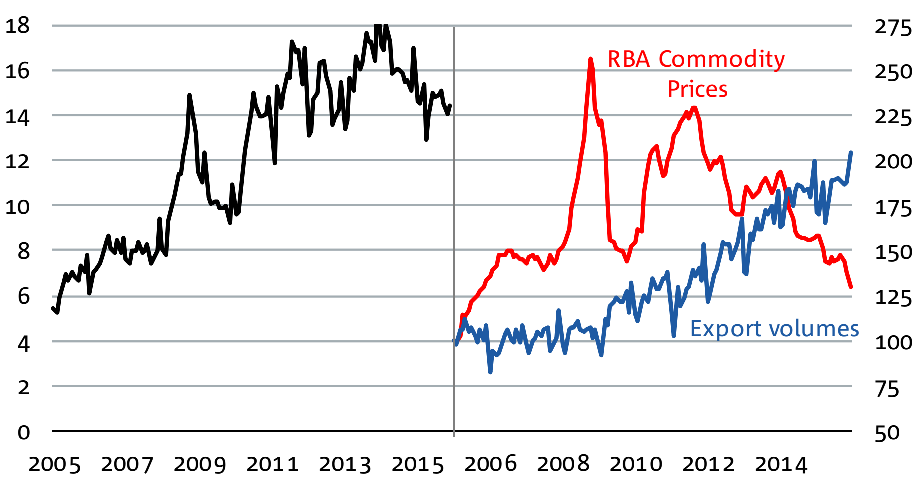
Composition of Australian exports 2014/15 (%)



Sources: ABS, NAB Economics

Commodity volumes to East Asia have continued to increase, lower prices drag down export revenues

Monthly exports to East Asia ($ billion) Index (Jan-05 = 100)

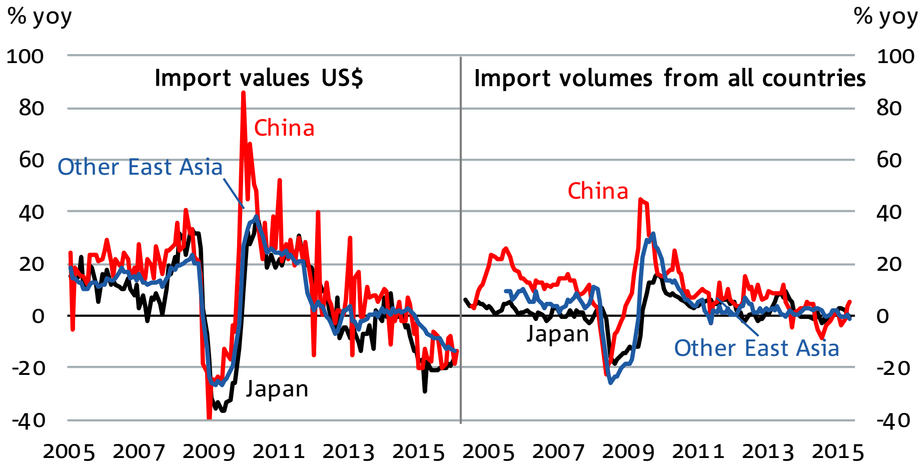


Sources: ABS, RBA, NAB Economics

- The downturn in export earnings masks the extent to which Australia is still integrating into the East Asian region. Lower commodity prices have certainly dragged down the value of exports but the volume of exports into the region has kept climbing and that shows every likelihood of continuing as the surge in LNG exports comes on through the next few years.
- These solid export volumes give a truer picture of the underlying trend of our integration into the region - and it is still making progress.
- Although the export product mix to key Asian markets varies, commodities are generally the dominant component. This is particularly the case with Japan – where hopes that the export base might become more diversified to include a greater share of manufactures and services have been disappointed. Exports to the other big resource-intensive markets of China, South Korea and Taiwan are also mainly made up of commodities with Hong Kong and Singapore showing a more diverse export mix.

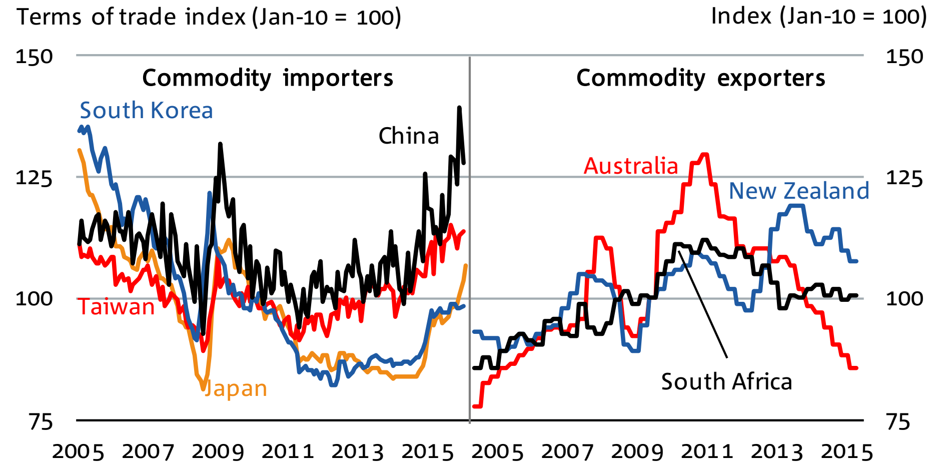
Australian commodity exporters face a tough environment in East Asia

Sharp pull back in trade flows mostly driven by prices, with volumes falling less significantly



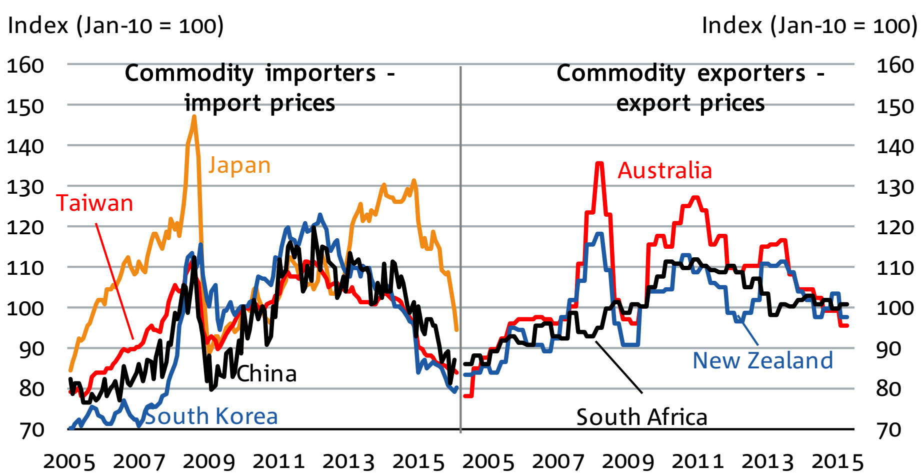
Sources: CEIC, NAB Economics

Falling commodity prices drive big shifts in the terms of trade – affects national incomes



Sources: Datastream, NAB Economics

Sliding commodity prices bring winners and losers – importing economies gain, exporters lose revenue



Sources: Datastream, NAB Economics

- East Asia – normally one of the powerhouses of globalisation – is experiencing a downturn in trade. While the decline in regional import values is not as severe as during the global financial crisis, it has been prolonged, serious and unusual for a period when the global economy is slowly growing and not in outright recession.

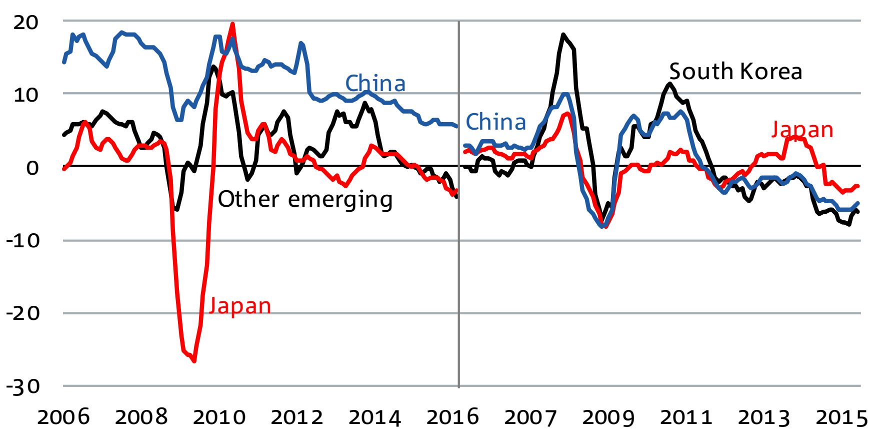
- Subdued growth in trade volumes explains some of these poor trade outcomes in a historically fast growing and open trading region. Sharply falling import prices for the goods imported into East Asia also account for the decline in the region's purchases and many of these imports are commodities. Falling import prices in East Asia have delivered sizeable gains in the terms of trade to the region's economies, boosting their national income. This represents the other side of the coin of the falling export prices and terms of trade experienced by big commodity suppliers into the region like Australia and New Zealand.


Industrial inputs – big
price falls erode earnings

Industrial activity has slowed across Asia – led by China's weaker growth

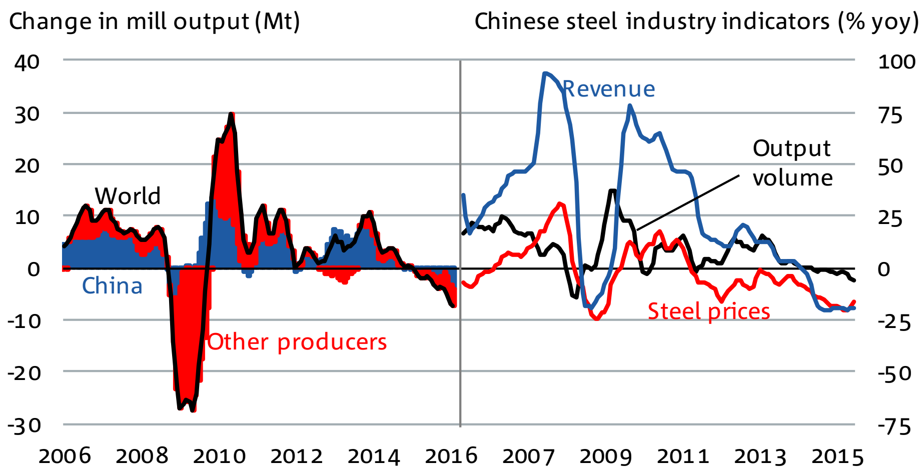
National Australia Bank

Industrial activity has softened across Asia – with falling output in many markets plus weaker growth in China



Sources: CEIC, NAB Economics

Conditions in China's steel industry have deteriorated in recent years on weaker construction demand

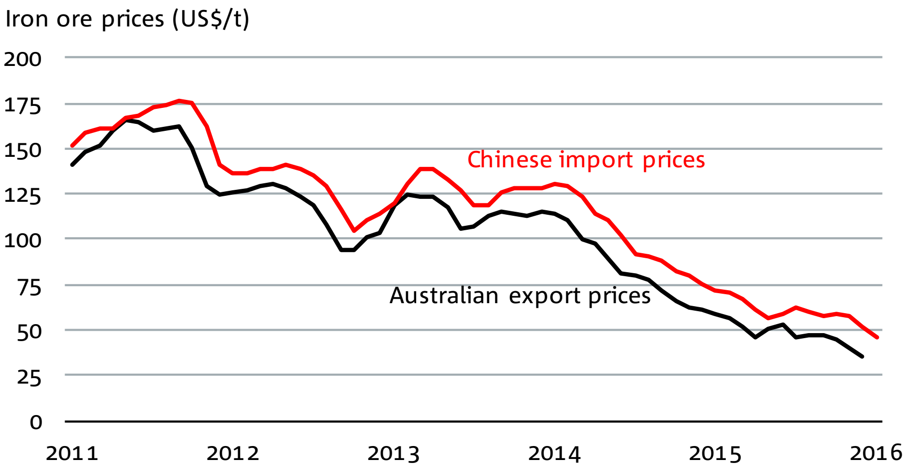


Sources: CEIC, Datastream, NAB Economics

- The downturn in Australian resource export values reflects the onset of tougher times in East Asian heavy industry. Chinese industrial growth is on a declining trend and industrial output across Japan and the rest of the region is running below year earlier levels. The weakness is broad-based with a run of weak output results for all the key economies starting in early 2015 and the onset of falling producer output prices as over-capacity in key heavy industries has led to fierce competition.
- Steel industry inputs are the biggest item in resource exports to East Asia – worth $65 billion in 2015, down from almost $90 billion in 2013. As China accounted for $43 billion of these exports in 2015, trading conditions in the Chinese steel industry have become the most important single driver of Australian exports. Chinese steel has had a difficult period with revenue dropping below year earlier levels as overcapacity drives steel output prices down.

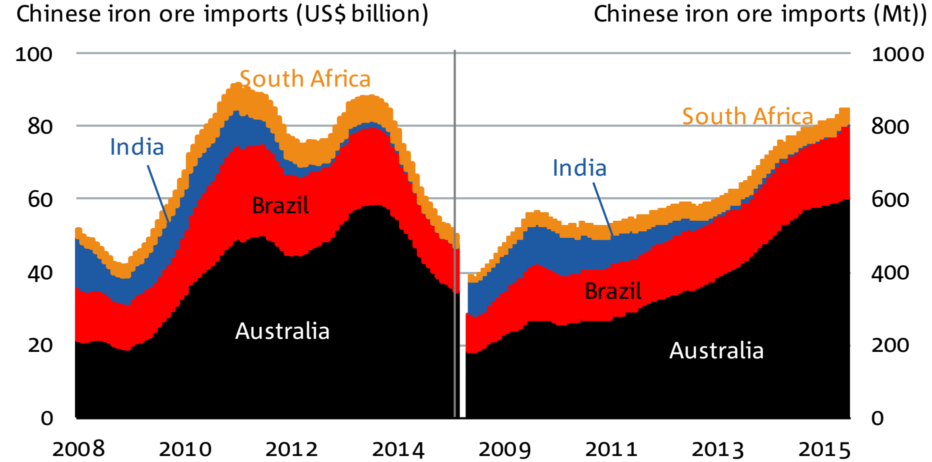
Iron ore trade hit by lower prices but volumes hold up

Steel sector downturn drags down global iron ore prices



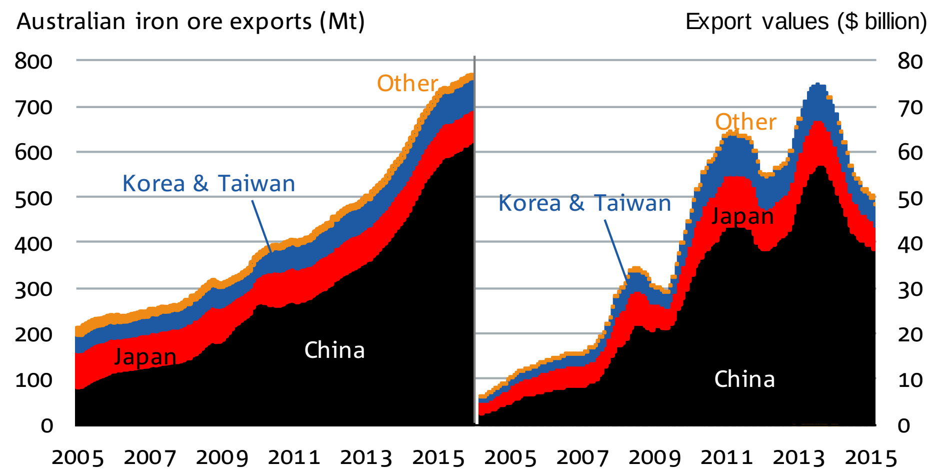
Sources: ABS, CEIC, NAB Economics

China's iron ore imports have continued to increase in volume terms – with Australia gaining market share



Sources: CEIC, NAB Economics

Australian iron ore exports have continued to climb, with producers favouring volume over profit

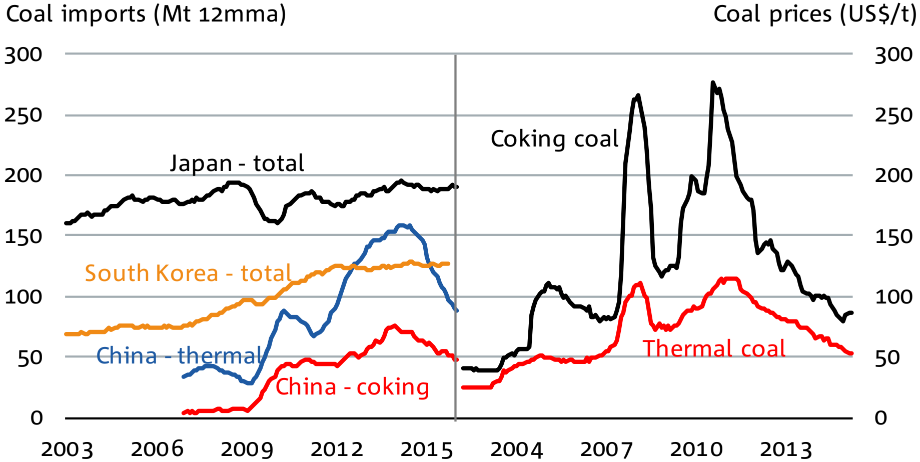


Sources: ABS, NAB Economics

- East Asia accounts for the decline in Australian export earnings. Australian iron ore exports have fallen from almost $70 billion in 2013 to just under $50 billion in 2015. This $20 billion fall in earnings exceeded the $12 billion decline in Australian total goods exports over the same period. Iron ore exports to the 4 big East Asian steel producers fell from $69 billion to $48 billion between 2013 and 2014 while shipments of coking coal declined from $19 billion to $17 billion.
- Iron ore is the best example where falling export values suggest lower integration with East Asia but the volume of shipments is actually increasing. The steep fall in global iron ore prices from their 2011/12 peak has eroded both total Chinese iron ore import values and Australian exports.
- Masked by these lower prices is a still rising trend in the volumes of both Chinese iron ore imports and Australian exports, despite the downturn in Chinese steel production. Australia is easily the biggest foreign iron ore supplier to China, with its biggest producing firms ramping up output, despite the tougher market conditions.

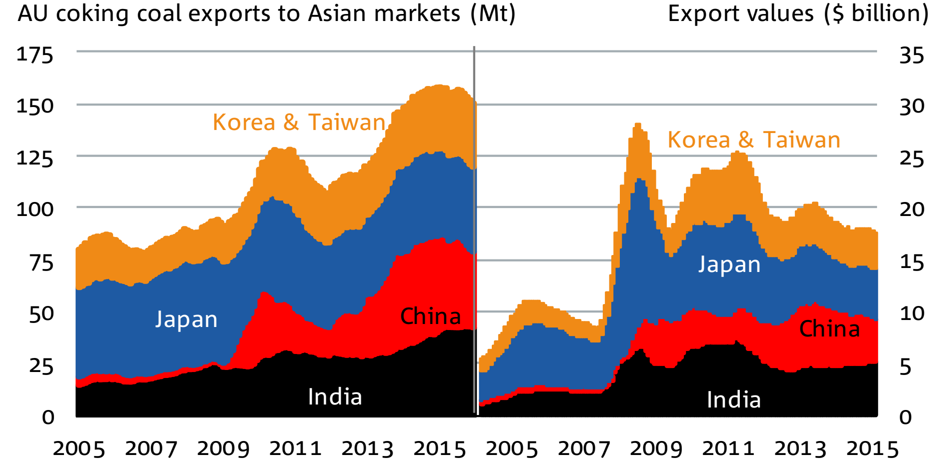
Price slide hits coal exports and volumes dip slightly

Weakness in coal markets driven by falling Chinese imports – as electricity and steel demand soften – prices fall heavily



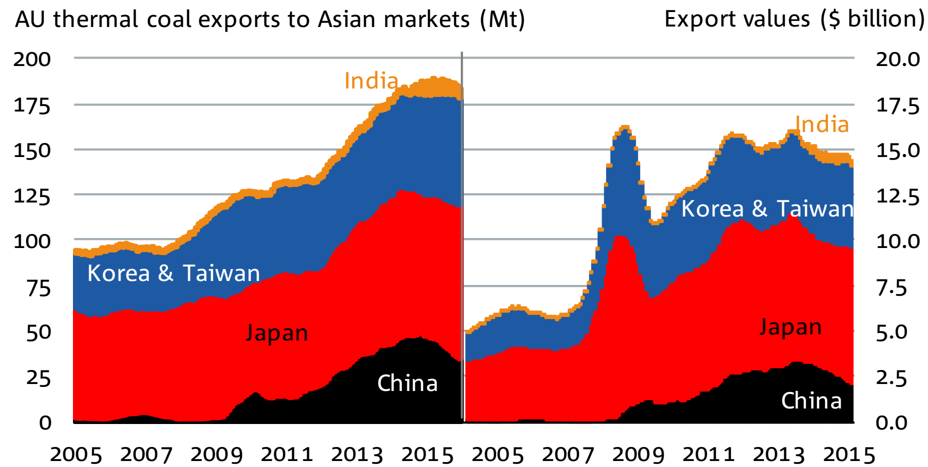
Sources: CEIC, ABS, NAB Economics

Australian coking coal exports dip in line with fall in Chinese coal imports as steel mills opt for local coal



Sources: ABS, NAB Economics

Falling Chinese electricity consumption in 2015 limited thermal coal demand and Australian volumes



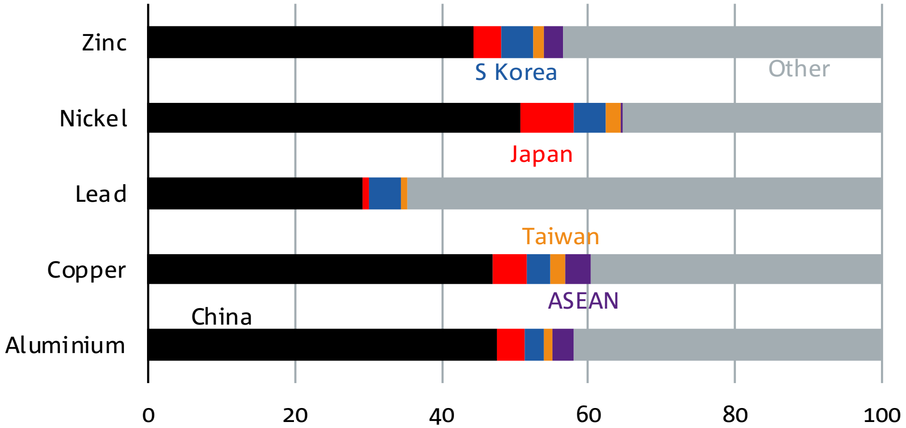
Sources: ABS, NAB Economics

- The downturn in Chinese steel output has squeezed demand for imported coking coal and that has been reflected in both much lower coal prices and a modest downturn in Australian export volumes to that market. As China accounts for a 20% of Australian coking coal exports as opposed to 80% for iron ore, the downturn in Chinese steel has had less direct impact on Australia's coal trade. However, although centred on the half of world steel output located in China, the steel downturn has become global with falling output through late 2015 and early 2016 in most key producers – including the key export markets of Japan, India, Taiwan and – until recently – South Korea.
- As Japan still buys almost half of Australian thermal coal exports, well ahead of China's 17%, electricity demand in Japan is the key driver of overseas demand and the generation of thermal power has been falling in Japan since 2014 – cutting the need for coal. Falling power demand in Chinese heavy industry through late 2015 also saw big declines in both Chinese imports and Australian exports of thermal coal.

Metals – Australian export values hit by the commodity price downturn

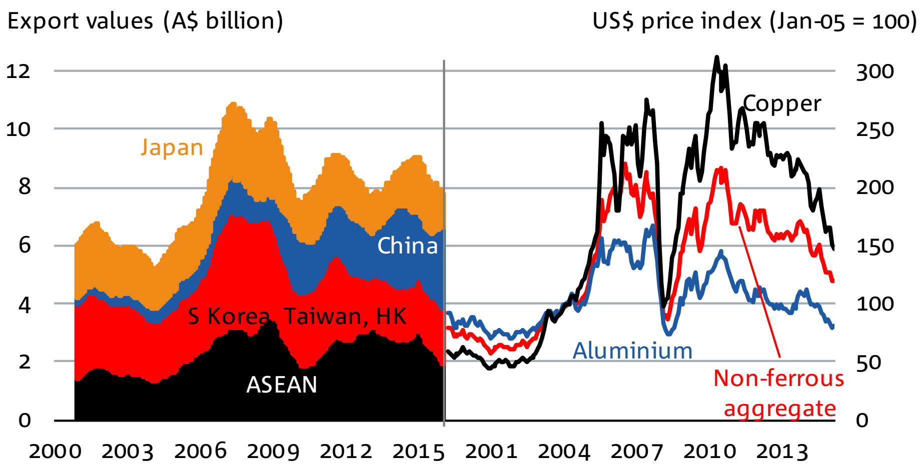
Asia – led by China – has come to dominate global non-ferrous metal consumption

Share of global non-ferrous metals consumption (%)



Sources: BREE, NAB Economics

Falling metals prices have hit the value of Australian metal exports in recent years



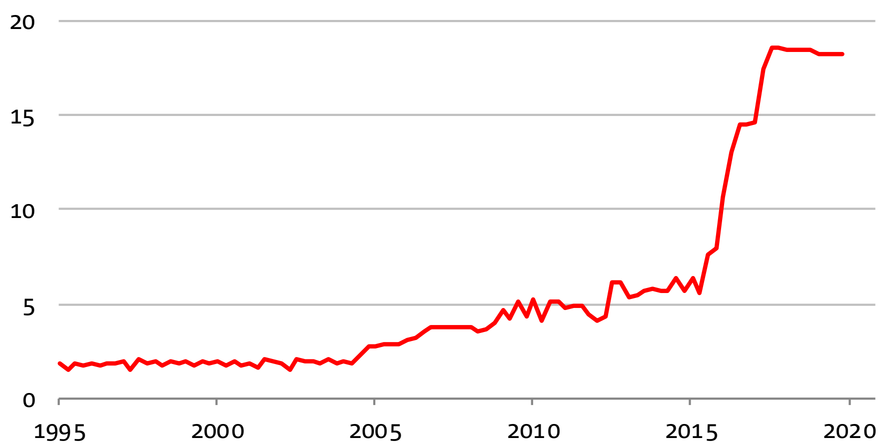
Sources: ABS, Datastream, NAB Economics

- Total non ferrous metal exports peaked at around $14 billion in the latter half of 2007 before the global financial crisis cut them sharply and they have since averaged around $10 billion annually.
- East Asia accounts for around half of global non-ferrous metals output and even that is not enough to supply its massive demand for these products. Consequently, Australia is also a major supplier of non ferrous metals to the region with shipments peaking at annual rate of $11 billion in early 2007 and still running at $8 billion in the 12 months ended in early February 2016.
- These fluctuations in metal exports reflect the big swings in the prices of key metals, which have been caught up in the general downturn in global commodity markets seen in the last few years. Underlying export volumes to the region remain strong.

Diversification of the resource export base

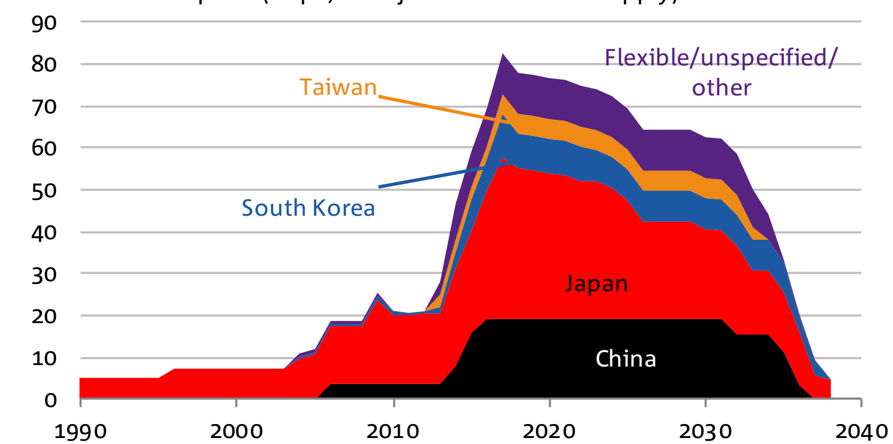
Australian LNG supply forecast to rapidly increase

Australian LNG exports are expected to more than triple by 2018 (compared to 2014)



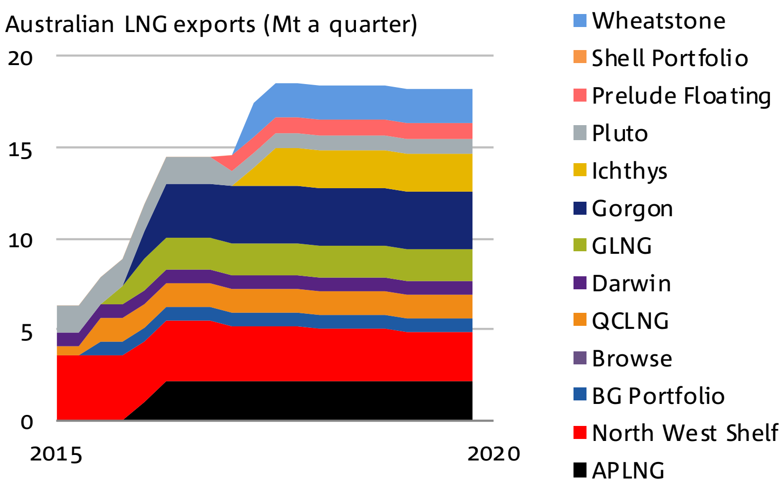
Sources: Bloomberg, Poten & Partners, NAB Economics

The vast majority of contracted LNG exports are destined for Asia



Sources: Bloomberg, Poten & Partners, NAB Economics

Projects in Western Australia and Queensland dominate LNG exports



Sources: Bloomberg, Poten & Partners, APPEA, Oxford, NAB Economics

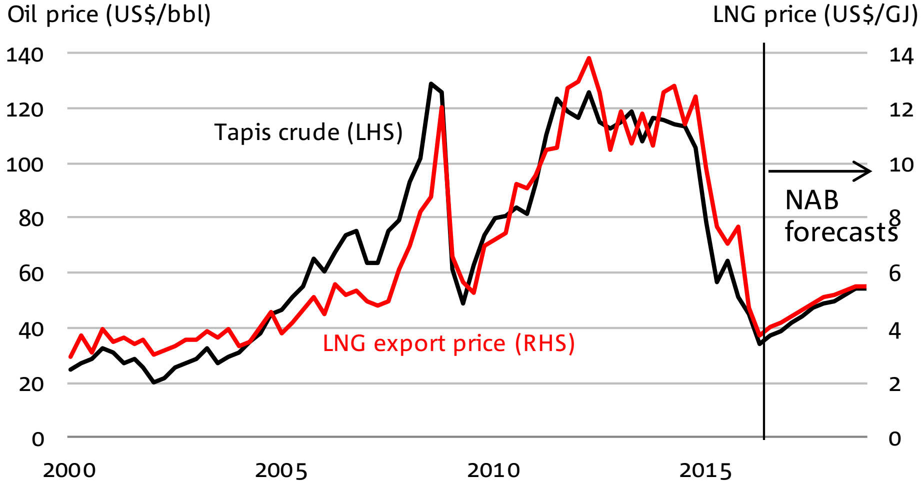
- Australia is significantly ramping up LNG production capacity, with new terminals in Western Australia, Queensland and the Northern Territory opening over the coming two years. This will give Australia the world's largest LNG production capacity – around 85 million tonnes per annum (mtpa) by 2017, around one-fifth of global capacity.

- Australia exported 27.6 million tonnes of LNG in 2015. NAB forecasts that exports will total 52.7 million tonnes in 2016 and 69.0 million tonnes in 2017.

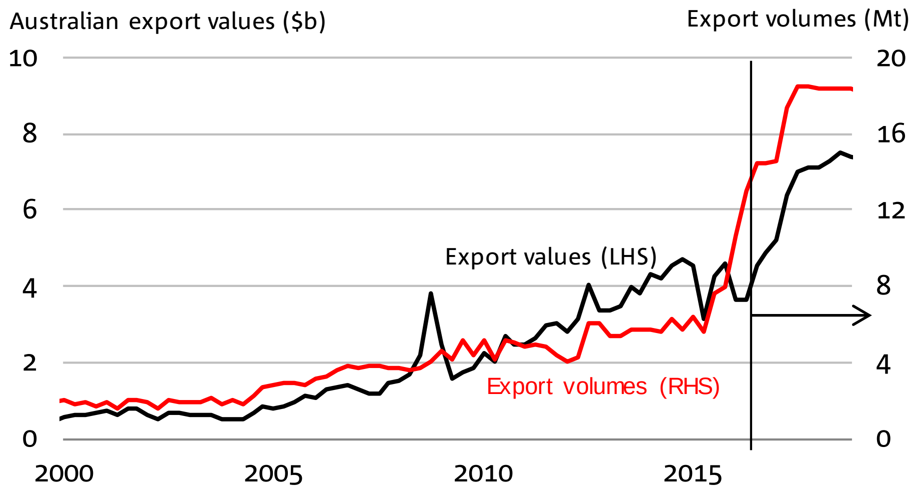
- The vast majority of Australian LNG is contracted to customers in East Asia. Japan will take almost half of contracted LNG, China around a quarter and South Korea around 10-15% (depending on year).

LNG prices likely to remain muted but volume will support growth

Most East Asian LNG contracts are tied to oil prices, which have fallen substantially since new Australian projects were approved



The value of exports will grow strongly, despite lower forecast prices (quarterly data shown)



Source: Bloomberg, Poten & Partners, APPEA, Department of Industry, ABS, NAB Economics

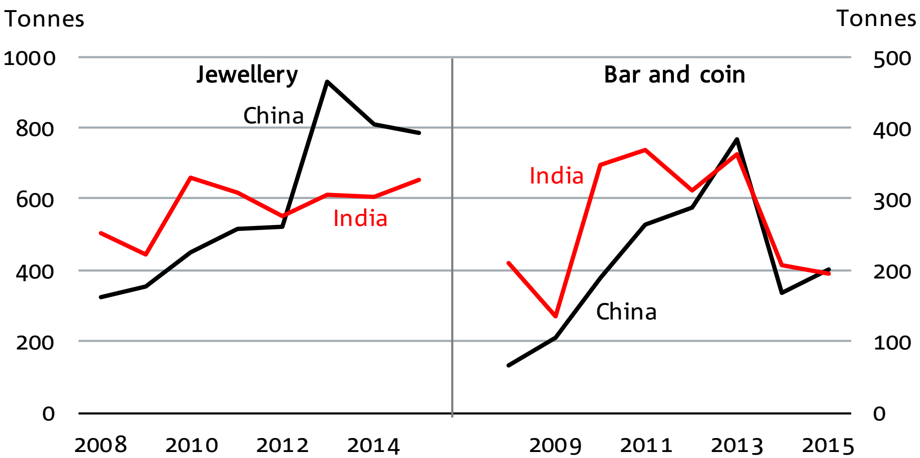
- We have developed an Australian LNG export price indicator based on ABS international trade data and LNG cargoes reported by Poten & Partners. A history of this series from 2000 is shown to the left.
- East Asian LNG prices have fallen significantly since mid-2014 on the back of lower oil prices, to which many LNG contracts are tied. For example, most Japanese LNG contracts are based on the Japan Crude Cocktail (JCC) – the import price of crude oil into Japan.
- While we expect crude oil prices to remain low in USD terms for at least the next two years, a lower AUD will provide some support to local prices.
- In export value terms, the price collapse will offset of the increased supply this year but we forecast values to grow from 2017. We see the value of Australian LNG exports at just under $17 billion in 2016, a slight increase on 2015.However, the value of exports should begin to climb again by early 2017, reaching $25.7billion in 2017.

Photo: Ken Hodge

Gold – China becomes world's biggest gold market, boosting our exports

National Australia Bank

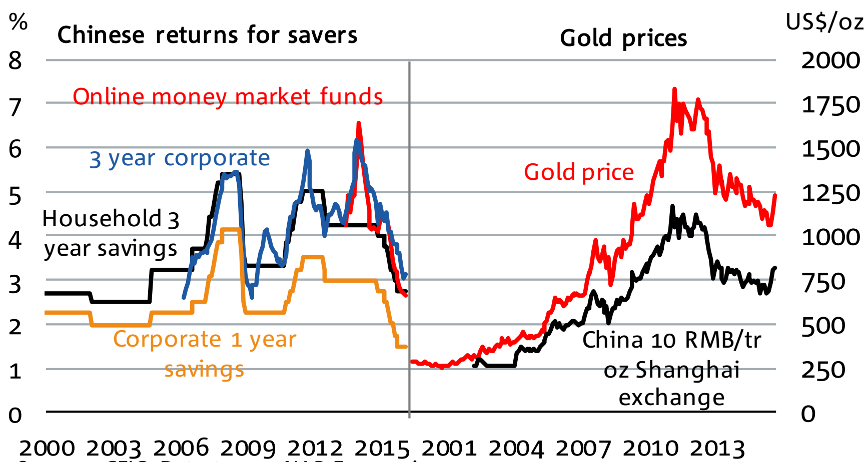
China joins India as global scale gold market



Sources: World Gold Council, NAB Economics

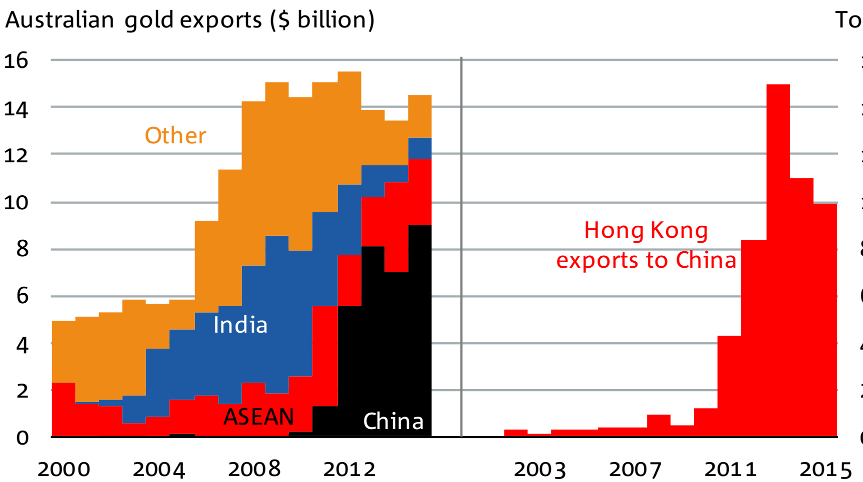
- China has displaced India as the world's biggest gold market. Chinese jewellery buyers consumed 783 tonnes of a 2015 world total of 2400 tonnes, well ahead of India's 654 tonnes. Chinese investment demand for gold bar and coins was 201 tonnes in 2015, ahead of India's 195 tonnes and China was around 20% of the global gold investment market.
- Falling interest rates on financial assets helped drive Chinese gold investment demand and rising wealth has seen gold take its place as a liquid asset in investor portfolios. Increased household incomes have supported jewellery demand with increased numbers of retail outlets and need for stocks.
- Rising Chinese gold demand has been reflected in trade flows with a ramping up in Australian gold exports as well as flows via Hong Kong. This represents a diversification in our export base to China and widens the range of influences driving our export trade to include Chinese jewellery purchases and investor decisions on the portfolio allocation – previously not important trade factors.

Low returns for savers help drive gold investment demand as a liquid store of wealth in China plus jewellery market



Sources: CEIC, Datastream, NAB Economics

China has become the key market for Australian gold exports



Sources: ABS, Hong Kong Customs, NAB Economics

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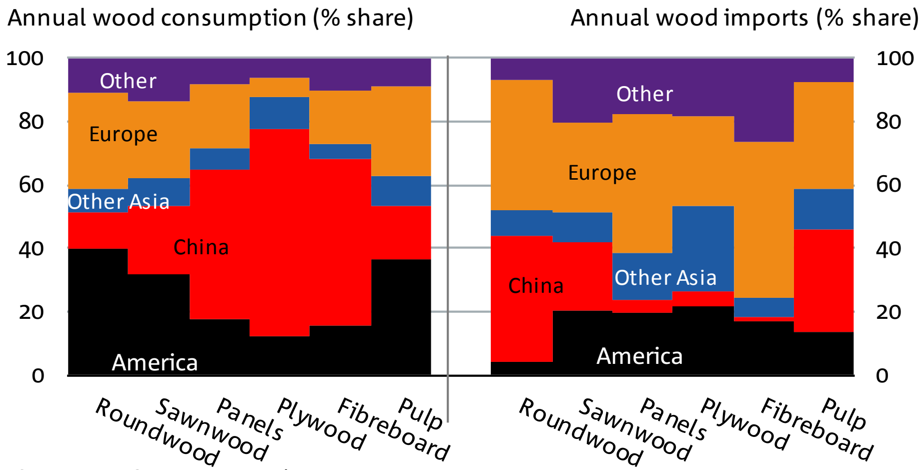
Wood – China driving world demand, lifts Australian exports

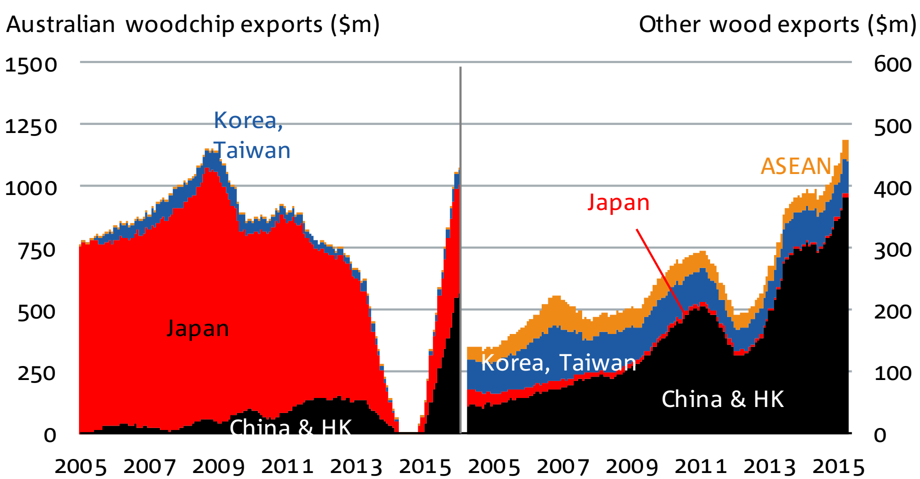
Construction boom makes China major global wood market



Sources: FAO, NAB Economics

- East Asia has been by far the biggest market for Australian forest products with the woodchip trade to Japan accounting for most of the export trade.
- The surge in Chinese construction has underpinned a rise in wood export trade to East Asia well as a broadening out in the product mix. China has joined Japan as a key market for woodchips and its building boom has seen China emerge as a huge market for other products from suppliers like Australia and New Zealand.
- China tends to import less highly processed wood products like roundwood and pulp. Although its massive construction industry consumes very high shares of global demand for plywood, fibreboard and panels, the value adding is usually done within China.

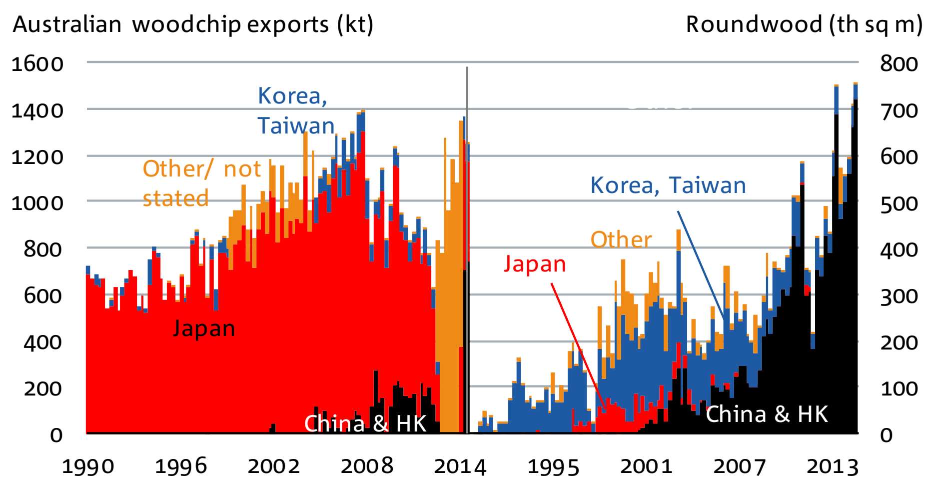
Woodchips and logs to China become big Australian trades



Sources: ABS, NAB Economics

Note: Data impacted by confidentiality in 2013

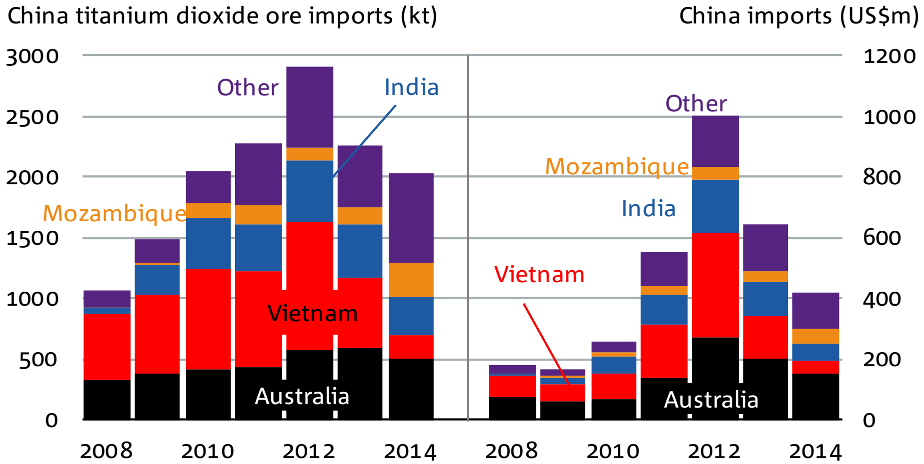
China displaces Japan as key market for raw wood products



Sources: ABARES, NAB Economics

Mineral sands – growth in China's construction demand

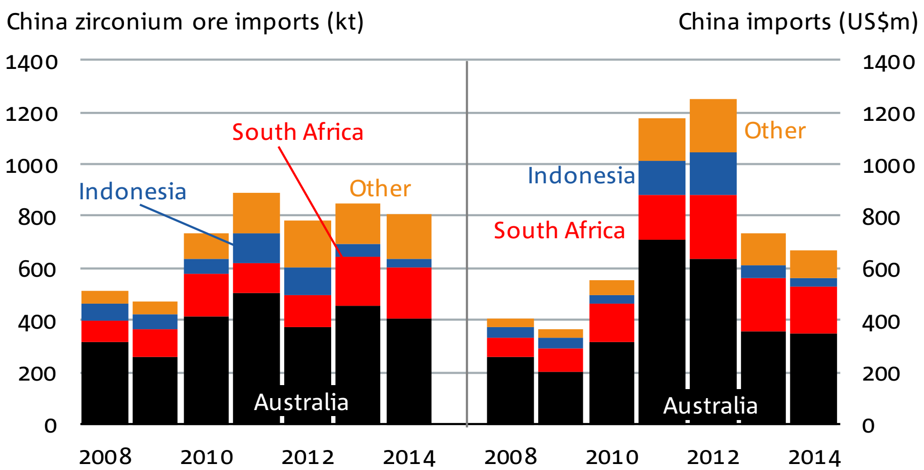
China's construction growth lifts paint demand



Sources: UN Comtrade, NAB Economics

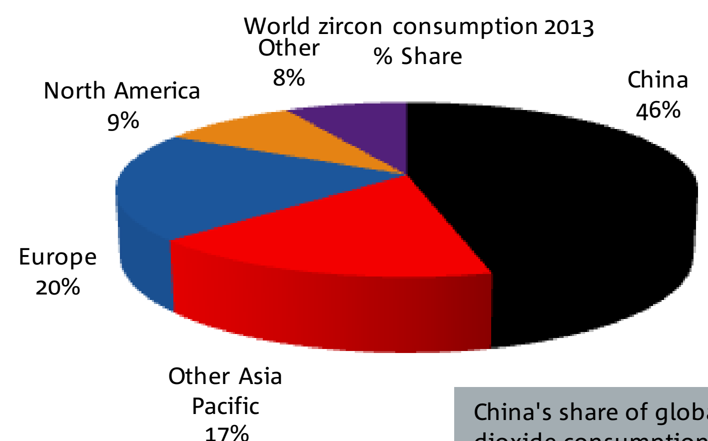
- Demand for mineral sands products – titanium dioxide and zircon – typically grow in line with GDP trends – reflecting their use in paint and ceramic products respectively used in construction.
- Titanium dioxide is a white pigment used in paint, plastics and paper, while zircon is consumed in ceramics and glass. Overall consumption of these products is therefore closely linked to construction activity and China's construction boom has seen it account for a very high share of global demand for all materials involved in building (raw timber, cement, mineral sands)
- China is the world's largest consumer of both minerals – at over 40% of the global total in 2013. Australia is one of the world's biggest exporters of mineral sands, much of it goes to China and Chinese firms are heavily involved in planned mining projects in Australia.
- China's titanium ore import volumes have fallen from 2012 peaks as domestic production has expanded. According to Iluka, Chinese ores are typically lower grade than internationally traded ores.

Construction boom lifts demand for ceramics – such as tiles – but market cycle still influences demand



Sources: UN Comtrade, NAB Economics

China has grown to be the leading consumer of both titanium dioxide and zircon



Sources: Iluka, NAB Economics

China's share of global titanium dioxide consumption: 44% (2013)

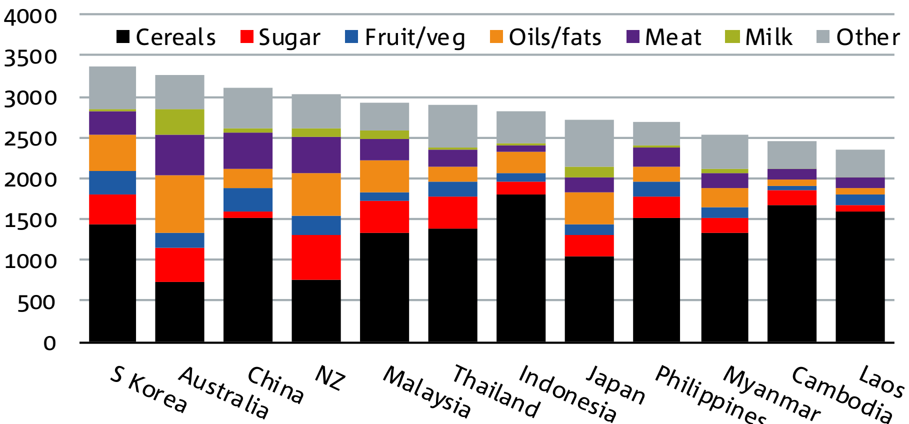
Food and agriculture – bright prospects

Rising incomes mean bright long term prospects for food exports

National Australia Bank

Diet changes as income rises – increased animal protein and reduced role of basic grains

Structure of diet (2014 kcal per capita a day)

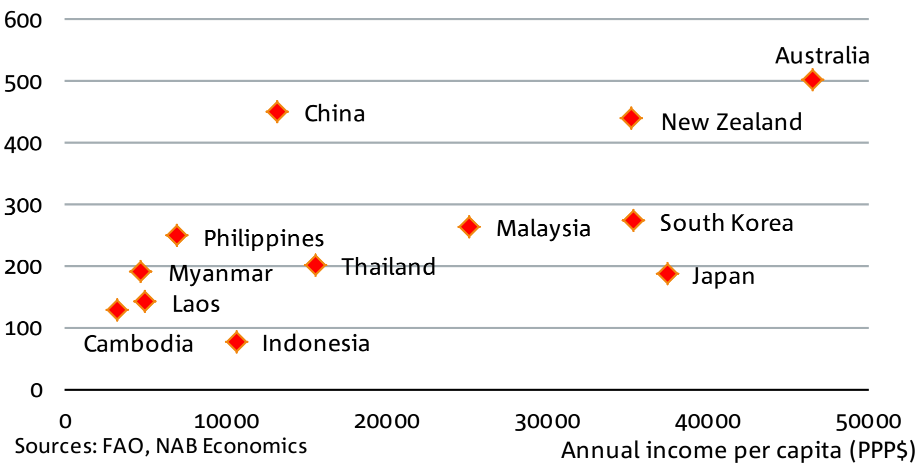


Sources: FAO, NAB Economics

- With increases in income generally leading to shifts in diet, the rise in East Asian spending power – with its influences like the growing number of middle class people who have travelled internationally - is producing new opportunities for food exports.
- The scale of opportunities opening up in China stands out in the region, reflecting the sheer size of its economy (four times the size of Japan) and the rapid pace of household income growth.
- China is experiencing the classic shifts in diet seen as household's get richer – reduced dependence on staple grains, increased consumption of animal protein (meat, dairy) and rising consumption of fruit. Comparisons of food consumption spending patterns across income groups in China show how the demand for meat, dairy and fruit rises alongside household income, highlighting the huge scale of market potential.

Scope for substantial increases in animal protein consumption across East Asia as income rises

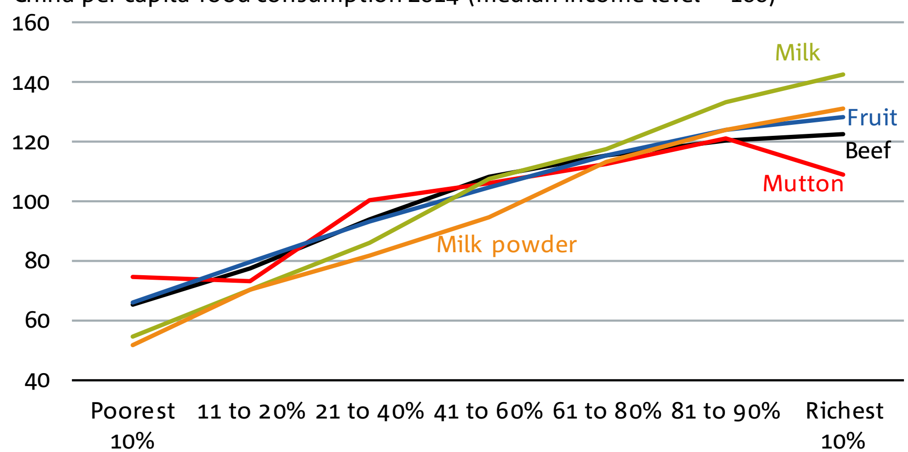
Average supply of animal protein (daily grams per capita)



Sources: FAO, NAB Economics

Chinese household income growth lifts demand for meat, dairy and fruit – process set to continue

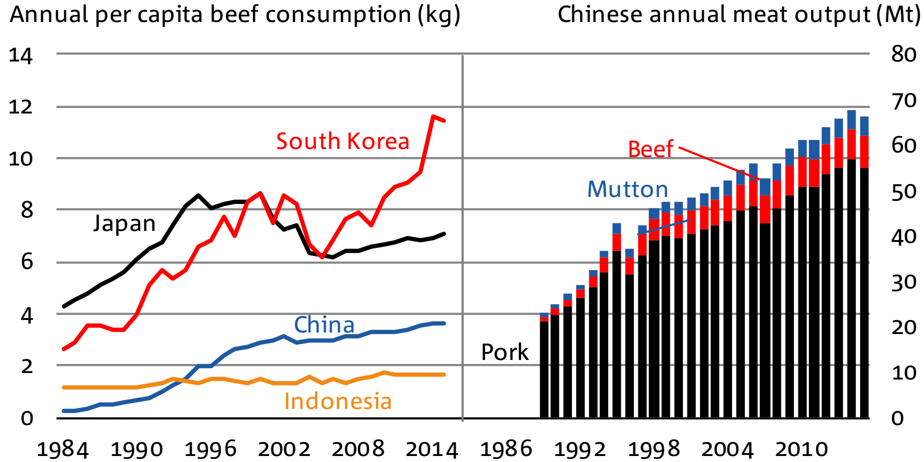
China per capita food consumption 2014 (median income level = 100)



Sources: NBS, NAB Economics

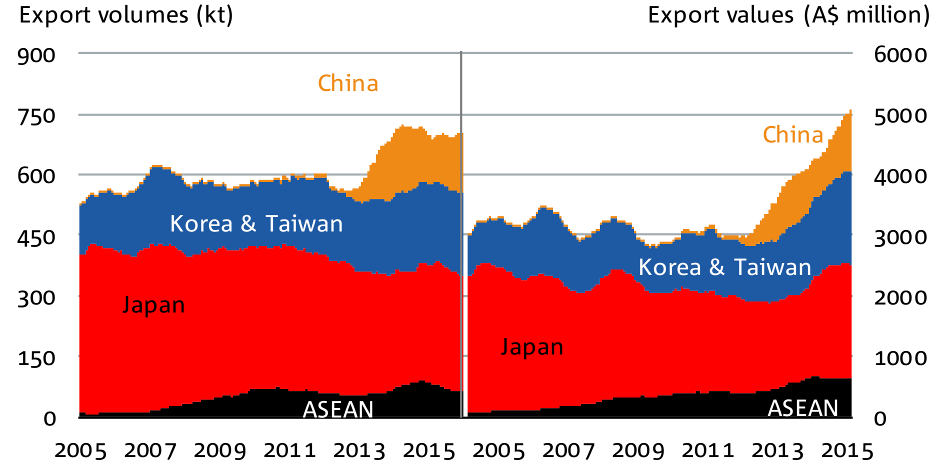
Rising Asian spending power and dietary change underpin beef trade

Beef consumption increases with wealth – China's per capita consumption still modest compared with neighbours



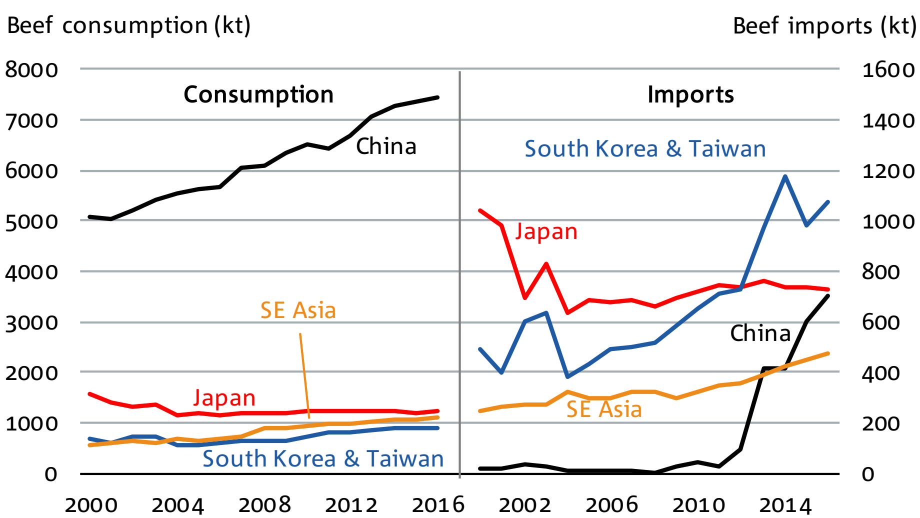
Sources: International Meat Secretariat, CEIC, NAB Economics

China has been the key contributor to recent export volume growth – though volumes to Asia have stagnated recently



Sources: ABS, MLA, NAB Economics

China's beef imports have risen rapidly in recent years, but still a modest share of consumption

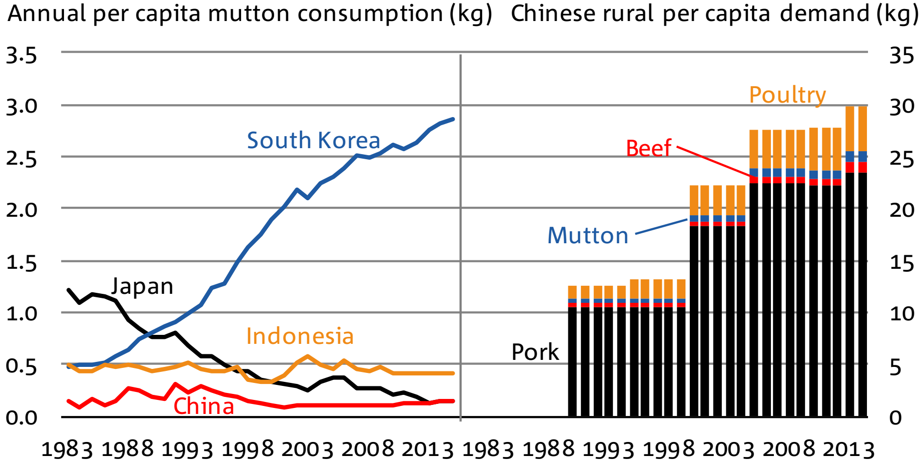


Sources: USDA, NAB Economics

- Beef demand trends in the biggest economies of East Asia show a very mixed picture. Chinese consumption and per capital demand have been trending up while Japan has gone the other way. There is ample scope for more growth in the Chinese beef market as incomes there rise and the market dominance of pork and poultry gets eroded.
- Shifts in demand have flowed into trade with Chinese beef imports rising from under 10kts in 2008 to over 650 kts in 2015 while 2015 Japanese beef imports of 700 kts are around one-third lower than they were in 2000.
- South Korea and Taiwan are also major beef importers with imports of around 550 kts in 2015 and rising per capita consumption in South Korea.
- East Asia is one of the key markets for the Australian beef industry, accounting for around $5 billion out of $9.3 billion in total 2015 exports. Exports to China have risen to around $1 billion but Japan is still the biggest outlet at $1.9 billion.

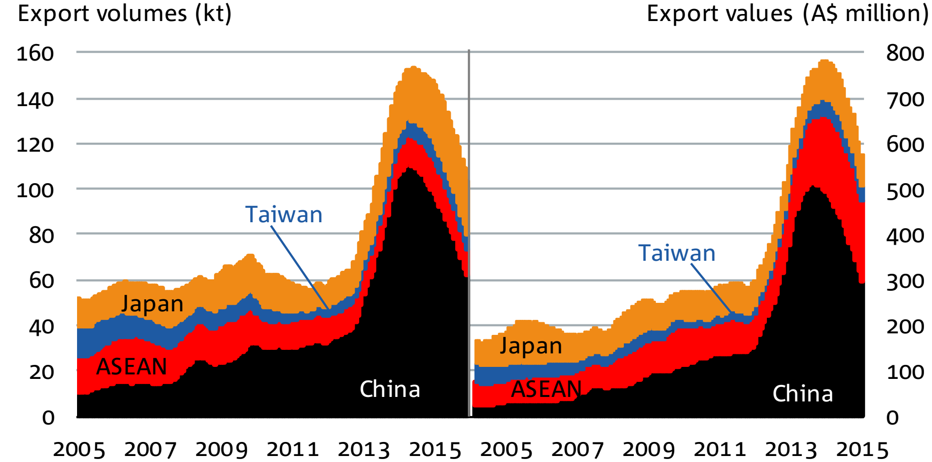
Sheepmeat – market cycles still exist even though demand is rising

Demand trends for sheep meat differ considerably between key markets



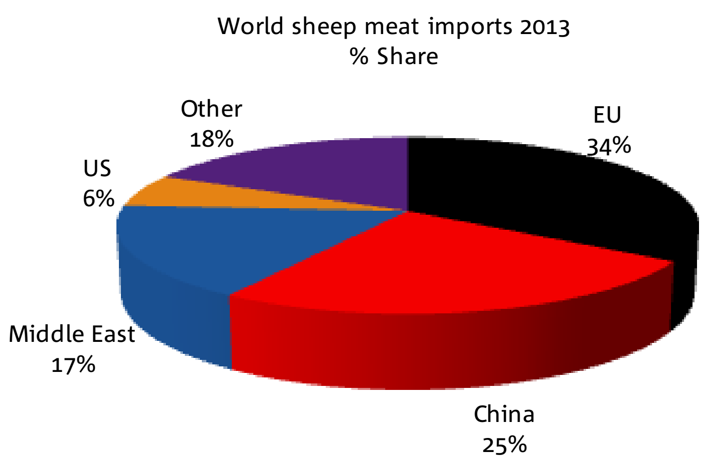
Sources: International Meat Secretariat, CEIC, NAB Economics

Australia's sheep meat exports have increasingly headed to China, though the pull back since 2013 has hit values



Sources: ABS, MLA, NAB Economics

China was a major import market in 2013, but imports have fallen heavily since

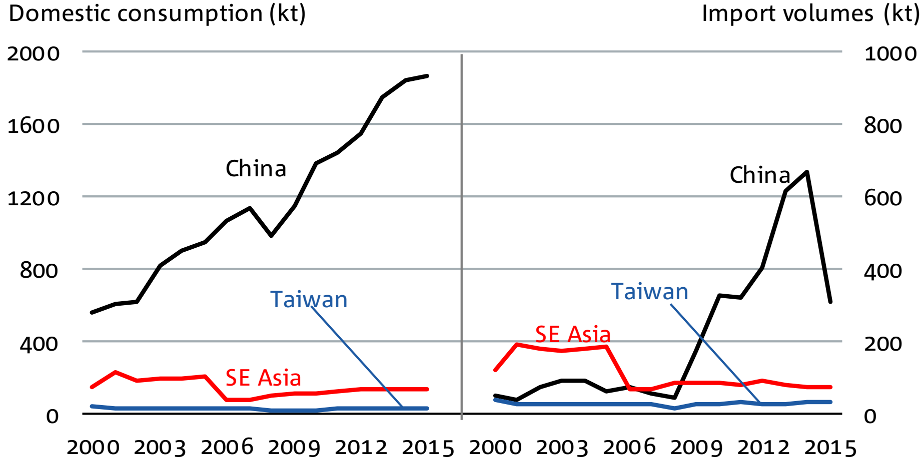


Sources: International Meat Secretariat, NAB Economics

- China is easily the biggest producer and consumer of sheep meat in the world, with domestic output 3 times larger than Australian production from a flock this is more than twice as big. Other important markets include South Korea, Japan and Indonesia. China accounts for a quarter of world sheep meat imports
- Chinese per capita mutton consumption tends to rise as household income increases but per capita demand remains well below that seen in South Korea or Indonesia. Pork and poultry dominate Chinese meat consumption and there is ample scope for sheep meat consumption to expand as diets change.
- Despite this favourable structural backdrop to demand, last year showed that it is still necessary to track the domestic supply-demand balance. Mutton exports to China halved between 2013 and 2015 and lamb shipments fell heavily as well. This reflected a build up in sheep meat held in store as local supply was strong.

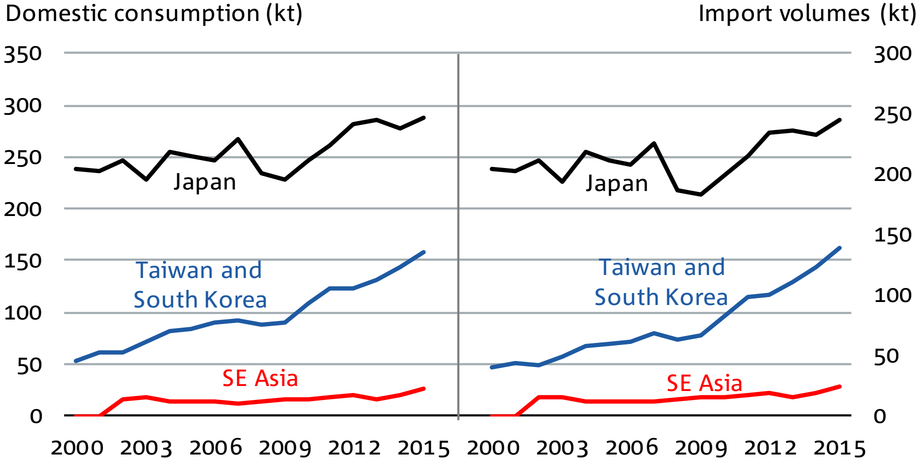
Dairy – Chinese demand for milk powder now a key global market driver

China now having a major impact on whole milk powder markets, with consumption rising, but imports falling



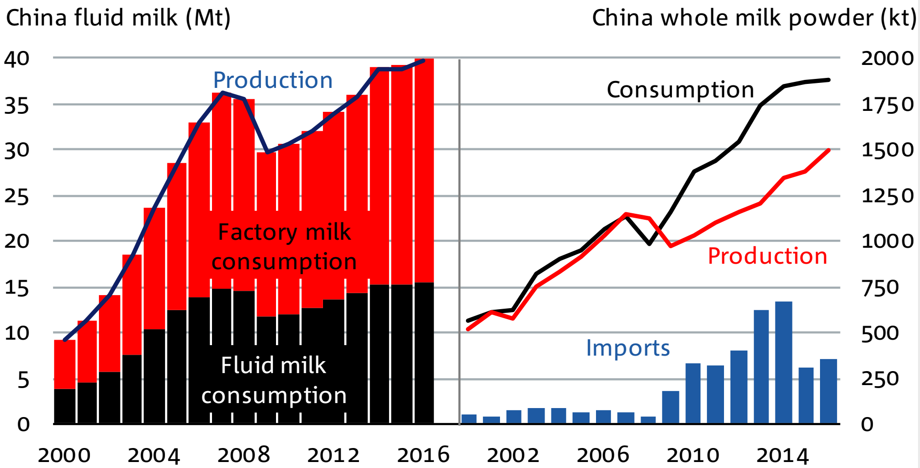
Sources: USDA, NAB Economics

Demand for cheddar cheese more evident in the more mature economies of the region



Sources: USDA, NAB Economics

China's fluid milk production has surged – with output exceeding Australia and New Zealand combined

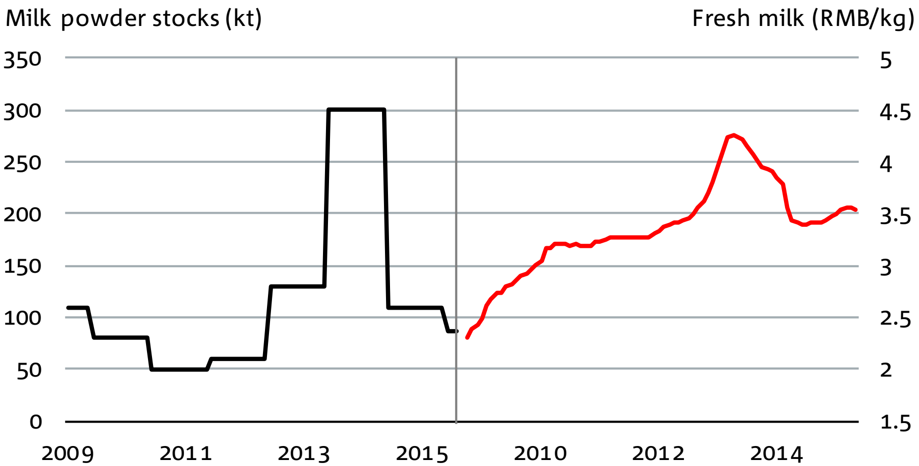


Sources: USDA, CEIC, NAB Economics

- East Asia is a major global dairy producer, particularly China whose fluid milk output exceeds that of Australia and New Zealand combined. While China has become a major market for dairy exporting nations, rising domestic output has accounted for the bulk of the 30 million tonne lift in milk consumption between 2000 and 2015.
- Despite a four-fold increase in local milk output since 2000, China has still become the world's biggest import destination for milk powder and third biggest for non-fat dry milk. Nowhere else in East Asia has seen a growth in dairy trade opportunities of comparable scale. The Japanese milk market was not much smaller than China's in 2000 but demand has actually fallen since then and by 2015 it was around one-sixth of that in China.
- Japan is however one of the world's biggest markets for cheese and dietary change (pizzas etc) have ensured that product's growth and similar trends are evident in other East Asian economies. Cheese exports to Japan are still Australia's biggest dairy trade item.

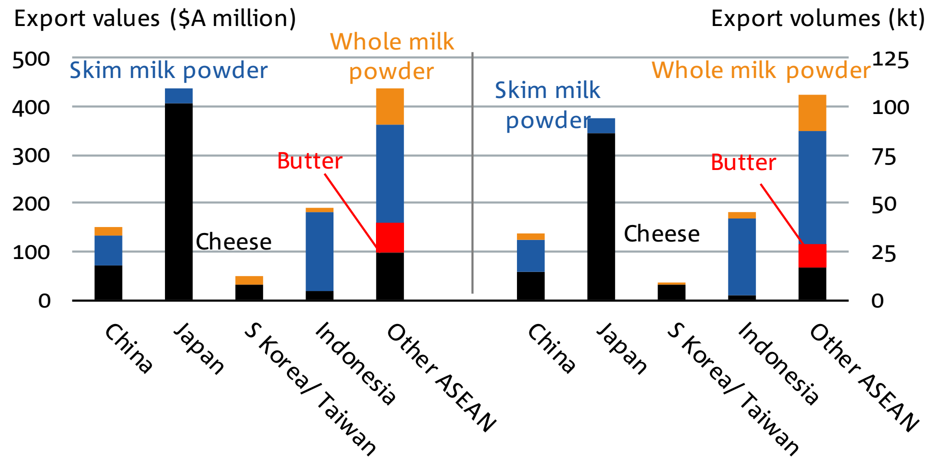
Dairy – Structural demand lift does not mean end of weak market phases

Chinese milk prices and imports show signs of market stress



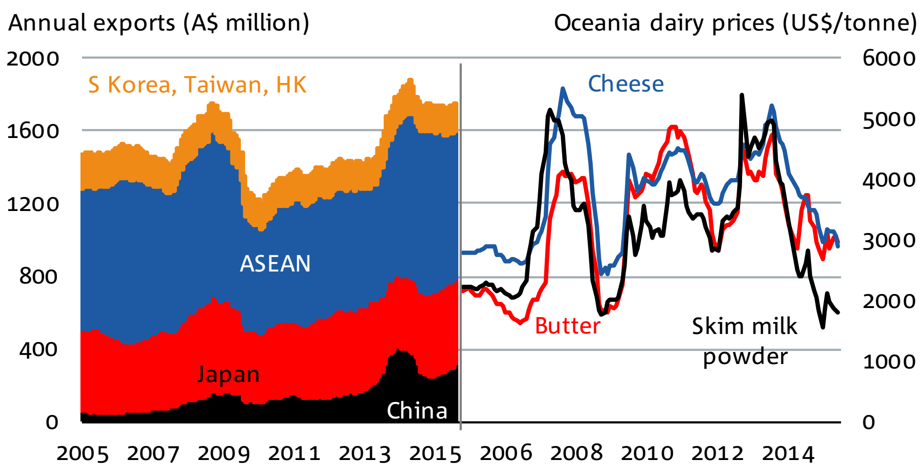
Sources: CEIC, USDA, NAB Economics

Australian dairy exports to East Asia



Sources: ABS, NAB Economics

Australian dairy exports and world prices

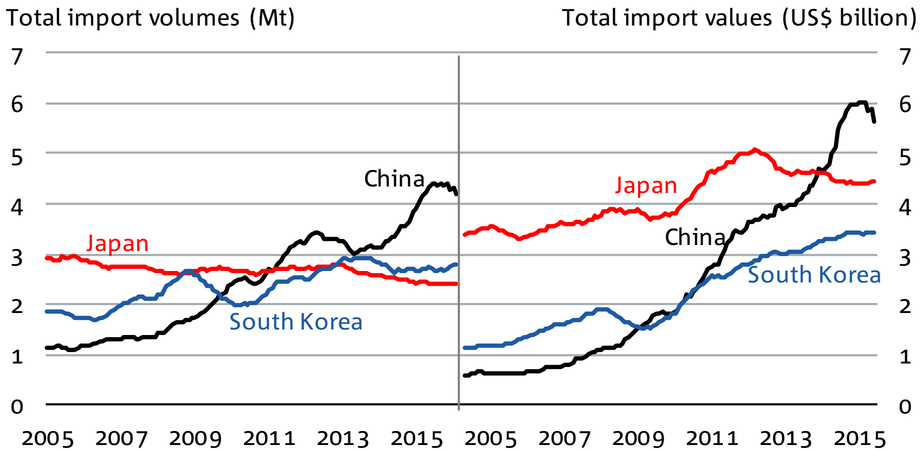


Sources: ABS, AHDB, NAB Economics

- While China's dairy consumption is increasing and the lift in milk demand as income rises bodes well for the future, that does not mean that everything is plain sailing.
- Global dairy export prices have fallen heavily since 2014 and part of the reason is over-supply into the Chinese market plus a softening in the pace of Chinese dairy demand growth. The ramping up of milk-powder stocks and the drop in Chinese milk prices testify to a market experiencing problems and these were duly reflected in a halving in the volume of Chinese imports of whole milk powder last year as well as a fall in import volumes of non-fat dry milk.
- The New Zealand dairy industry has been hit hard by the onset of tougher times in the Chinese dairy market as it accounts for 90% of the whole milk powder trade and over half of Chinese non-fat dry milk imports. Australia's industry was less exposed as China is less prominent in its dairy market mix and its product mix is more diverse with less reliance on milk powder.

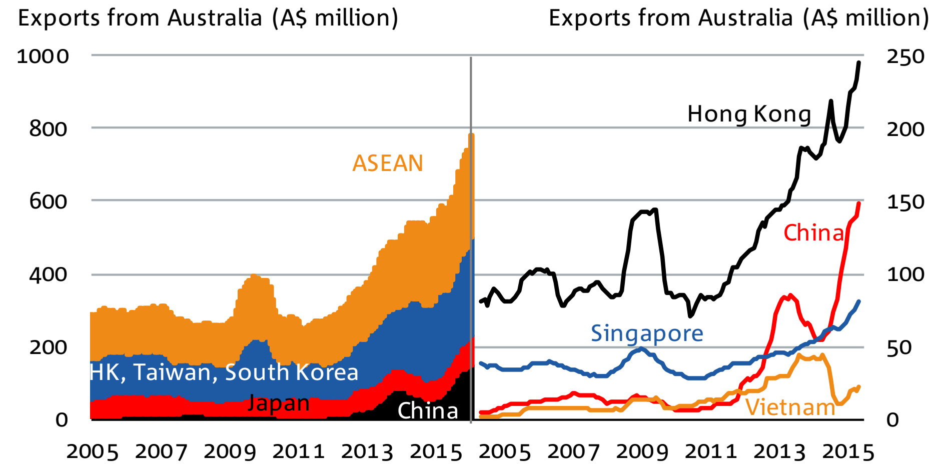
Fruit – China leads the way in demand and trade

China's rising consumption has driven the increase in Asian fruit demand and trade



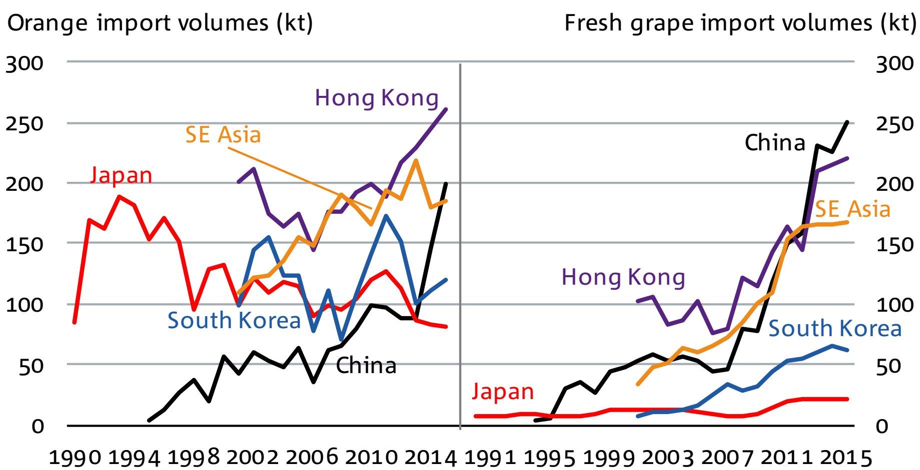
Sources: CEIC, NAB Economics

Australia's share of China's market still small, despite recent growth



Sources: ABS, NAB Economics

Chinese fruit imports surge, now the dominant regional market

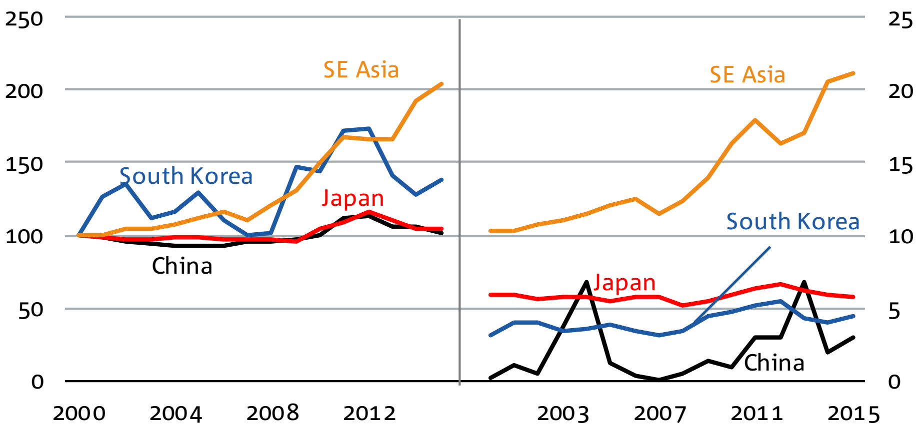


Sources: USDA. NAB Economics

- China has displaced Japan as the biggest fruit importer in East Asia. As Chinese fruit consumption rises alongside income and household incomes are steeply rising, the Chinese market looks likely to become increasingly dominant in the region.
- China is also a massive fruit producer so foreign suppliers gain market niches by trading on their quality and counter-seasonal supply availability – both of which help Australian growers in important markets like citrus and grapes.
- Australian fruit exports to the region have been growing rapidly, rising from around $300 million in 2010 to around $800 million in 2015. Hong Kong has long been a crucial intermediary stage market for Asian fruit trade but the value of shipments going directly to China is now growing rapidly as well.
- Free trade agreements will help improve market access for Australian fruit but it is also crucial that quarantine agreements are made and standards maintained.

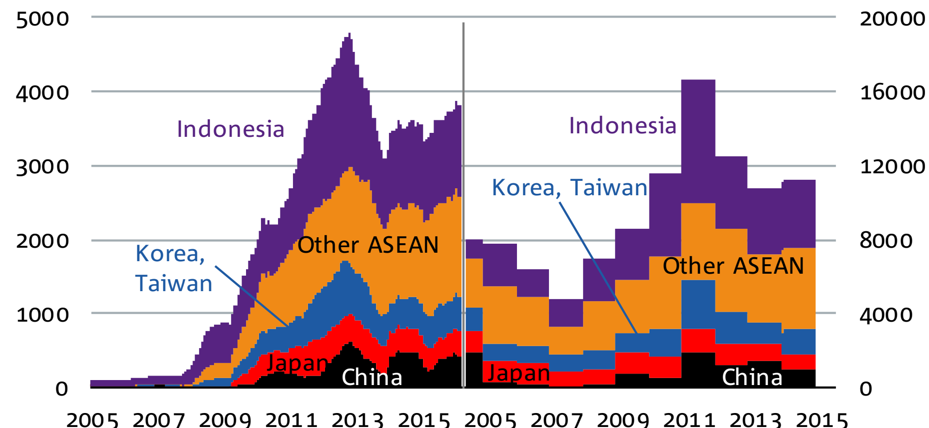
Role of policy – North Asian quotas limit trade, growth markets in SE Asia

SE Asia the big growth driver, wheat demand and imports in Japan and China marking time



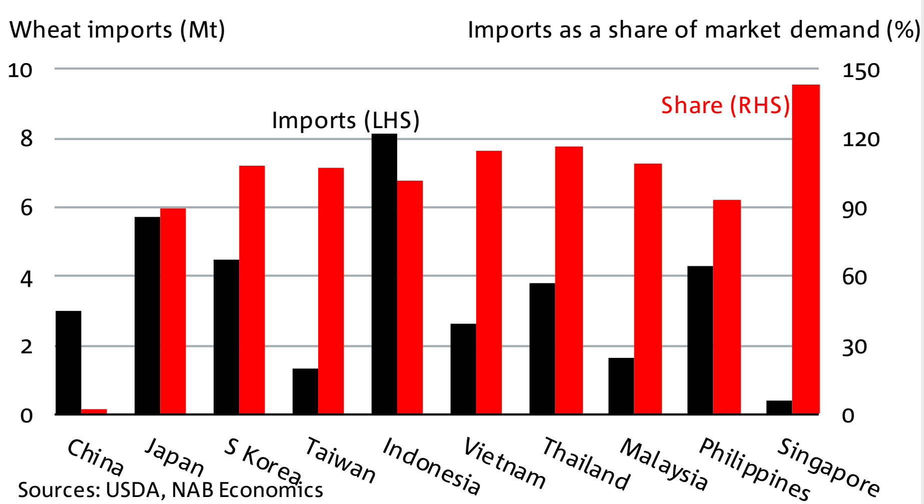
Sources: USDA, NAB Economics

East Asia our biggest wheat market but policy constrains trade



Sources: ABS, NAB Economics

Massive Chinese market largely closed, SE Asia the key importer

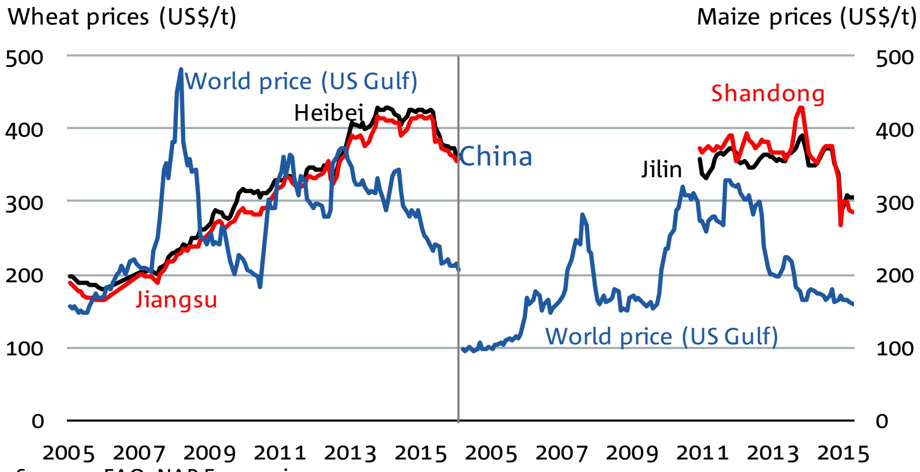


Sources: USDA, NAB Economics

- China ranks number 2 in global wheat consumption but imports only supply 3 million of the 112 million tonnes consumed. This low share reflects Chinese farm policy with a 1% tariff rate on wheat brought in under the 9.6 million tonne quota but 65% tariffs paid above that and 90% of the trade in the hands of state trading enterprises. This restrictive trade policy helps hold Chinese domestic wheat prices well above global levels, helping local farm incomes but penalising Chinese consumers and industry.
- Japan imports around 5¾ million tonnes of the 6½ million tonnes it consumes but again there is a quota of 5.74 million tonnes limiting imports. Australia supplies the special wheats used for noodles to both Japan and S Korea, that product differentiation providing a greater degree of market security but securing the required quality and getting a premium price in the Japanese import system raises issues for growers in this trade and could limit supply.
- Quotas in China and Japan help ensure that SE Asia is the biggest market for Australian wheat, Indonesia has long been a top ranking market and Vietnam trade has been growing rapidly.

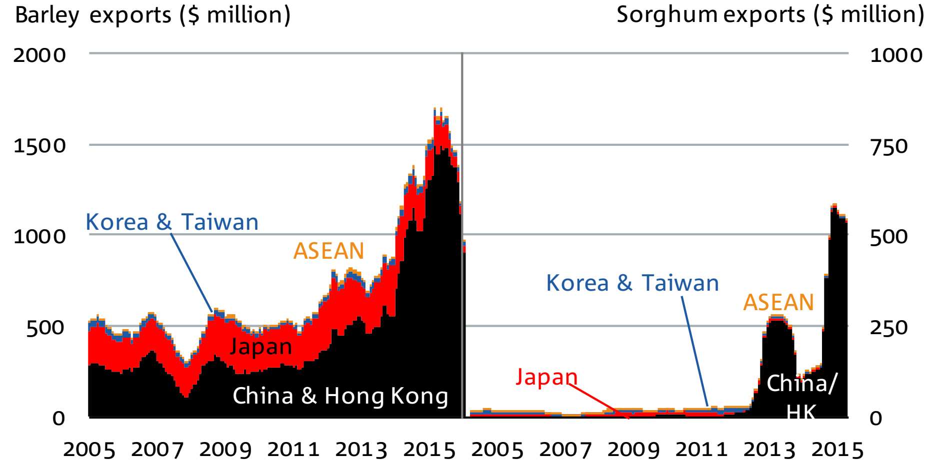
Role of policy – Australian grain exports rise to feed Chinese cattle

Chinese policy measures keep domestic wheat and corn prices well above world market levels



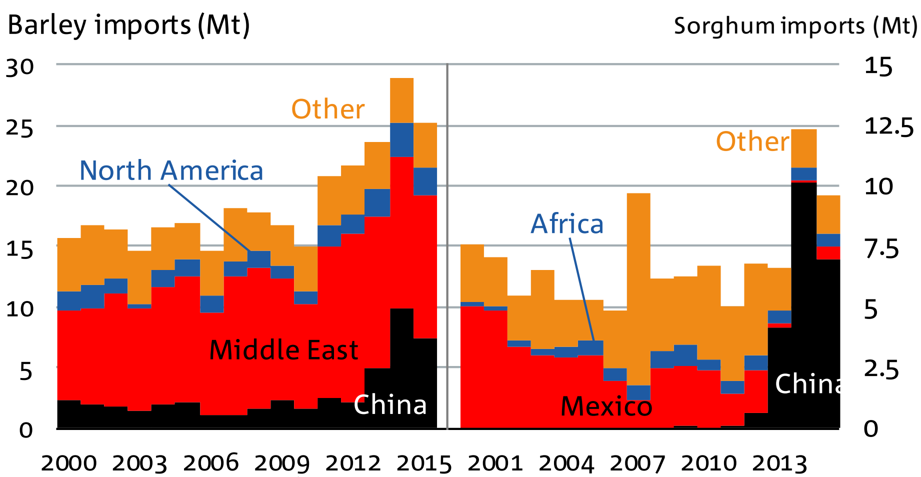
Sources: FAO, NAB Economics

Australian barley and sorghum exports to China have risen as consumers seek cheaper alternatives



Sources: ABS, NAB Economics

China looms larger in global feed grain markets

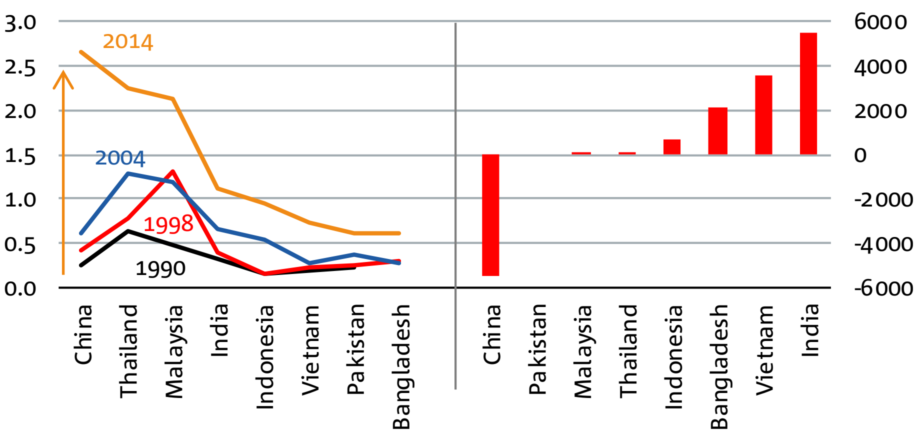


Sources: USDA, NAB Economics

- Promoting self sufficiency in basic grains is a keystone of Chinese farm policy and this is achieved by a mix of border protection (quotas to ensure imports of rice, wheat and corn above quite low levels face high tariffs) and price support for Chinese farmers growing basic grains.
- These price supports have been a little too effective with huge amounts of corn and wheat ending up in government stockpiles as the support prices have been set so high they encourage over-production of low quality grain and encourage grain consumers to shift to cheaper substitutes where possible.
- Feed grains have seen most of this substitution away from high priced Chinese corn toward sorghum and feed barley, which have not been limited by import quotas as wheat and corn have. Australian exports of alternative feed grains have risen sharply in response to these distortions produced by Chinese farm policy but changes to corn support systems could curb the growth prospects for this trade.

Role of policy – Australian cotton exports to China crash

Rising wage costs has resulted in China losing competitiveness in basic textiles



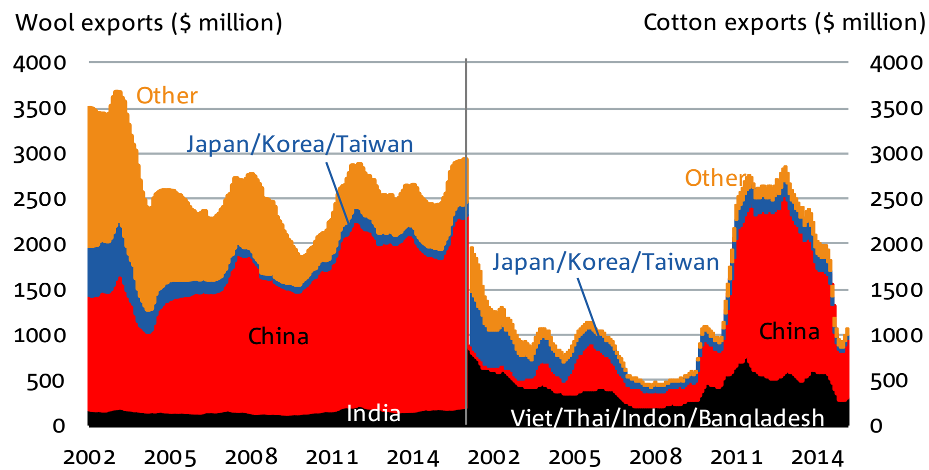
Sources: Werner International, USDA, NAB Economics

China's imports of yarn and textiles growing fast, particularly from lower cost near neighbours

Sources: CEIC, NAB Economics

- China is a major player in global textile fibres trade as it is easily the biggest global wool processor and until a couple of years ago it was also the world's biggest cotton importer.
- Rising labour costs have seen Chinese cotton spinners losing competitiveness against rivals in SE Asia and the Indian sub-continent. The outcome has been a drop in Chinese cotton demand, growing yarn and cloth imports from lower cost suppliers like Vietnam and a lift in the technology and quality of Chinese mills seeking to compete.
- The sudden downturn in Australian exports of cotton to China was not, however, due to these long run structural factors – the combination of lower Australian cotton output and Chinese farm policy. Like grains, China held internal cotton prices above world levels to support farm incomes and the outcome was cotton piling up in government stocks and growing volumes of cheaper imports.
- Changes in government policy involved reduced subsidies to some growers as well as restrictions on cotton imports, the outcome has been a modest drop in stocks but imports are only a fifth of their peak in 2010/11.

Australian wool exports stay around $3 billion, cotton trade falls heavily as Chinese policy shifts

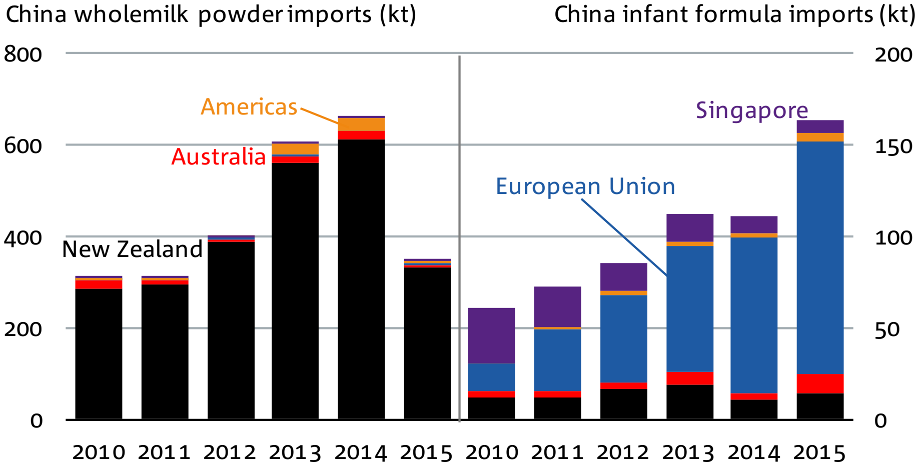


Sources: ABS, NAB Economics

(c) Tough competition in Asian food markets

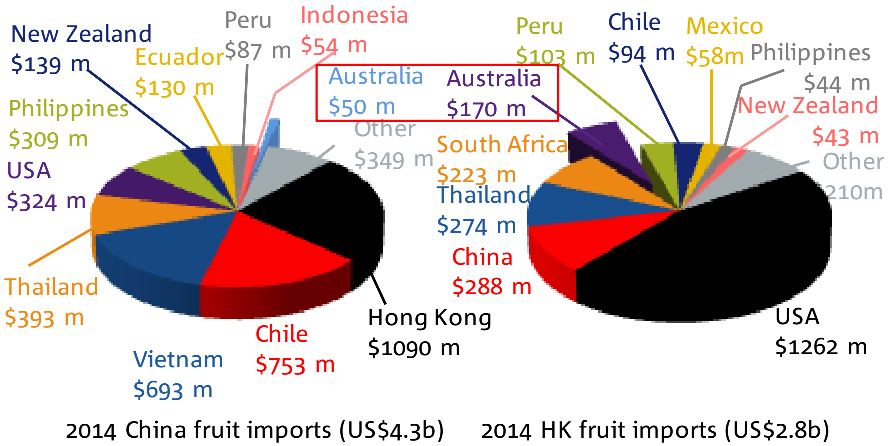
National Australia Bank

New Zealand and the EU swamp Australia in key dairy market segments in China



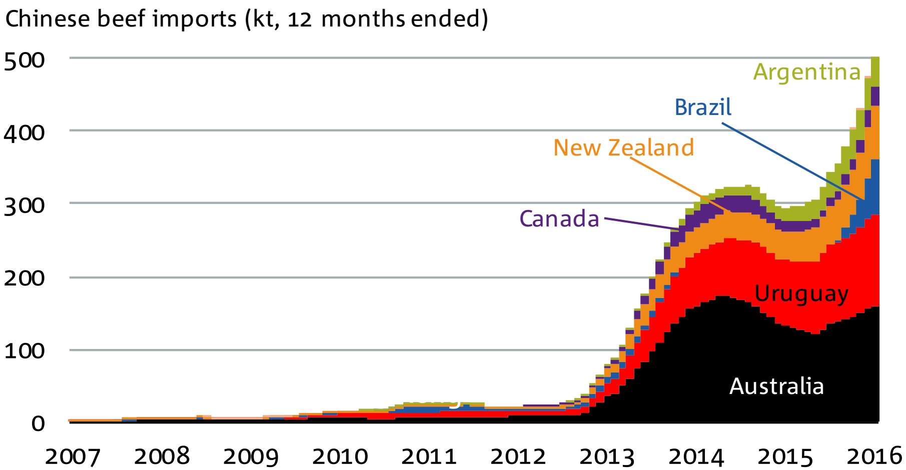
Sources: CLAL, NAB Economics

Australia's share of China's fruit imports is modest, even through the Hong Kong channel



Sources: UN Comtrade, NAB Economics

Australia has significant beef exports to China, but South American competition is growing



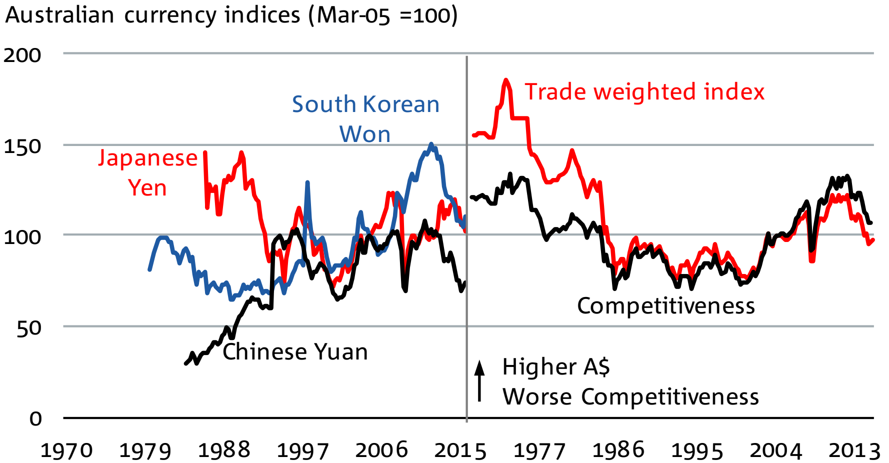
Sources: CEIC, NAB Economics

- While rising incomes and dietary change underpin rising demand for the foods Australia exports and free trade agreements improve market access, it is still necessary to out-compete rival suppliers to lift sales.
- Even in those areas where free trade agreements have substantially improved access, notably meat, dairy and fruit, there is tough competition from rival suppliers like New Zealand and Chile who also have extensive networks of free trade agreements across East Asia.
- Chile and Peru offer stiff competition in markets like Chinese fruit as low cost efficient out of season suppliers with free trade access. Brazil and Uruguay are already supplying cheaper beef to the Chinese market than Australia. New Zealand is in a similar position in key dairy markets.
- This highlights the importance of maintaining cost competitiveness and product quality for Australian producers, linking to the need to improve distribution and transport systems and keep production costs down.

Services and manufacturing – lower $A brings competitive gains and trade responds

Deflating commodity boom cuts $A, helps competitiveness

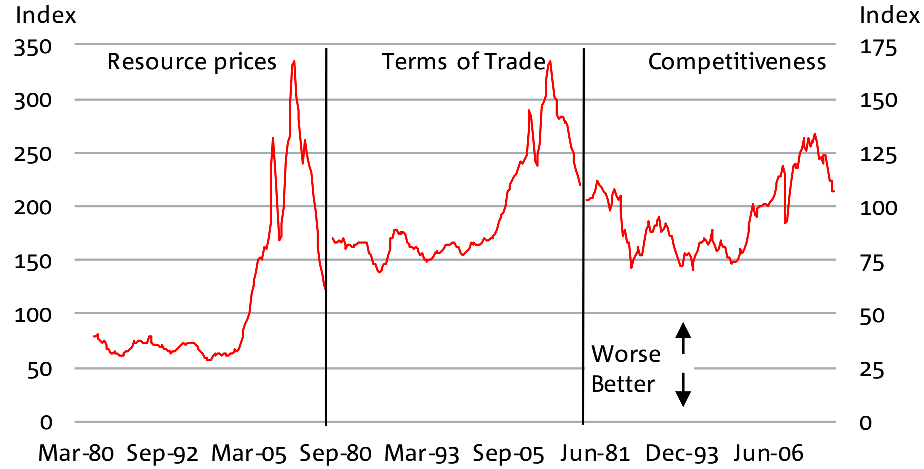
Post-commodity boom exchange rate more favourable for other exports to key markets



Sources: Datastream, CEIC, NAB Economics

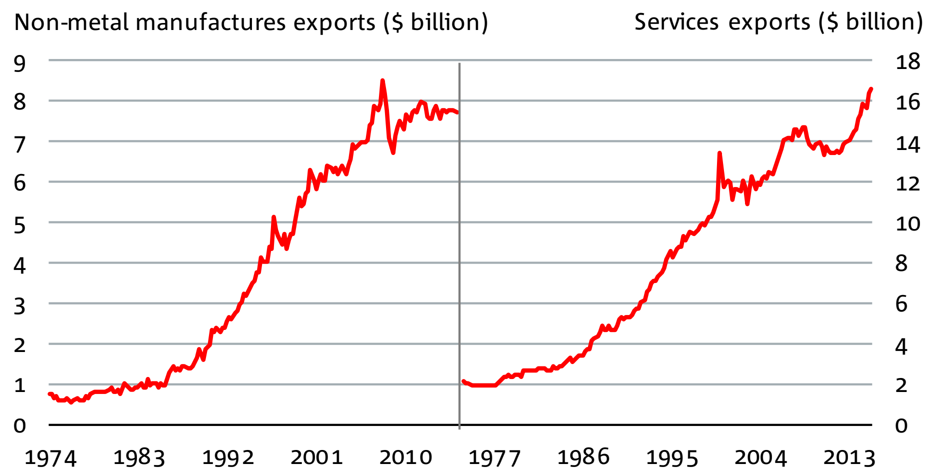
- The $A has fallen considerably against key Asian currencies like the RMB and Won but less so against the Yen. These currency shifts are part of a broader decline in the $A trade weighted basket that has improved the competitiveness of Australian suppliers in global markets.
- During the mining boom, exceptionally high resources prices drove the terms of trade to multi-decade highs and the associated lift in the $A took our cost competitiveness to its worst since the mid-1970s.
- Inevitably, that loss of competitiveness hit non-commodity sectors like services and manufacturing, triggering a series of major factory closures that have eroded industrial capacity and a pause in the multi-decade growth trend in exports of services and non-metal manufactures.
- $A depreciation and improved competitiveness have resulted in a surge in total service sector export volumes but volumes of non-metal manufactures have levelled out rather than picked up – possibly reflecting earlier losses in industrial capacity.

Surging commodity prices from the early 2000s had a significant impact on Australian competitiveness



Sources: RBA, ABS, NAB Economics

Non-metals and services suffered during the commodity boom; service exports now starting to trend up again

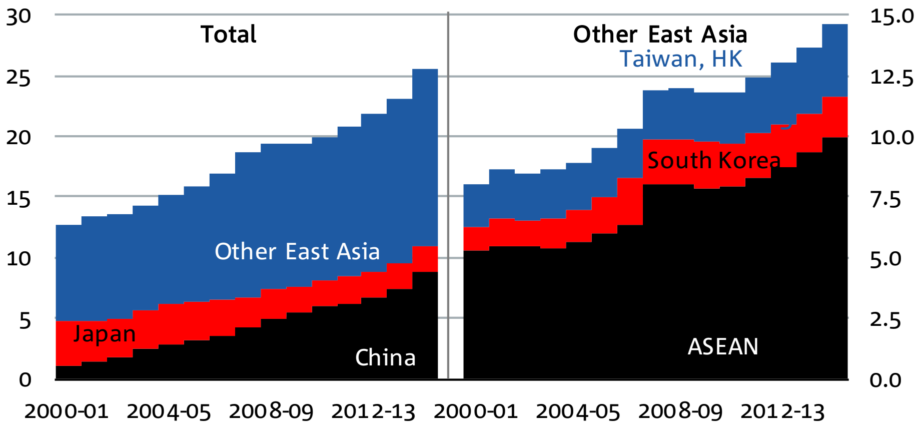


Sources: ABS, NAB Economics

Services exports to East Asia rising fast, focus very much on Chinese visitors

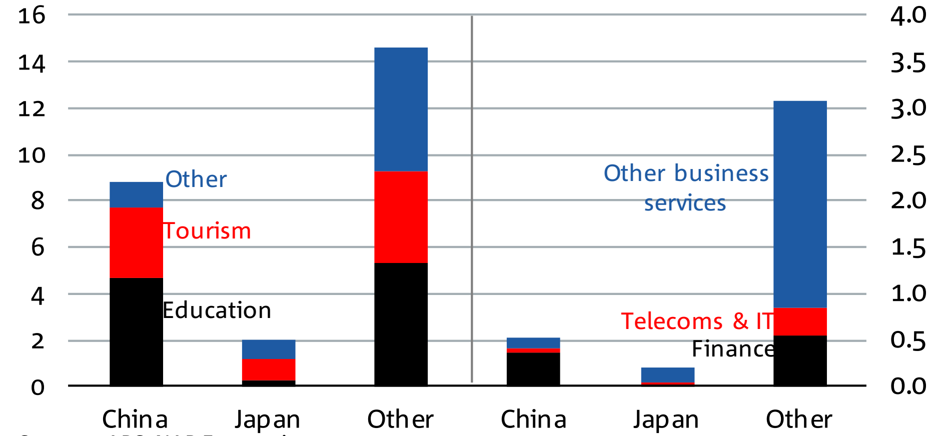
National Australia Bank

China and ASEAN have driven growth in Australian services exports, while Japan has stagnated



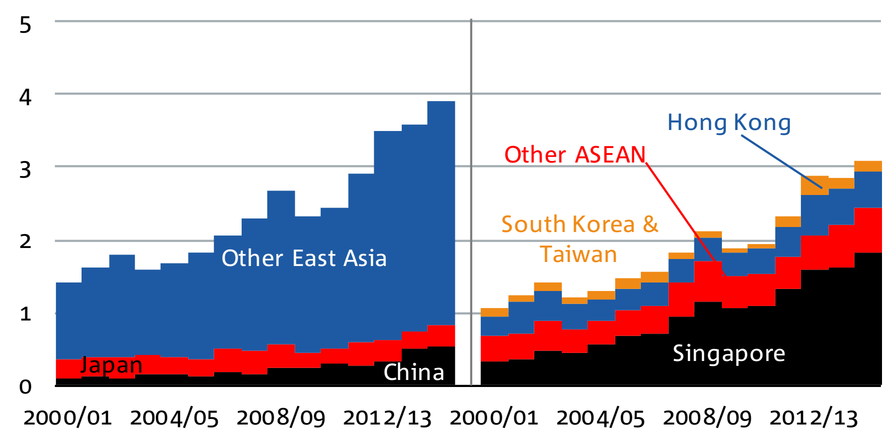
Sources: ABS, NAB Economics

China's service imports are mainly travel related, while business services are important to ASEAN…



Sources: ABS, NAB Economics

…with Singapore the key market



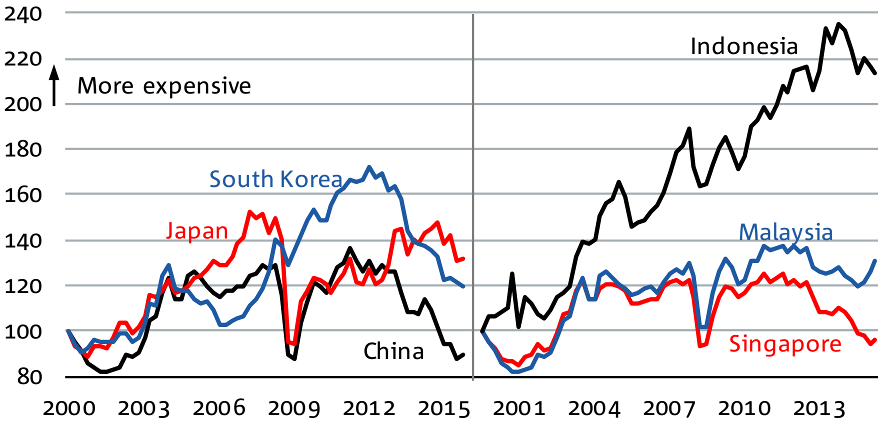
Sources: ABS, NAB Economics

- Japan was Australia's biggest East Asian service market in 2005 but by 2014/15 services earnings from China were 4 times greater than from Japan. Exports to China climbed from $6 billion in 2010/11 to $9 billion in 2014/15 while those to ASEAN increased from $8 billion to $10 billion. By contrast, services exports to Japan fell slightly to just over $2 billion during that period and earnings from the South Korean market slipped too.
- The bulk of Australian service sector earnings are provided to visitors coming here to study or holiday rather than the offshore operations of Australian businesses, important though these are. While business service earnings from East Asia are rising, by far the biggest single component of our services exports is the $7¾ billion spent by Chinese visitors to Australia.

Travel receipts surge underpinned by tourism and education

Depreciation of the A$ has made Australia a cheaper favourable destination for a range of Asian nations

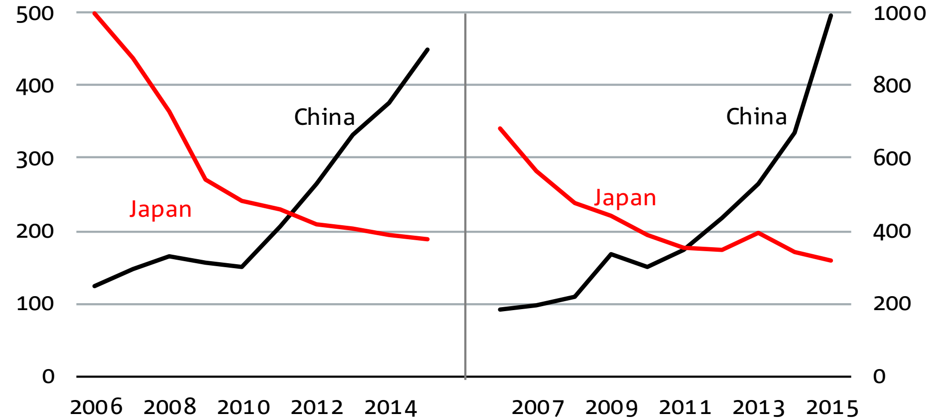
Index of costs to foreign travellers for visiting Australia (Jan-00 = 100)



Sources: Datastream, NAB Economics

China has overtaken Japan in both the number of holiday visitors and the level of spending

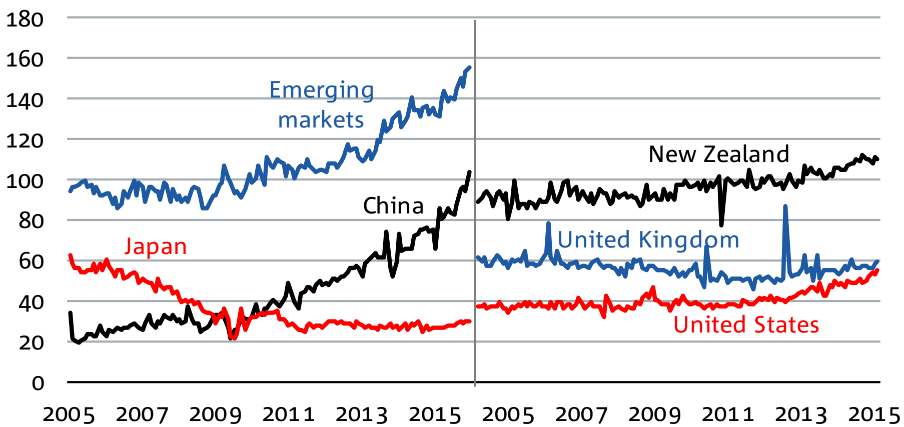
Number of holiday visitors (000s) Spending ($m)



Sources: ABS, NAB Economics

Chinese visitor numbers to Australia have surged across the past decade – now second behind NZ (and closing)

Monthly short term visitor arrivals (000s, sa)

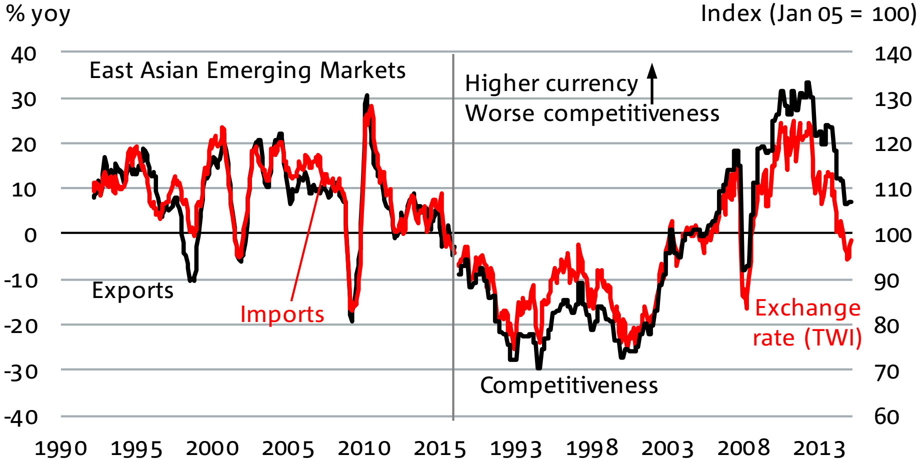


Sources: ABS, NAB Economics

- $A depreciation, particularly against the RMB, has cut the cost of holidaying here and further fuelled the surge in visitor numbers coming from China. Short term visitor arrivals from China have doubled over the last 4 years, now running at an annual rate of over 1 million visitors and getting close to displacing New Zealand as the biggest source of arrivals.
- China has displaced Japan as the biggest East Asian source of visitor numbers and spend. The long period of disappointing economic performance in Japan, the lack of wage growth and the persistently weak yen against the $A have all contributed to a near halving in visitor numbers and spending over the last decade. Visitor numbers from ASEAN have also risen heavily, almost doubling since 2006.
- Contrasting experience between China and Japan shows how diverging macro-economic performance drives discretionary spending like international travel and highlights the importance of continued household income growth in China.

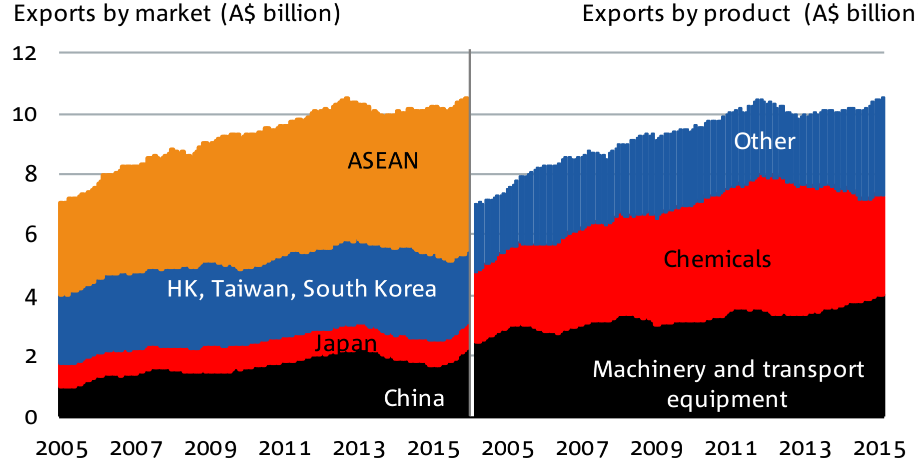
Manufactured exports hit by tough business environment

Unfavourable environment for manufactured exports into East Asia, but competitiveness improving with the exchange rate



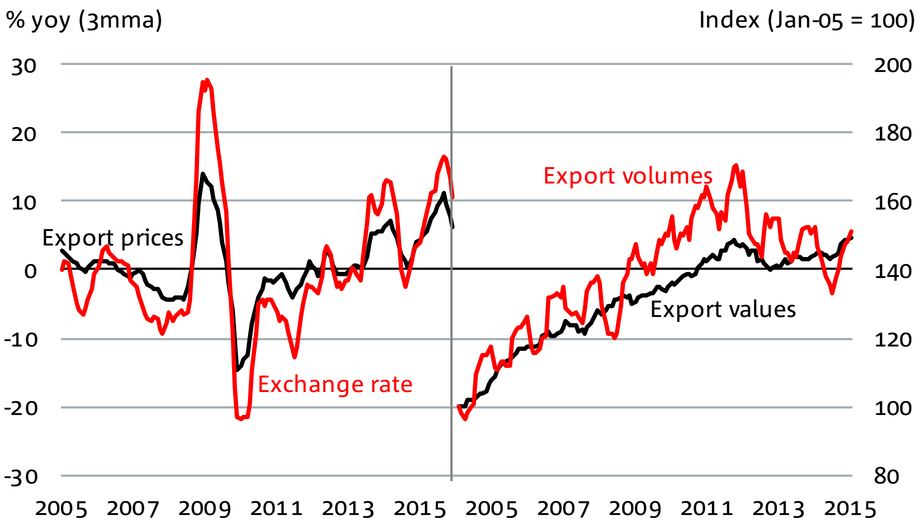
Sources: CPB, Datastream, RBA, NAB Economics

Export values stagnated to East Asia as domestic producers lost competitiveness



Sources: ABS, NAB Economics

Lower $A lifts export prices but volumes have been weak following closures

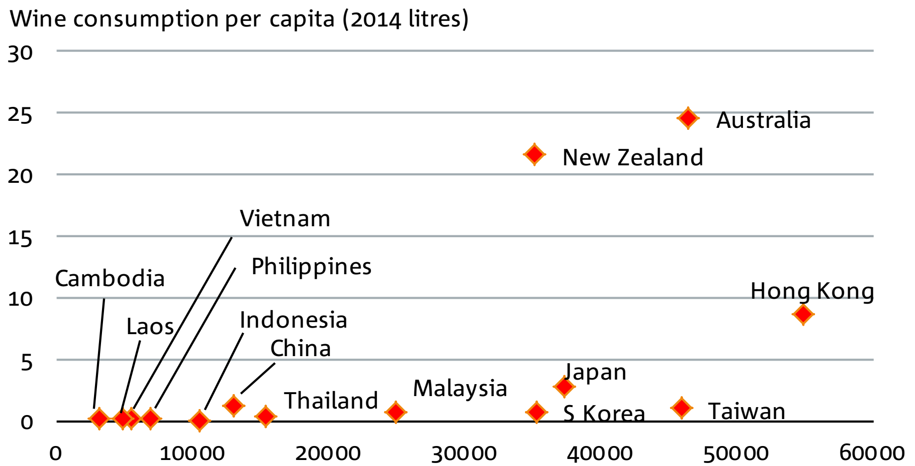


Sources: ABS, Datastream, NAB Economics

- The combination of weak growth in East Asian trade and the high $A during the mining boom have taken their toll on Australian exports of non-metal manufactured goods to the region. The $A value of exports stagnated between 2013 and late 2015, despite the $A depreciating over that period, which increased prices for manufacturers and boosted earnings.
- Stable export values combined with rising export prices imply that the export volume of non-metal manufactures to East Asian markets has been falling. Normally the lift in competitiveness associated with the weaker $A would lead to a lagged increase in export volumes and there are a few signs that this could have started in the latter half of 2015.
- Industrial output has fallen from its mid-2008 peak by around 15% in Australia and there has been a serious erosion of the industrial base as major plants and industries have either closed or are winding down. That could well limit the extent to which exports can respond to the lower A$.

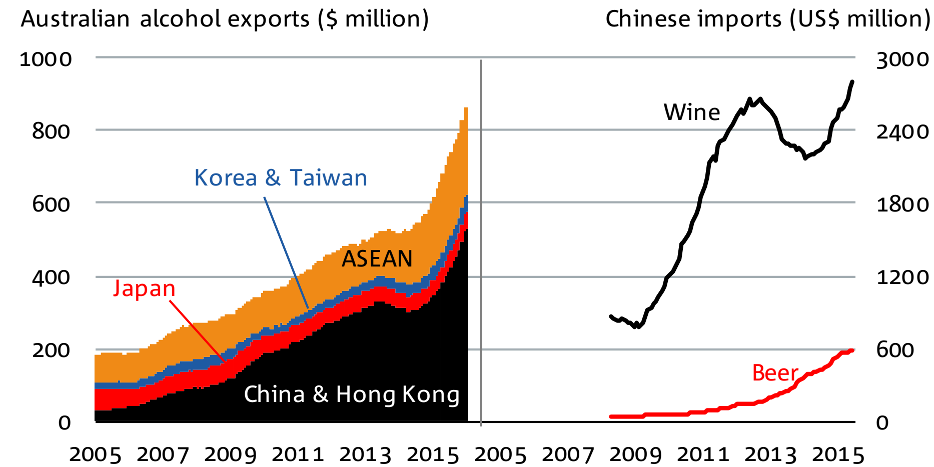
Wine – China leads the way in region wine demand

Link between income and wine consumption affected by cultural factors at regional level



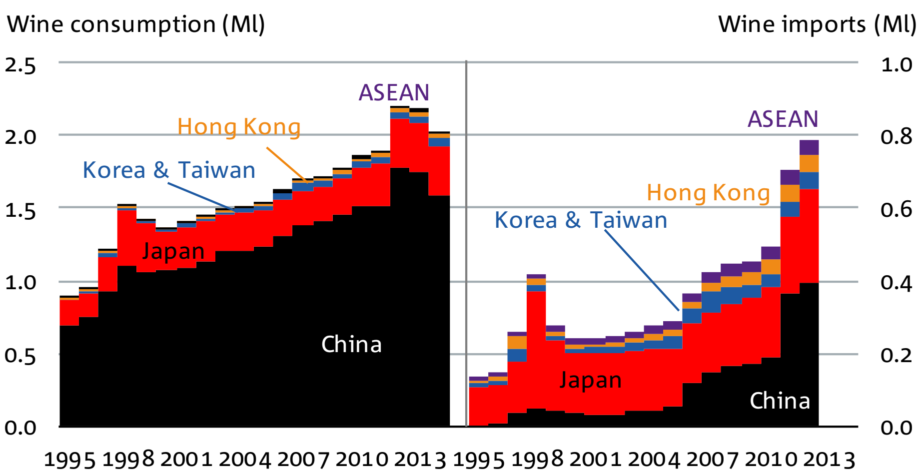
Sources: The Wine Institute, NAB Economics

China now easily our biggest alcohol export market in East Asia – led by wine



Sources: ABS, CEIC, NAB Economics

China easily Asia's biggest wine market, with imports rising in recent years



Sources: The Wine Institute, OIV, NAB Economics

- China is one of the world's biggest wine markets, the fourth biggest market in 2014 and with a record of strong trend growth. There is also ample scope for wine consumption to keep climbing as rising incomes boost the number of middle class consumers.
- Australia has become a major supplier to China, raking fourth overall in 2015 volumes (behind France, Chile and Spain) but second only to France in bottled wine imports. Chile dominates the low value bulk wine trade and out of Australia's $370 million wine exports to China in 2015, only $13 million were bulk – the rest were bottled. Mainland China ranks fifth as an Australian export market but including Hong Kong, it comes first with $500 million in 2015 exports.
- Even though wine is a differentiated branded manufactured good, Australian exports still suffered heavily during the period of $A strength in the commodity boom. Modelling from Adelaide's Wine Economic Research Centre shows the strong impact of currency driven changes in competitiveness on Australian wine export volumes.

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