

Still plenty of growth to come from China

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The World Bank and the IMF have cut their forecasts for Chinese growth. But with a trade deal in the bag, China still looks set to deliver for the Australian economy.

Sure, it's easy to tick off China's vulnerabilities. The bears point to sluggish real estate sales and construction activity. Home prices began falling in a majority of Chinese cities as far back as last May. Yet by December, in year on year terms they were down just 4.3 percent on average. If that qualifies as a property market collapse, it must be the most orderly on record.

The bears also like to remind us that the real estate sector accounts for around 15 percent of China's GDP. That's just one way of saying that seven-eighths of the economy can be singing to a different tune.

And indeed it is: official data released yesterday showed that China's economy as a whole grew by 7.4 percent in 2014. That's well within the range of "new normal" growth that Chinese President, Xi Jinping, has been telling us about at every opportunity.

As for this year, the World Bank cut its forecast for Chinese growth last week from 7.5 percent to 7.1 percent, while also on Tuesday the IMF moved from 7.1 percent to 6.8 percent.

Downgrades always jar but put that into perspective. Every year growth in China is coming off a higher base. In terms of the number of dollars being added to China's economy – which is what buys Australian iron ore, beef and hotel stays – 6.9 percent growth this year is the same as 7.4 percent growth last year.

According to the IMF's new numbers, China will still contribute more to world economic growth in 2015 and 2016 than any other country, and that includes a resurgent US.

In Australia, the commentary on China has mostly been focused on falling prices for iron ore. But the state of the iron ore market says much more about Australian supply than Chinese demand.

According to the Bureau of Energy and Resources Economics (BREE), in 2014 China's imports of iron ore are expected to have risen by 14.4 percent. That's even faster growth than in 2013, and it came off a higher base. The problem is that while China's imports jumped by 118 million tonnes (mt) last year, this was trumped by a 139 mt increase in Australia's exports.

There's something else: macroeconomics 101 tells us that the outlook is mostly determined by what's happening to quantities across the board, not prices of single commodities, even important ones such as iron ore.

Australian firms experience demand for their products in "real" terms - tonnes of iron ore, kilograms of beef and nights of hotel stays.

When demand climbs, they produce more output. Employment gets a boost.

Data from the Australian Bureau of Statistics show that when iron ore prices skyrocketed between 2003-2013 the annual growth rate of total employment didn't rise above its long run average.

That's why the economy's pulse is measured by real GDP, not nominal GDP.

BREE tips that China's imports of iron ore will increase yet again this year. Australian producers are set to get the biggest cut.

As for agriculture, it's hard to know where to start.

The Australian Bureau of Agricultural and Resources Economics and Sciences (ABARES) says China's demand for our beef production leapt by 68 million kilograms in 2013-14. That's a 74 percent increase, year on year. A report by ANZ in September found that Australian beef exports had the potential to reach $130 billion between now and 2030. Changing Chinese tastes is the driver. In fact, we'll struggle to produce enough to supply their supermarket shelves.

It's the same for services. Tourism Research Australia (TRA) says in the year to September 2014 Chinese visitors stayed a total of 31.4 million nights. That's 5 million more than second-placed U.K. TRA expect that the annual number of Chinese arrivals will reach 1.4 million by 2022-23, double the number now.

Smooth sailing for the Australian economy is far from guaranteed in the coming year. But there's every reason to believe that China will once again be providing a tailwind.

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