Do we need to worry about China?

Yes, we do, but with a dose of perspective

By Harley Dale

Back in 2008 the headline of an Access Economics quarterly *Business Outlook* read:-

"If we're right on China then Australia is fine; if we're wrong on China, Australia's buggered."

I immediately found that quote to be both potent and accurate. I referred to it – with the appropriate sourcing obviously - in many presentations I gave in 2008 and into 2009. Some HIA members may remember the reference.

This quote about China's link with Australia is even more relevant now than it was back in 2008. If China holds up then so does Australia, but if China 'falls over' then Australia immediately faces considerable economic challenges.

Australia has, not unexpectedly, become increasingly integrated with and reliant on the Chinese economy in recent years – a trend that first began some decades ago. As I wrote in the ACI *Construction Brief* on Monday, if China was to fall over (in a major way), then Australia would be in a world of hurt. Indeed we could experience a recession - our first in more than a generation.

Concerns within Australia about China falling over have been around for many years now, especially but not solely in the resource-rich states. I have been queried by many people and audiences about such an outcome for a long time now. My usual response has been that 'any short term concerns are overblown' - that has proven to be a consistent trend in recent years. I've long also said that China's on-going economic/financial development will at times be bumpy, that some of those bumps will be quite big, and that there is a high risk of a very large jolt at some point. This final (jolt) outcome would have grave consequences for the Australian economy. Does such a jolt happen this year, in three years, eight years … who knew (or knows)?! Everybody can speculate, nobody knows, but the risk is increasing...

That was my point in mid-2014 when I started becoming less sanguine than I had previously been about China. I first made this point publically at a HIA Industry Outlook Lunch in July 2014 – appropriately located, in hindsight, in Western Australia. The reason for my subtle change of view was that China's financial (and economic) challenges were continuing to mount post the GFC. However, the Chinese authorities continued to lack credibility in plans and actions to undertake structural reform, yet the financial and economic risks appeared to be increasing at an escalating rate.

There was certainly a sharp (and rapid) economic slowdown in China in early 2015 (which doesn't appear to be replicating itself this year, btw) which prompted widespread calls of an impending 'hard landing'. This slowdown was almost certainly sharper than official Chinese figures (more on them shortly) would have us believe and the volatility in equity markets in China last year – which HIA Economics wrote about on a few occasions in 2015 – was extreme.

It is true that the risks of a 'hard landing' for the Chinese economy have increased, but this outcome didn't eventuate in 2015 and probably won't in 2016. People are right to be more on guard. The upshot, though, is that you can't take the official GDP figures at face value, and even if you do and then delve below the surface you will find that these figures (and other, partial economic indicators) don't suggest there is a material weakening underway in the Chinese economy in late 2015/early 2016.

You wouldn't think that was the case reading many of the recent headlines on China. That is also before you take account of the policy stimulus in the system which is yet to have an impact on economic activity, which should help in 2016.

China's official GDP growth rate did ease from 6.9 per cent in the September 2015 quarter to 6.8 per cent in the final quarter of last year. Hardly a breath-taking decline. Nobody believes China's official growth numbers, yet most of the recent talk about a slowdown in China is based around these very same numbers! Many people even came up with forecasts for China's economic growth in the latest (December 2015) quarter based on the numbers they don't find credible. Go figure! In seriousness, the Chinese economy is facing a more troubled time, largely but not solely because it owes a mountain of debt, but the real economy is in better shape than widely suggested.

Clearly the Chinese economy is growing at a significantly slower rate than a few years ago - hardly surprising nor alarming in its own right. How much slower, according to what metric, and is that slowdown accelerating? Hard questions to answer, but a slowdown in late 2015/early 2016 of a magnitude to cause alarm about a hard landing seems overblown.

China's equity markets still appear to be in bad shape and its currency is under increasing pressures. China's policy makers still don't appear capable of addressing core structural problems, hardly a fresh concern but one that still increased my focus back in 2014. For the real economy, though, the jury is still out on whether there really was a material slowdown underway as we entered 2016.

China's financial market turbulence and what impact that may have on the economy, together with its excessive debt levels, are the real focus and cause for concern. For example: China's debt is estimated at around $US25 trillion; as a percentage of GDP it stood at 240 per cent in 2015 compared to 160 per cent in 2008 (See a great Business Spectator article by Stephen Bartholomeusz on January 21 – *A global debt time bomb is ticking*.); commodity prices have fallen sharply …

So, yes, we need to worry (more) about China. Is it likely that the risks to China have a significant impact on new residential and commercial construction activity in Australia in 2016? No, that's unlikely. Do developments in China represent a downside risk to construction industry in 2017 and beyond? Yes, they do, but let's keep a watching brief and not get carried away with exaggerated headlines.

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