China's slowing growth rate is not the hard landing feared

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Pick up any major Australian newspaper these days and the business section is sure to be filled with coverage of the latest economic developments in China.

Australia's fixation with China is justified.

In 2014-15, Australia's bilateral trade with China stood at $A149.8bn. That's more than double the value of trade with Japan, Australia's second-largest trading partner.

But while the quantity of news coverage about China's economy has increased dramatically, the quality of analysis has often struggled to keep up.

To believe many of the headlines written since Shanghai's stock market bubble burst last June would be to accept that China's economy is slowing sharply and the best Australia can hope for is that it comes to a grinding halt rather than end in a crash.

But the irony is that China is buying more of Australia's goods and services than ever before.

Here are the facts. In 2014-15:

- Australia's exports of minerals and fuels to China stood at $55.6bn. This compares with $A35.7bn five years ago, and $21.3bn to Japan.

- Australia's agricultural exports to China stood at $A9.0bn. This compares with $3.7bn five years ago, and $5.2bn to the US.
- Australia's services exports to China stood at $A8.8bn. This compares with $A5.5bn five years ago, and $A7.1bn to the US.

Since the early 2000s there's been no brighter spot on Australia's economic radar than China. So why all the negativity now?

In part it comes down to a failure to comprehend that the size and structure of China's economy has changed, as well as the huge opportunities this has created.

China's economy has more than doubled in value since 2008. It's now the world's largest economy in purchasing power terms and second largest in US dollar terms.

This means that each year growth is coming off a bigger base. In growing at 6.9 percent in 2015 the volume of purchasing power added was two-thirds more than in 2005, when it grew by 11.4 percent.

That's more purchasing power to be spent on everything from Pilbara iron ore, Barossa Valley wine and Gold Coast holidays.

China bears also worry about sluggish activity in China's secondary sector (industry and construction) and slowing fixed asset investment.

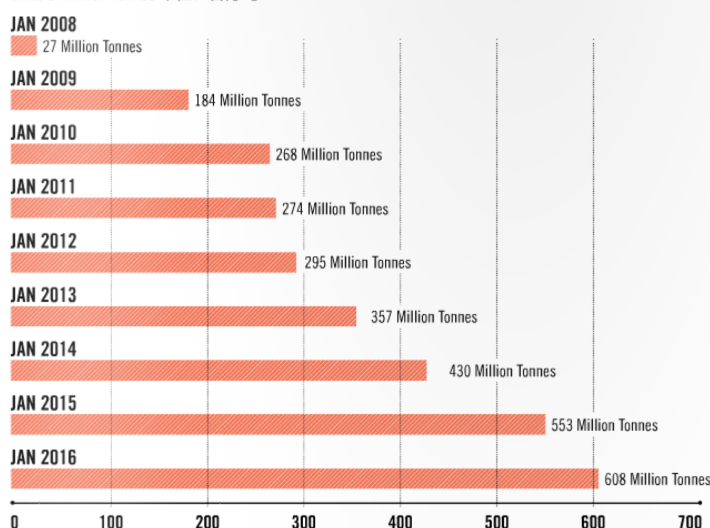
But this misses the point that the services sector and consumption are now driving China's economy.

Last year the services sector share of GDP hit 50.5 percent, a full 10 percentage points clear of the secondary sector. And consumption accounted for two-thirds of China's GDP growth, up from one-half in 2014.

An increased emphasis on services and consumption does not mean that Australia and China will trade less. Rather, it means that new areas of engagement will open up.

In 2010-11, iron ore accounted for 56.4 percent of Australia's exports to China. By 2014-15, this had fallen to 46.6 percent.

To be sure, last year Australia exported more iron ore to China than ever before, up 9 percent on 2014. But its relative importance declined in part because Chinese demand for other Australian goods and services is booming.



Consider tourism: last year 1.02mn Chinese visited Australia, spending $A7.7bn. At the beginning of the decade Tourism Australia predicted that a best case scenario would see Chinese tourists spending $A9 billion in 2020. Now they reckon that $A13 billion is more likely. Chinese tourists are expected to account for a stunning 44 percent of the growth in total international tourist spending in Australia out to 2024-25.

Or education: last year enrolments by Chinese students in Australian schools and universities reached 170,212, up 12.8 percent on 2014, and nearly 100,000 more than those from India.

The potential for further services and consumption-led growth in China is vast. In the US, services accounts for 78.1 percent of GDP, compared with 50.5 percent in China. Consumption is more than 80 percent of GDP in the US, while being just a touch over 50 percent in China.

Being optimistic about China's ability to realise this potential doesn't require a huge leap of faith.

While many economists have spent the last few years worried that China might get stuck in a "middle income" trap, some parts of the country have simply gotten on with the job of attaining high income status.

In 2014, Shenzhen's income per-capita was RMB149,497, or $US24,259. In Nanshan district, Shenzhen's technology heartland, it was $US49,730. This compares with $US27,971 in Korea and $US40,170 in Hong Kong, SAR.

Sure, Shenzhen it just one of 293 prefecture-level cities in China. But Silicon Valley is just one small part of the US. The point is that Shenzhen shows that whatever the limitations of China's economy, achieving a high level of income per-capita is not beyond it.

It's striking that in 2014 research and development expenditure accounted for 4.02 percent of Shenzhen's GDP, compared with 0.74 percent in Hong Kong, SAR. Shenzhen serves as the global headquarters of leading manufacturing and tech companies including:

- Tencent, which has over one billion monthly active users across its desktop platform QQ and mobile instant message app Wechat.
- Huawei, the world's largest telecommunications equipment manufacturer.
- BGI, the supplier of 50 percent of the world's gene sequencing capacity.
- BYD, the world's largest supplier of rechargeable batteries.
- DJI, which produces 70 percent of the world's civilian drones.

And then there's the evidence that rising Chinese incomes are spreading beyond the tier-one metropolises of Shenzhen, Beijing, Shanghai and Guangzhou.

By 2022, McKinsey estimates that 84 percent of China's middle class, already the world's largest, will live outside these cities.

In Australia we don't have to look far to see this transformation. In 2011, the only direct flights to Australia were from Beijing, Shanghai, Guangzhou and Shenzhen. Now there are direct flights from 11 Chinese hubs, including inland success stories such as Chengdu, Chongqing, Wuhan and Xian.

The lesson for Australia in all this is clear. Rather than endlessly looking for ghosts in China's economy, a better bet would be to assume that China is following the same

development path travelled by its neighbours just a couple decades earlier. In 2012, Ken Henry, author of *Australia in the Asian Century* white paper, argued that we must invest to ensure that Australians are endowed with capabilities that are relevant to reaping the benefits of China's rise, and that of the region as a whole. Three years have now passed. The sooner we get started the better.