CHINA ECONOMIC UPDATE AUGUST 2016

Troubled trade – China's slowdown has hit export dependent East Asia

NAB Group Economics

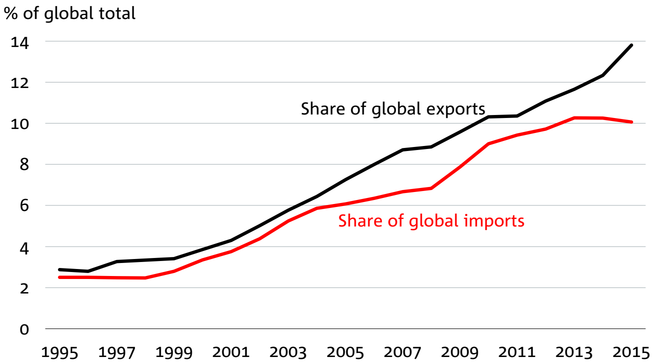
The rise of China as a major global economy had significant impacts on the broader East Asian region, with these highly trade dependent economies benefiting from the growth in volumes across most of the 2000s and the first half of this decade. However, China's slowing growth over the past few years has had flow on effects to these economies – with weak intra-regional trade contributing to sub-trend economic growth in the East Asian region.

CHINA'S ECONOMIC RISE HAS INCREASED ITS IMPACT ON TRADE

The rapid industrialisation of China across the past two decades has had a major impact on global trade flows. According to World Trade Organization data, China's share of global merchandise exports rose from around 2.5% in 1995 to almost 14% in 2015 – in the process becoming the world's largest exporter. Similarly, the need for raw materials to fuel this industrial growth also saw imports rise sharply – up to 10% of the global total in 2015, just behind the United States, the top ranked importer (with its share at 14%).

CHINA'S SHARE OF GLOBAL TRADE

Rapid increase as China industrialised



Sources: WTO, NAB Economics

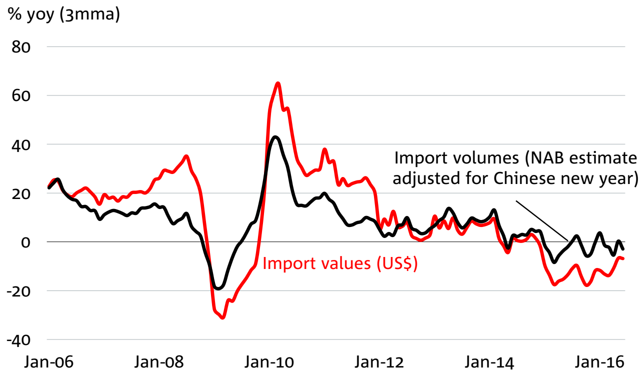
However the changing pattern of China's growth – away from heavy industry towards less resource intensive service sector growth – has seen the country's imports contract more recently. In 2015, the total value of China's imports fell by 14%, with volatility in global financial markets highlighting the fears about the strength of the country's economy.

In part the decline in import values reflects the lower cost of key commodities. Commodity prices peaked in 2011 and have been trending broadly lower ever since. Crude oil is China's largest single import by value – even after a 41% decline in import values in 2015. This decline was driven by the plunge in global crude prices, with import volumes increasing by almost 9%. A similar trend was evident in iron ore – the second largest import – with values falling by 38% in 2015 as volumes increased by around 2%.

That said, recent trade trends have been more negative, with both values and volumes contracting. In the first seven months of 2016, the total value of China's imports fell by 10.5% year-on-year. However, the impact of commodity price declines has been less significant, and we estimate that the total volume of imports fell by around 4.1% yoy over this period – with volumes having peaked in 2014.

CHINA'S IMPORTS SLOWING

Both values and volumes lower in 2016



Source: CEIC, NAB Economics

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CHINA'S SLOWDOWN HITS EAST ASIAN EXPORTERS

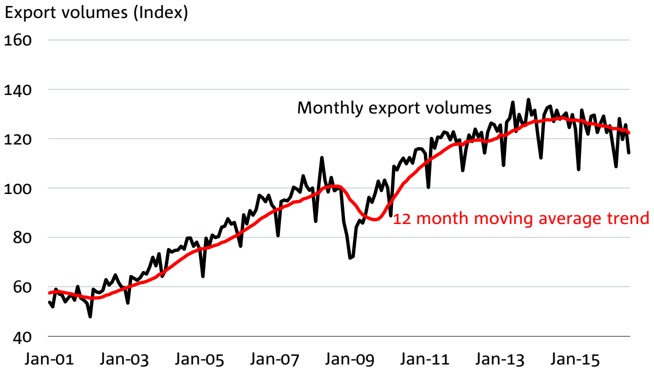
The slowdown in China's import demand has been felt by key East Asian economies – including Indonesia, Malaysia, Hong Kong, Taiwan, Philippines, Thailand, Singapore and South Korea. In the past fifteen years, China's industrialisation has shifted the pattern of exports for these countries, with China accounting for around one-quarter of the total exports of these East Asian economies in 2015, up from around 13% in 2001.

That said, the value of East Asian exports to China peaked in late 2013 and has trended downwards since. This trend goes beyond the impact of weaker commodity prices alone – with weaker imports from predominantly commodity exporters like Indonesia (down 14.5% in 2015) matched by lower values from manufacturing exporters like Taiwan (down 13.4%).

Although we can't break down trade volumes between East Asian economies and China, overall export volumes from East Asia have been declining in recent years. Total volumes from the eight major East Asian economies declined by 2.2% in 2015, having trended lower since early 2014. In a global environment where economic growth is unlikely to accelerate – given the continued slowdown in China and the long, drawn out recovery in a highly indebted and high unemployment Europe – prospects for a recovery in East Asian export volumes appear limited, with flow on effects for their domestic economies.

EAST ASIAN EXPORT VOLUMES

Downward trend since early 2014



Sources: CEIC, NAB Economics

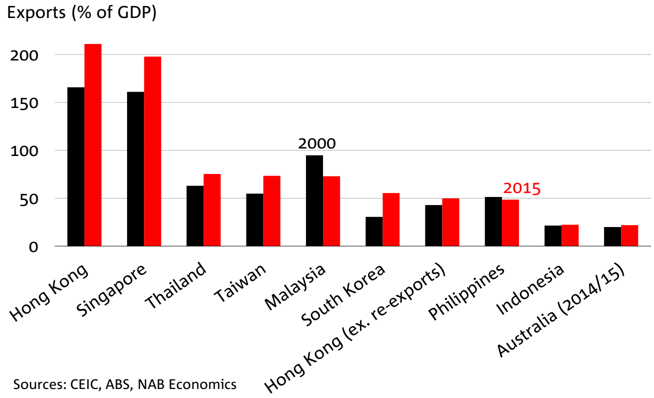
EAST ASIA OVERLY RELIANT ON EXPORTS TO DRIVE GROWTH

Compared with other regions globally, East Asian economies are particularly trade dependent and the weakness in global trade volumes in recent years has resulted in a period of sub-trend economic growth. From trend growth at around 5% between 2000 and 2008, East Asian economic growth has fallen below 3.5% in early 2016 – with lower export revenues having both direct impacts on GDP accounting – through the net export component – as well as indirect effects. Export oriented corporates have seen weaker profit conditions and are less inclined to invest (given weak export growth prospects), while workers have seen wage growth negatively impacted – slowing potential growth in domestic consumption.

The impact varies across countries. Major trading hubs – ports such as Hong Kong and Singapore – have particularly outsized ratios of exports to GDP – at 211% and 198% respectively in 2015. Counting only domestic exports brings Hong Kong's ratio back to 50% of GDP – a similar level to South Korea. In contrast, Indonesia's export dependency is relatively low – at just 22% (similar to Australia).

EXPORT SHARE OF GDP

East Asia is highly trade dependent



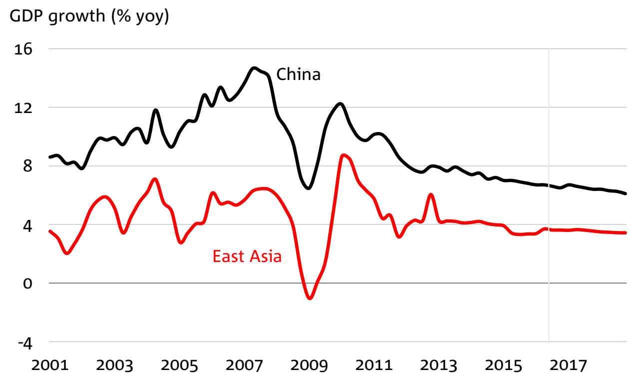
Sources: CEIC, ABS, NAB Economics

CONCLUSION

The gradual transition of China's economic growth model has placed significant downward pressure on East Asian economic growth, and means comparatively weak prospects over the short term.

GROWTH PROSPECTS ARE MODEST

East Asia and China set to slow further



Source: CEIC, NAB Economics

While predominantly commodity based exporters face weaker demand growth in coming years, higher value add producers (such as South Korea and

Taiwan) may face increased competition – as Chinese manufacturers attempt to push higher up the value chain – posing longer term threats as well. As a result, East Asia's growth prospects are set to remain considerably weaker than the pre-GFC period.

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