

CHINA ECONOMIC UPDATE MAY 2021



Buy, buy, bye: political tensions could impact Australia's trade relationship with China

NAB Group Economics

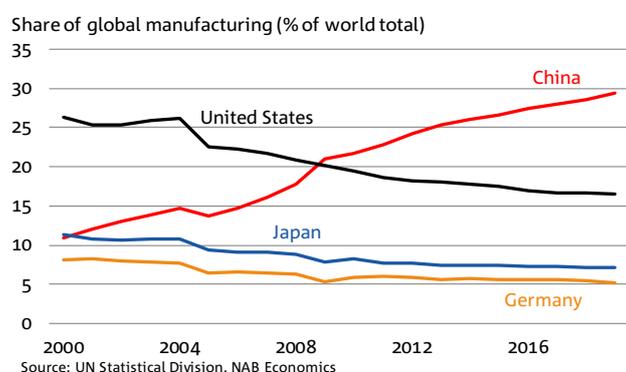
China's rapid industrialisation over the past few decades drove increased demand for resource commodities, while rising incomes shifted diets towards increased consumption of animal proteins. These factors contributed to increasing demand for Australian exports. However, the relationship between the Australian and Chinese governments has deteriorated in recent times, which could negatively impact exports in a range of sectors, even as economic trends gradually return to normal following COVID-19.

THE EVOLUTION OF THE AUSTRALIA-CHINA TRADE RELATIONSHIP

China's manufacturing sector grew dramatically over recent decades – expanding by over 10% a year over the thirty years to 2019. This has seen China's share of global manufacturing increase from close to 10% in 2000 to over 29% in 2019. Although China has sizeable domestic supplies of some natural resources, the country also became a major importer of resources, leading to closer trade relationships with commodity exporting countries such as Australia.

CHINA THE LARGEST MANUFACTURER

Share almost tripled since 2000

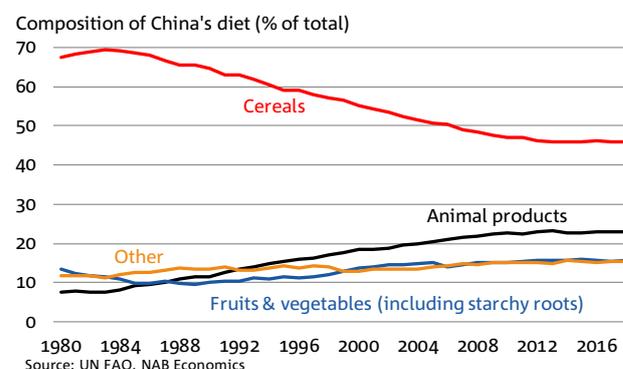


As China's economy has grown, this has seen a rapid increase in household incomes, which has also supported in a shift in dietary patterns – away from grain intensive subsistence diets to ones higher in animal proteins. In 1980, cereals provided around two-thirds of the average Chinese resident's daily calorific intake. By 2018, this had fallen to 46%, with

the increase in animal products accounting for most of this change. This increased demand has boosted Australian exports for beef and other meat along with dairy products and animal feed.

CHINA'S CHANGING DIET

Higher incomes support increased consumption of animal products



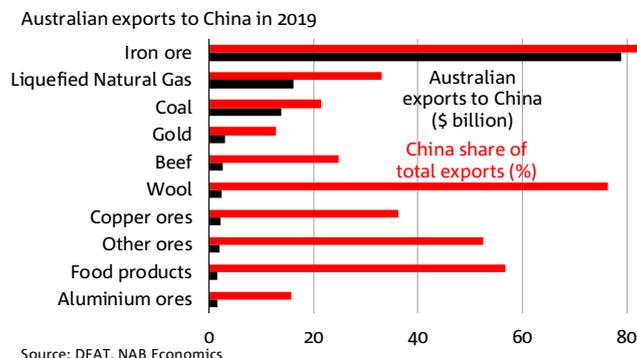
Overall, China has been Australia's largest merchandise export market since 2009 – when it overtook Japan (which had previously been the largest partner since 1966). Australia was China's fifth largest source of imports in 2019, behind South Korea, Taiwan, Japan and the United States.

Australia's merchandise exports to China have been dominated by iron ore – the key raw material for China's steel industry – with iron ore accounting for almost 53% of the total in 2019. This was followed by liquefied natural gas and coal, with the value of other exports comparatively smaller. Over 80% of Australia's iron ore exports are shipped to China,

along with over 75% of wool exports and over 50% of food products and non-copper base metal ores.

AUSTRALIA'S GOODS EXPORTS TO CHINA

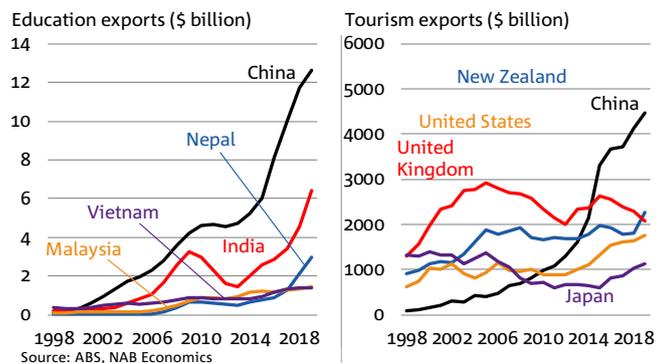
Iron ore dominates trade



China is also the largest export market for Australian services, followed by the United States and India, with education and tourism accounting for the bulk of this trade. China overtook New Zealand in mid-2017 to be the largest source of short-term visitors.

AUSTRALIA'S SERVICES EXPORTS

Education and tourism lead the way



POLITICAL TENSIONS THREATEN TO IMPACT TRADE

Tensions between the Australian and Chinese governments have gradually built over the past few years. One of the earlier incidents was the decision to block equipment from Chinese technology firms Huawei and ZTE from Australia's 5G telecommunications network on national security grounds. Seemingly in response to this measure, northern ports in China informally banned imports of Australian coal in early 2019 – however neither country's government formally acknowledged these restrictions.

The relationship deteriorated further in 2020, following Australia's call for a global inquiry into the

origins of the COVID-19 pandemic. In response, China publicly released a list of fourteen grievances it has against Australian authorities – including (beyond the already identified factors) blocking Chinese investment in Australia, government funding for policy research bodies deemed “anti-China” by Beijing, the treatment of Chinese journalists and academics in Australia and Australia's comments about China's activities in Taiwan, Hong Kong and Xinjiang province in international forums.

In addition, Chinese authorities implemented a series of trade measures across 2020 and into early 2021 on a range of Australian goods and services (listed at the end of this report). These comprised both formal restrictions (such as tariffs) and informal ones (such as instructions to domestic importers not to purchase from Australian firms). For example, in late March 2021, China's Ministry of Commerce announced its final determination on claims of dumping of Australian wine, confirming its initial tariffs (implemented in November 2020) would be applied for the next five years. In contrast, there have been no formal trade restrictions imposed on Australian coal, however Chinese traders were instructed to purchase coal from other suppliers. In total, the goods and services impacted by these measures accounted for around one-quarter of Australian exports to China in 2019.

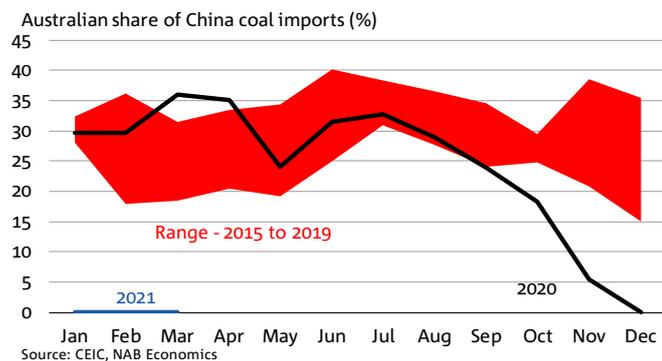
Further escalation in tensions is possible, following the Australian Federal Government's decision in late April to veto an agreement by the Victorian state government to participate in China's Belt and Road Initiative.

CONCLUSIONS – WHAT IMPACT HAVE CHINA'S TRADE MEASURES HAD ON AUSTRALIAN EXPORTS?

At the time of writing, there is limited available data showing the full impact of China's trade measures on Australian exports. The primary exception is coal, which shows a steep decline in China's imports across the second half of 2020, dropping to zero in January 2021. That said, it is not clear that Australian exporters have been significantly impacted by the loss of access to the Chinese market, with exports to other markets rising. This reflects a realignment of coal trade, with China sourcing increased coal supplies from other exporters, while Australian volumes filling the void in other Asian markets (who previously purchased the coal now diverted to China).

AUSTRALIA'S COAL EXPORTS TO CHINA

Volumes have fallen to zero, as trade has realigned



Trade volumes for agricultural exports can be more difficult to interpret, as they are impacted by the volatility in domestic production due to prevailing seasonal conditions as well as changes in global demand. For example, Australian cotton production fell rapidly in 2019-20 due to dry conditions in key growing regions, which resulted in a sharp fall in exports unrelated to China's trade measures. That said, China's trade measures could influence agricultural production decisions – with ABARES

expecting the area of barley planted to fall in coming years.

It is also unclear what impact trade tensions could have on the education and tourism export sector – given that current travel restrictions mask any impact that Chinese policy could have on demand. Chinese authorities could actively discourage tour operators from offering travel packages to Australia (similar to a directive in 2017 which saw Chinese tourist numbers to South Korea plummet), however individual tourists and parents seeking to educate their children overseas may overlook informal government directives.

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LIST OF CHINA TRADE MEASURES

Sector	Details
Coal	Chinese authorities unofficially restricted Australian coal imports in mid-2020 - reportedly discouraging coal buyers from purchasing Australian volumes. The National Development and Reform Commission recognised this ban in December, when it announced that importers could exceed annual quotas in order to meet a supply shortfall, but excluded Australian suppliers.
Barley	China imposed anti-dumping and anti-subsidy tariffs on Australian barley in May 2020 - totalling 80.5% - alleging that Australia dumped barley into the Chinese market in 2018. These tariffs are scheduled to be in place for 5 years.
Wine	In November 2020, China's commerce ministry announced preliminary anti-dumping tariffs (between 107% and 212%) on Australian bottled wine, along with temporary anti-subsidy tariffs of 6.3%-6.4%. In March 2021, China confirmed the tariffs, announcing they would be in place for five years.
Beef and lamb	A range of major beef processing plants were blacklisted by China in May 2020, reportedly over mislabelling and health certificate concerns. Further plants (impacting both beef and lamb exports) have been subsequently banned, citing COVID-19 outbreaks.
Cotton	Reports suggest that Chinese cotton mills were instructed not to purchase Australian cotton in October 2020. There are rumours that China will introduce tariffs, thought to be around 40% (the rate imposed on above quota imports).
Timber	In November, China banned timber imports from Queensland and Victoria, followed by South Australia and Tasmania in December, citing bio-security issues, with reports of live pests found within timber imported from these states.
Lobsters	Australian lobster exports in early November were held at Chinese airports and clearing houses without receiving quarantine inspections. Subsequently reports suggest an unofficial ban was implemented.

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