

If China sneezes, there's no reason for Australia to get pneumonia

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January 9 2019

This article appeared in *The Australian Financial Review* on January 9 2019.

In 2018 China delivered the Australian economy what it has come to count on: another big boost in demand.

The latest data show annual Australian goods exports to China hitting \$112 billion, up 10.3 percent on a year earlier. Services exports stand at \$16.9 billion, jumping 17.2 percent.

China now injects 2.3 times the purchasing power of Japan. A decade ago the two were tied.

A major reason the federal budget is on track for surplus this financial year stems from better than expected iron ore and coal prices. Josh Frydenberg can thank China for that.

All of this explains why, according to last year's Lowy Poll, 82 percent of Australians consider that whatever the challenges that China presents in the military and strategic realm, it is viewed first and foremost an economic opportunity.

But in 2019 [could the China opportunity shift into reverse?](#)

Financial markets are meant to be forward-looking. The Shanghai and Shenzhen stock indexes declined throughout 2018.

[In December the official Purchasing Managers Index](#) covering China's manufacturing sector fell into contraction territory for the first time since July 2016.

Monetary stimulus

And last week China's central bank showed its assessment of the current state of economic activity by announcing a new monetary stimulus in the form of cutting the reserve requirement for banks. Of course, China has defied the pronouncements of the China bears before. The latest update by the World Bank last month still sees China expanding at a robust 6.2 percent in 2019-2020.

But fresh doubts have accumulated. These include President Trump's trade war and, potentially far more worryingly, President Xi's dubious commitment to ongoing market reform.

Given that China buys one-third of Australia's exports, it's worth contemplating what a serious slump in China might mean.

In 2017 Deloitte Access Economics [modelled](#) the impact of a Chinese hard landing in which growth fell from 6.5 percent to less than 3 percent.

The cost to Australia's national income was 7 percent, or \$140 billion, and 550,000 fewer local jobs than would otherwise have been the case.

Nightmare predictions like this get the headlines.

Yet recent research points to something different.

In 2018, economists at the Asian Development Bank Institute [estimated](#) that a one percentage point drop in China's growth rate would cause GDP growth in Australia to fall by around 0.05 percentage points.

Quick local recovery

Even allowing for a much bigger Chinese shock, this suggests the spillover to Australia would be manageable.

Last May [a report](#) by the International Monetary Fund looked at the outcome of a sharp four percentage point fall in Chinese growth. The effect was to knock 0.4 percentage points from Australian growth in the short term.

That's not trivial, but still a good way off an Australian recession. And this was followed by a quick local recovery in the medium term.

In the latest analysis, Nicolaas Groenewald from the University of Western Australia [finds](#) that a three percentage point fall in Chinese growth would deduct no more than 0.6 percentage points from GDP growth here.

He concludes that 'these estimates are hardly enough to justify prophecies of doom'.

Australian resilience owes much to a flexible exchange rate that depreciates at the first signs of Chinese economic weakness, improving the competitiveness of exports overall.

Australia also has only a limited exposure to China through the channel of bilateral investments.

Previous US economic hiccups have hurt Australian prospects despite two-way trade never having been particularly important. This is because the US hosts 29 percent of Australian investment abroad, compared with just 3 percent for China.

Another factor is that while China accounts for one-third of Australia's exports, total exports are worth 22 percent of GDP, or \$419 billion. That compares with \$1.8 trillion for domestic demand.

Ongoing urbanisation

The weight of numbers points to the Australian economy being more vulnerable to a wobble in domestic consumer confidence than a Chinese hard landing.

Finally, there's a big chunk of Chinese demand that isn't particularly sensitive to the business cycle.

China's steel manufacturers buy Australian iron ore to support ongoing urbanisation and infrastructure upgrading.

The reason that China now accounts for one-quarter of total inbound tourism spending reflects its 1.4 billion population and emergence as an upper-middle income country.

The overall evidence is that Australia is better protected from a Chinese downturn than is commonly assumed.

And if the bears are wrong once again, the Australian economy will bank another increase in Chinese spending.

That's not a bad distribution of risks coming from our most important trading partner.

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