

China's growth — implications for Australia's growth and international economies

Prepared for

Australian Business Economists
Swissotel Sydney
68 Market St, Sydney

Prepared by

Dr Andrew Stoeckel

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www.TheCIE.com.au

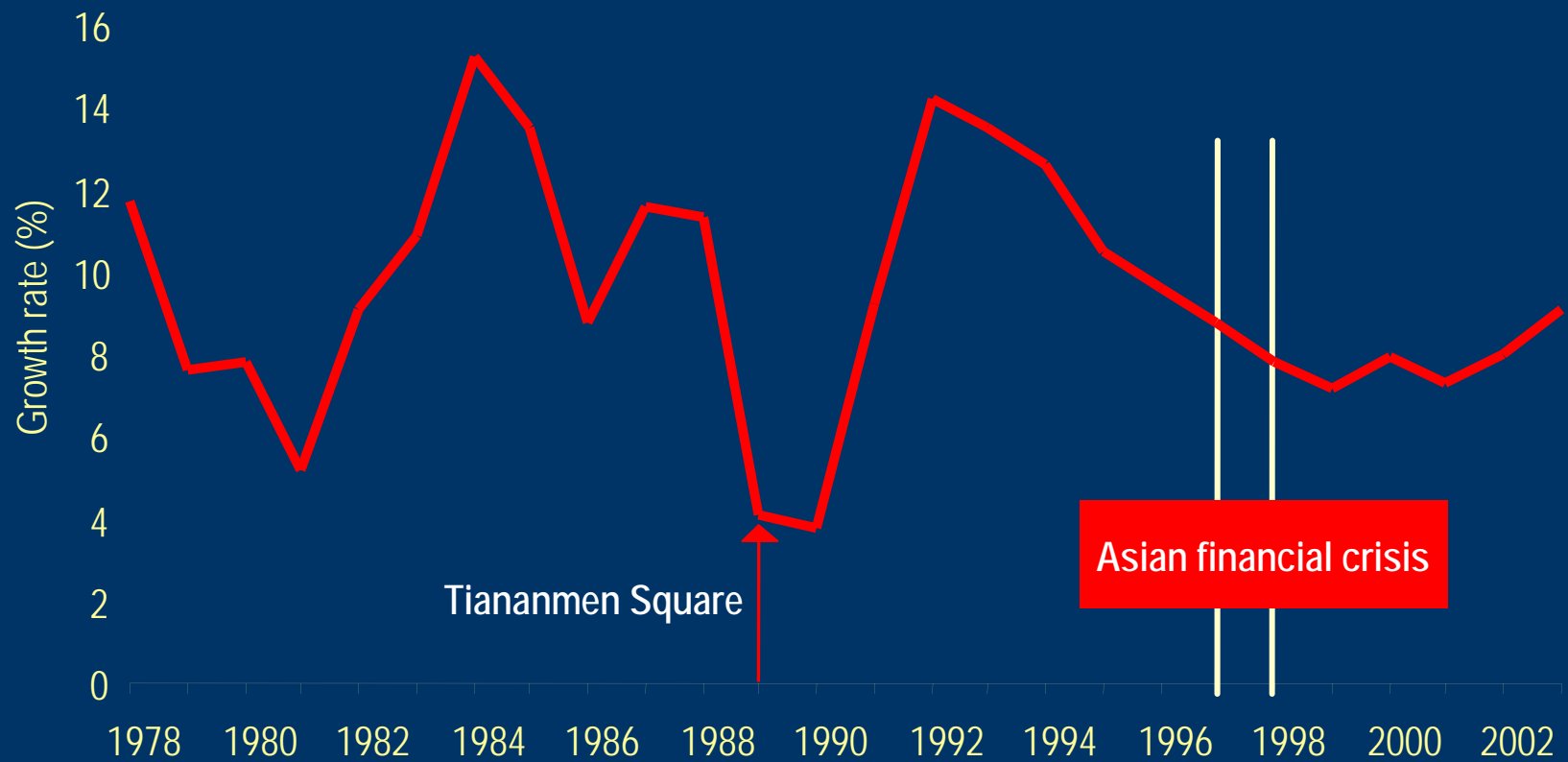


Background

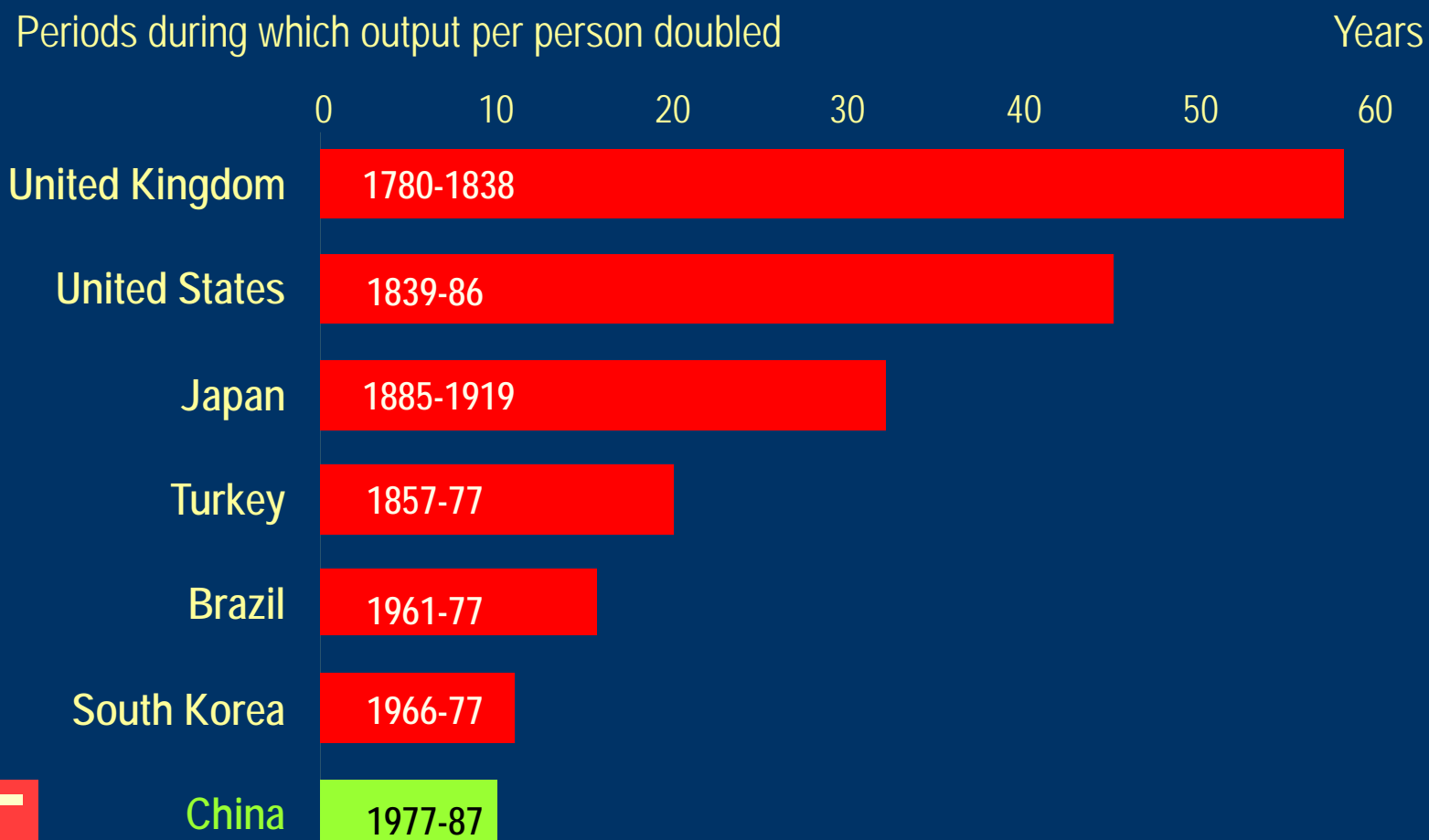


- China's growth is a 'big deal'
- Pace of change fast
- Significant boost to world economy
 - commodity markets
- But easy to overstate impacts
 - offsetting financial and real effects

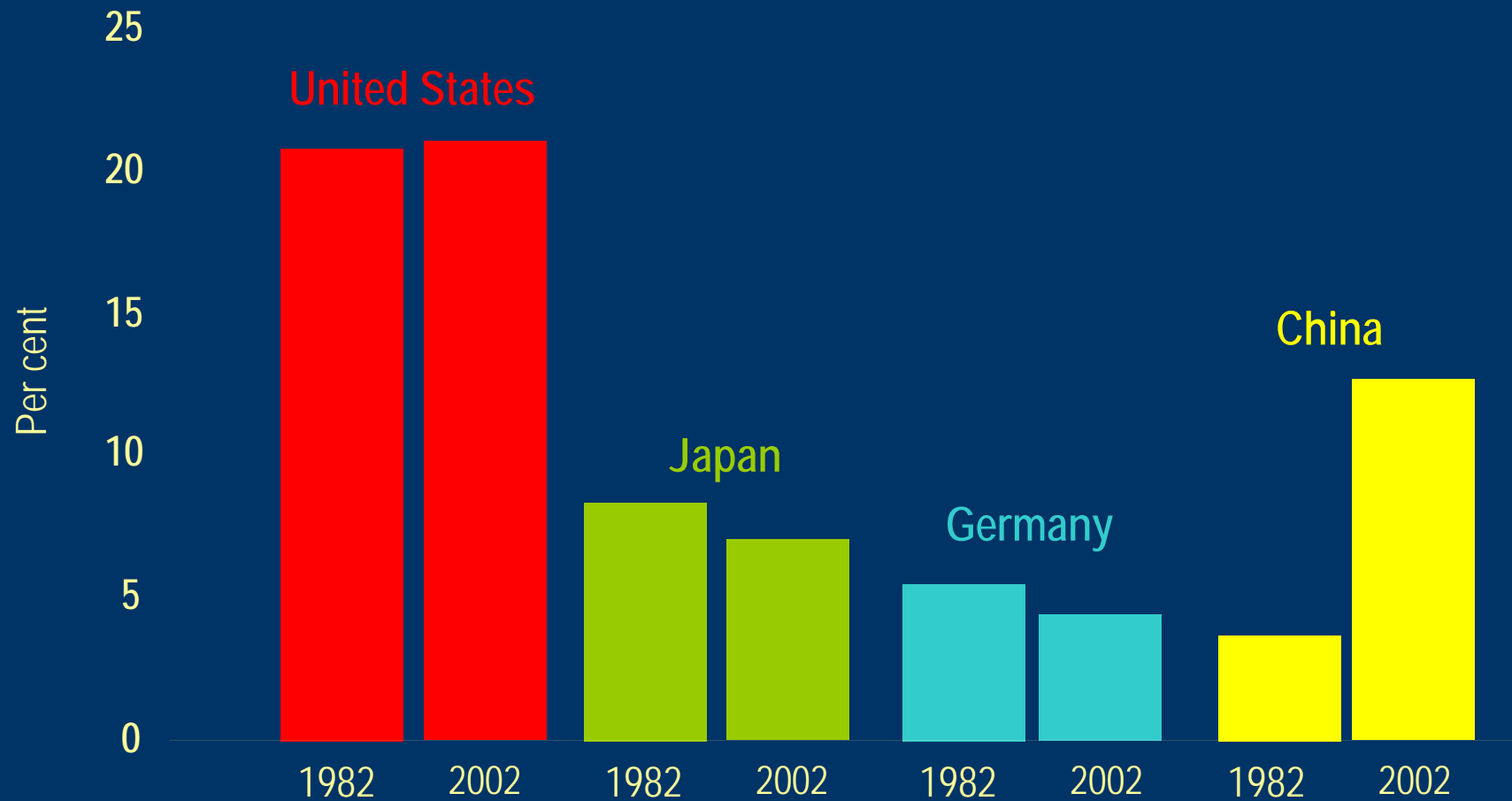
China's economic growth rate



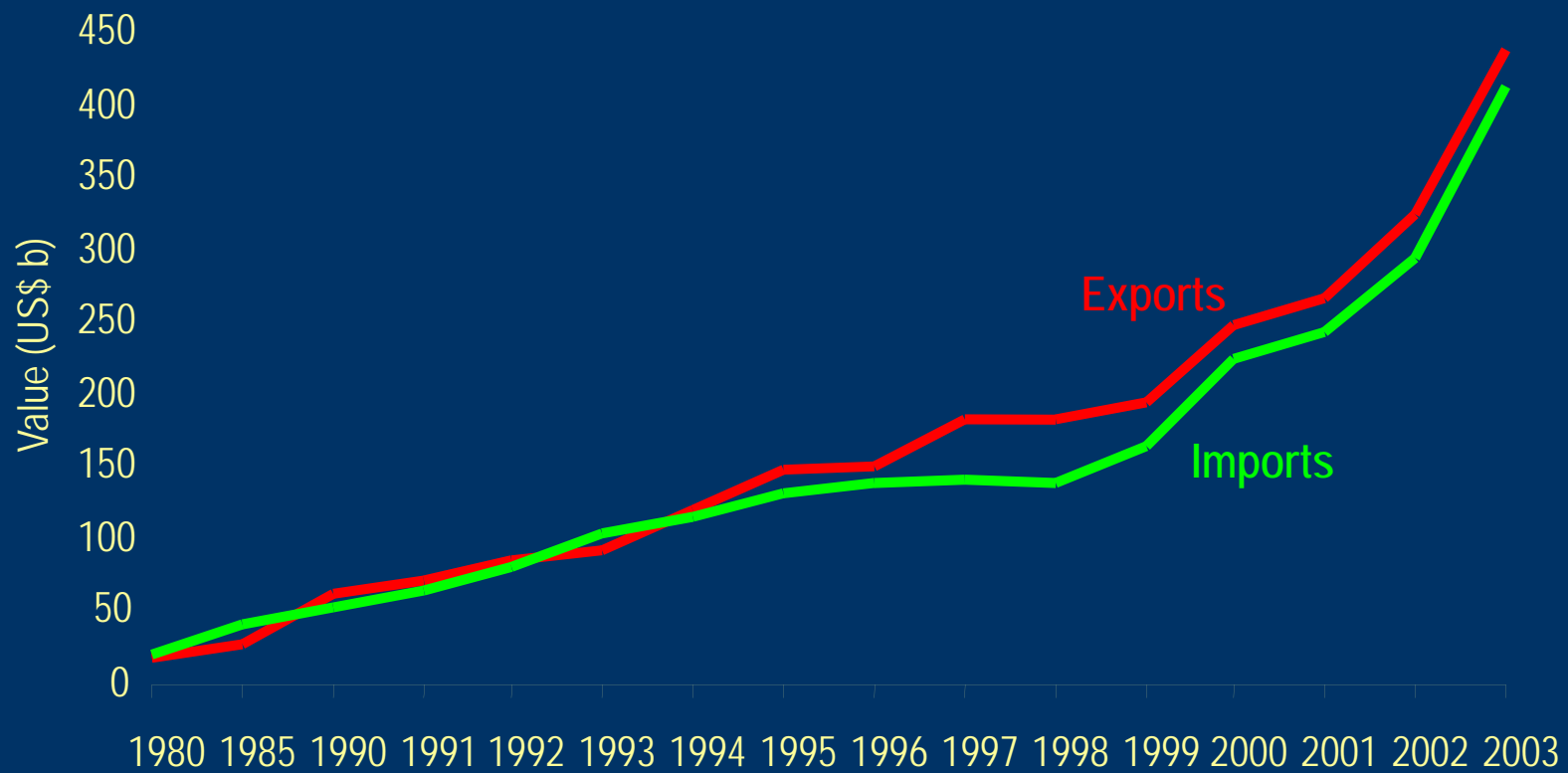
Pace of development quickens



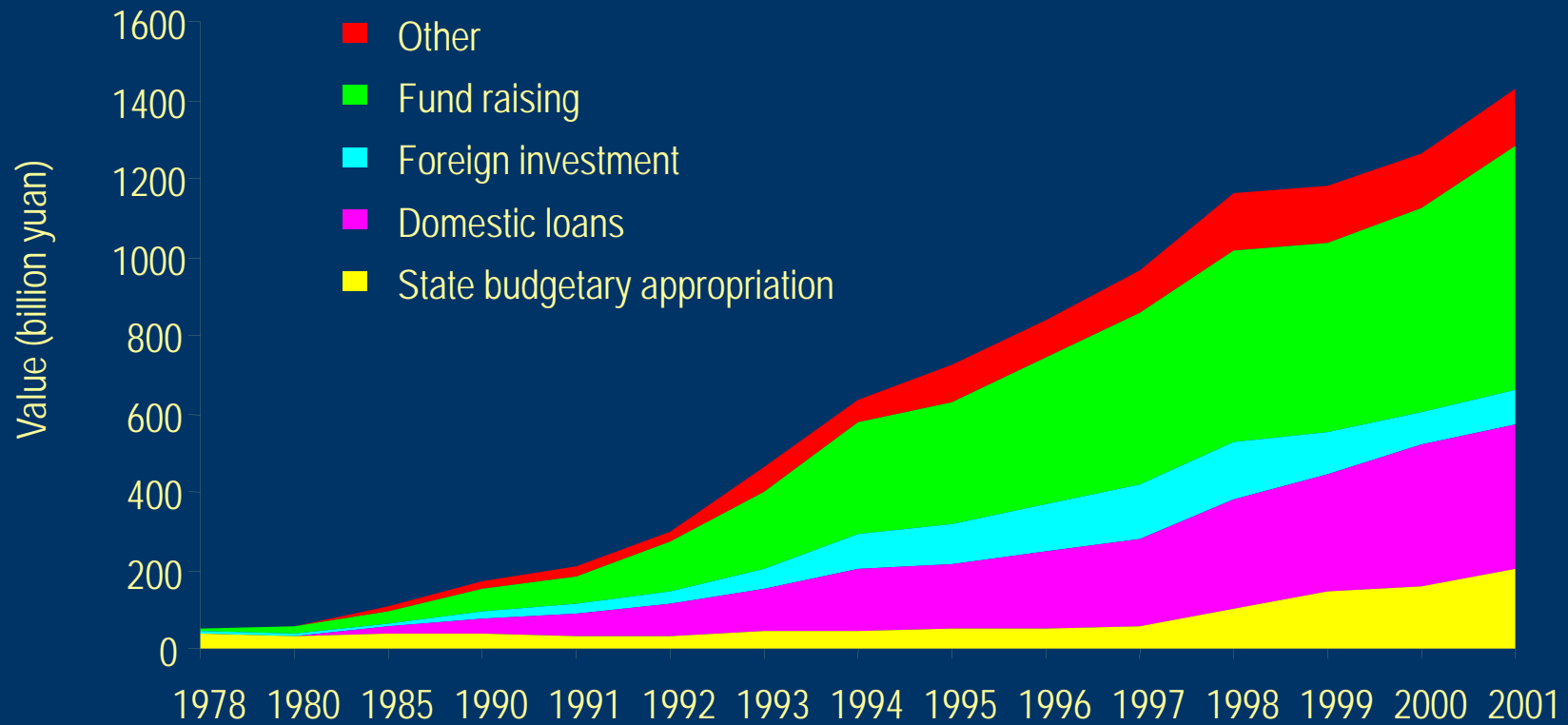
Where is the Chinese economy going? Share of world output (PPP basis)



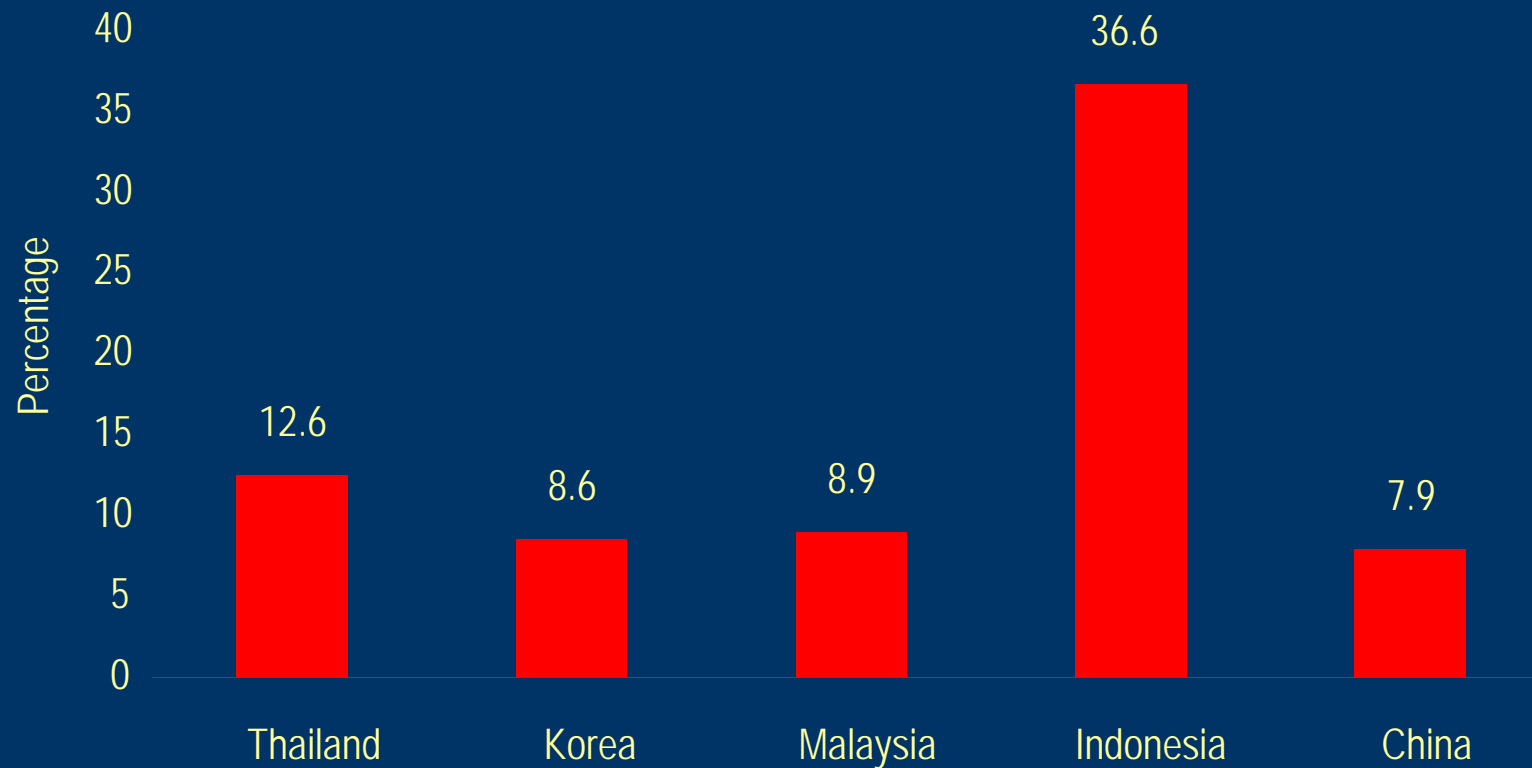
China's imports and exports



Composition of investment in physical capital construction



China's debt service as a percentage of exports is low



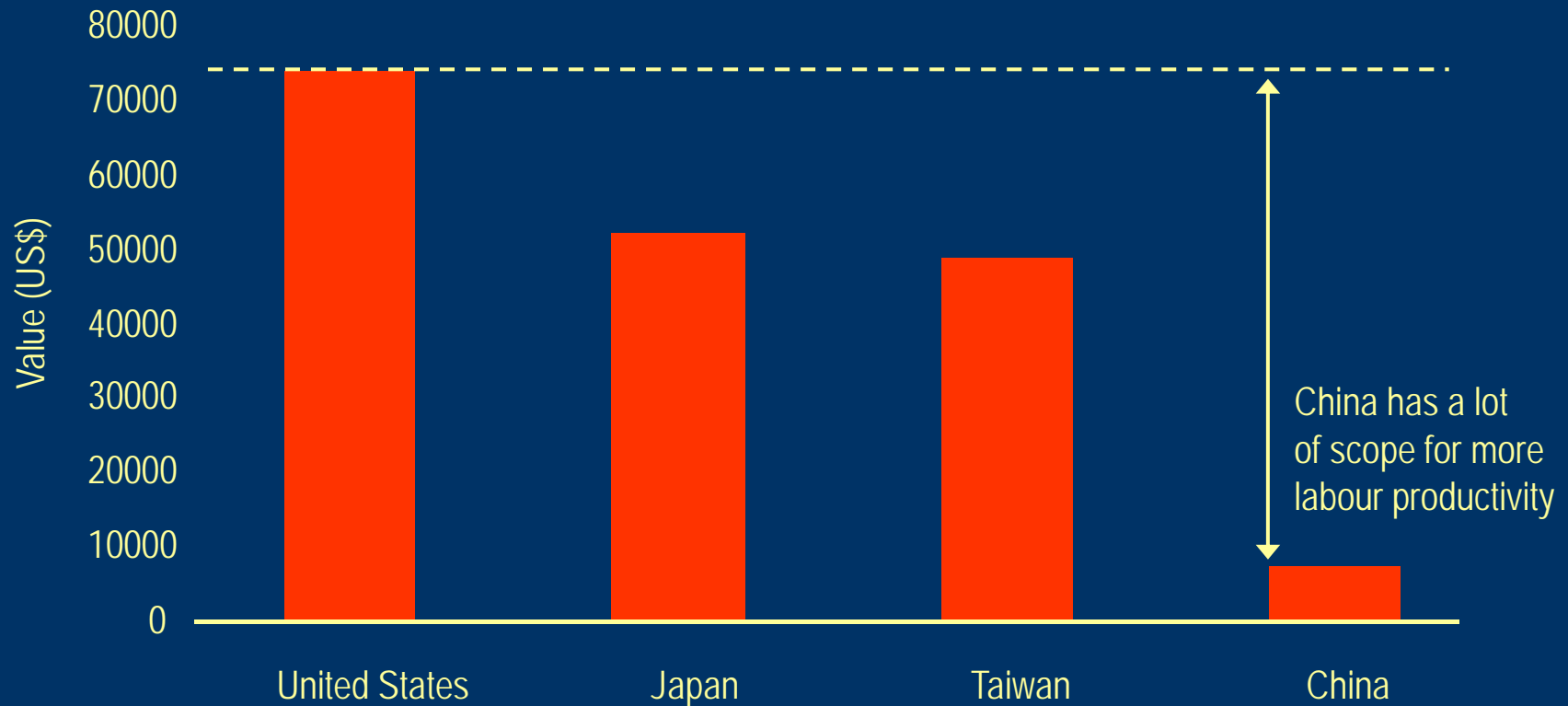


Key questions



- Will China's growth continue?
- If it does, what are the implications?
- What could happen to the world economy if:
 - slowdown
 - banking crisis

Labour productivity in 2001: GDP (PPP US\$) per worker



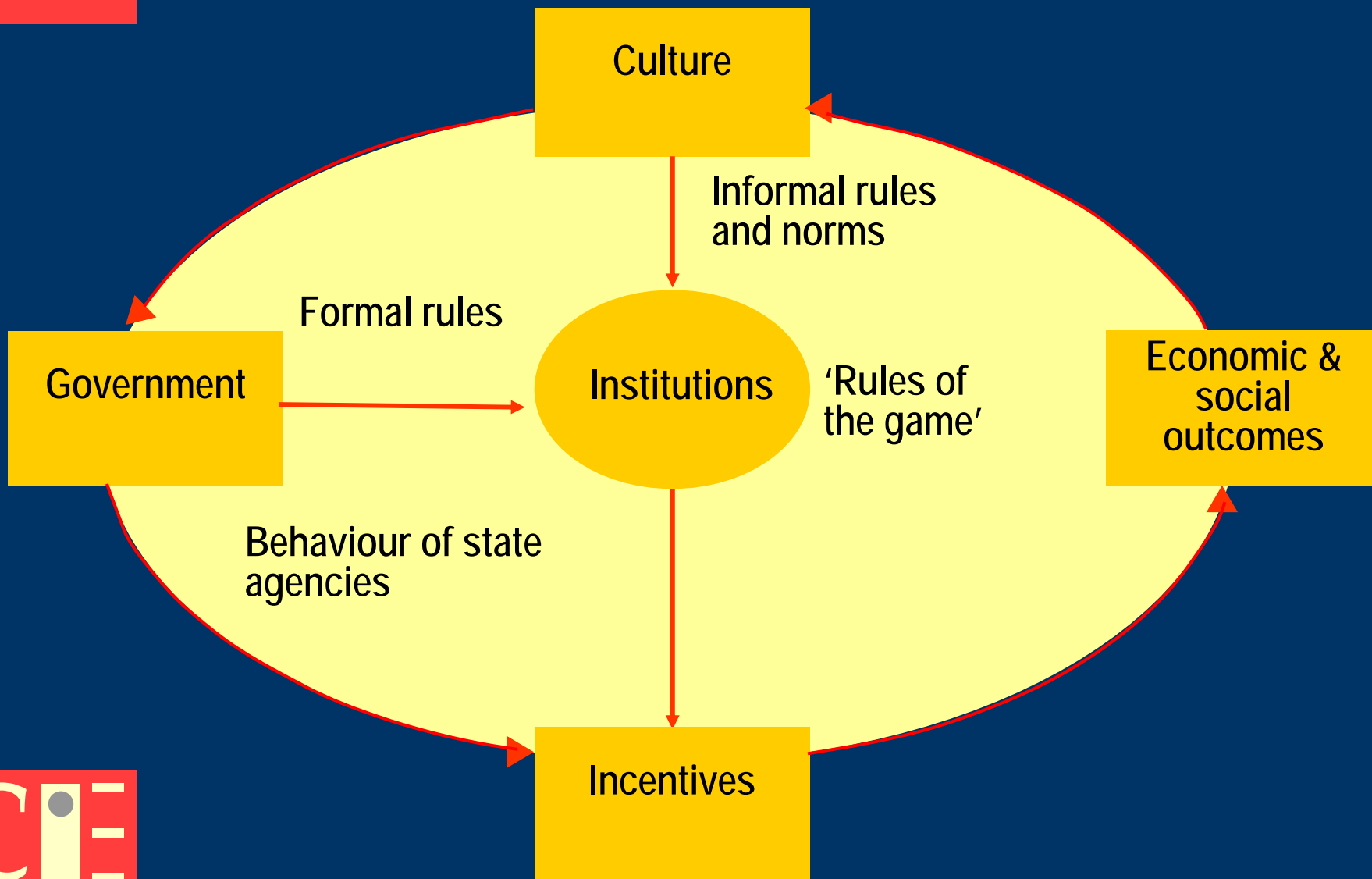


Chinese challenges



- One-party state and political tensions
- Corruption at local level
- No mechanism to price risk
- Banking system bankrupt
- Lack of secure property rights
- Environmental degradation
- High unemployment
- State-owned enterprises (SOEs)

Institutional development is critical





Some responses



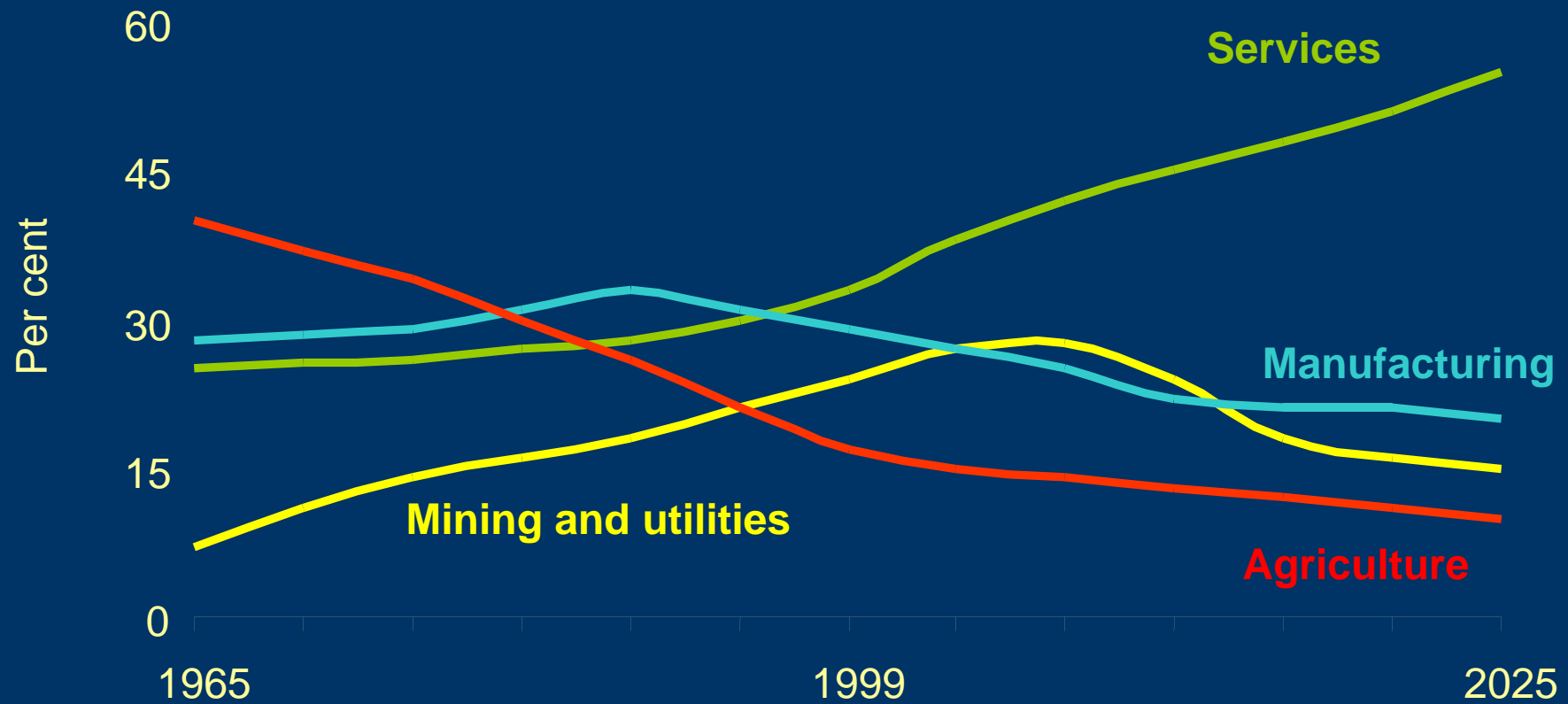
- Legal rules to tackle corruption
- Private banks encouraged in
- Foreign media allowed in
- Environmental issues tackled



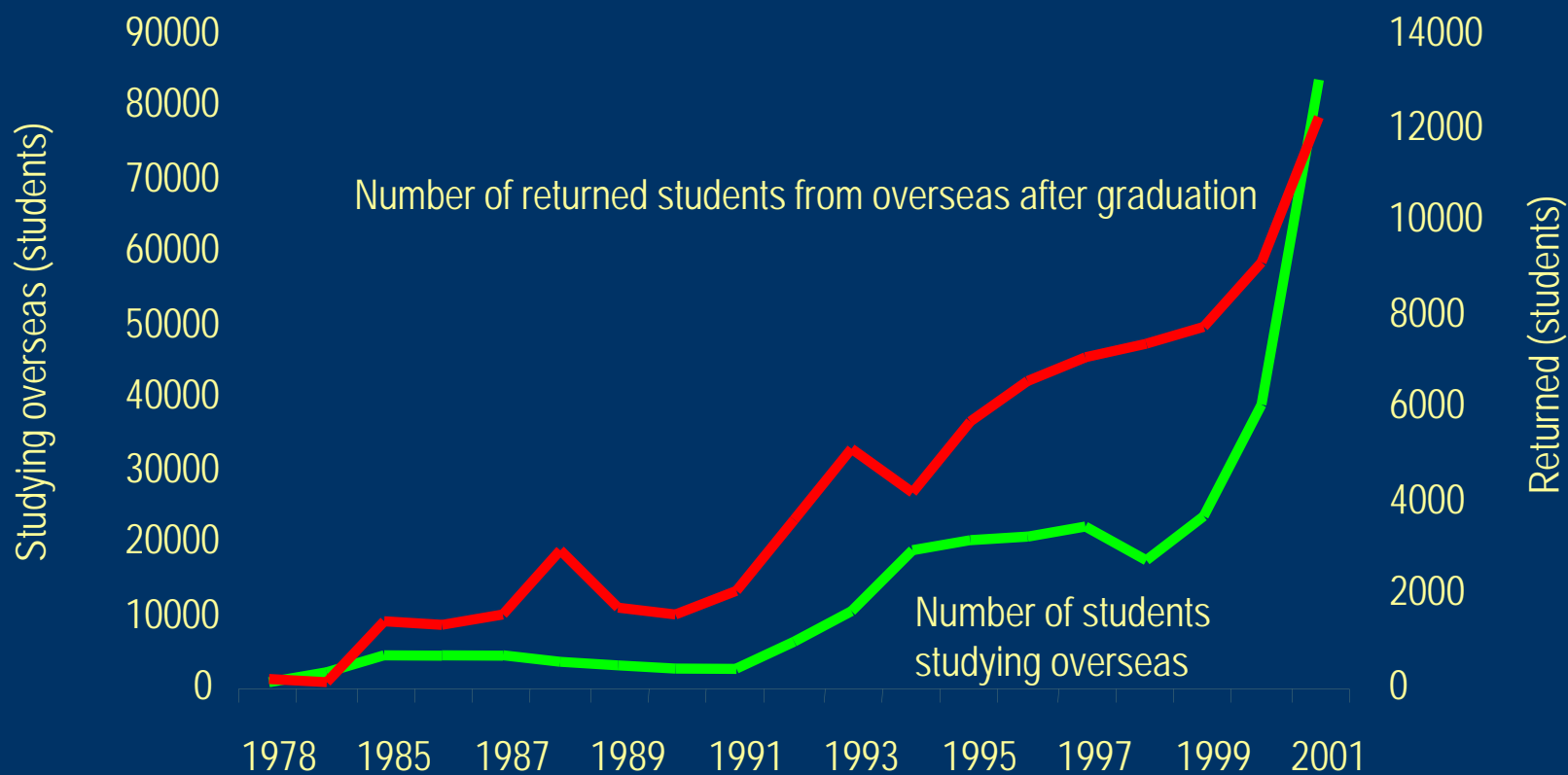
Growth 'bind'

- High growth needed to address high unemployment
- Stimulatory fiscal policy even though deficit running at 3 per cent of GDP
- Government has to un-pick the framework that underpins its own power

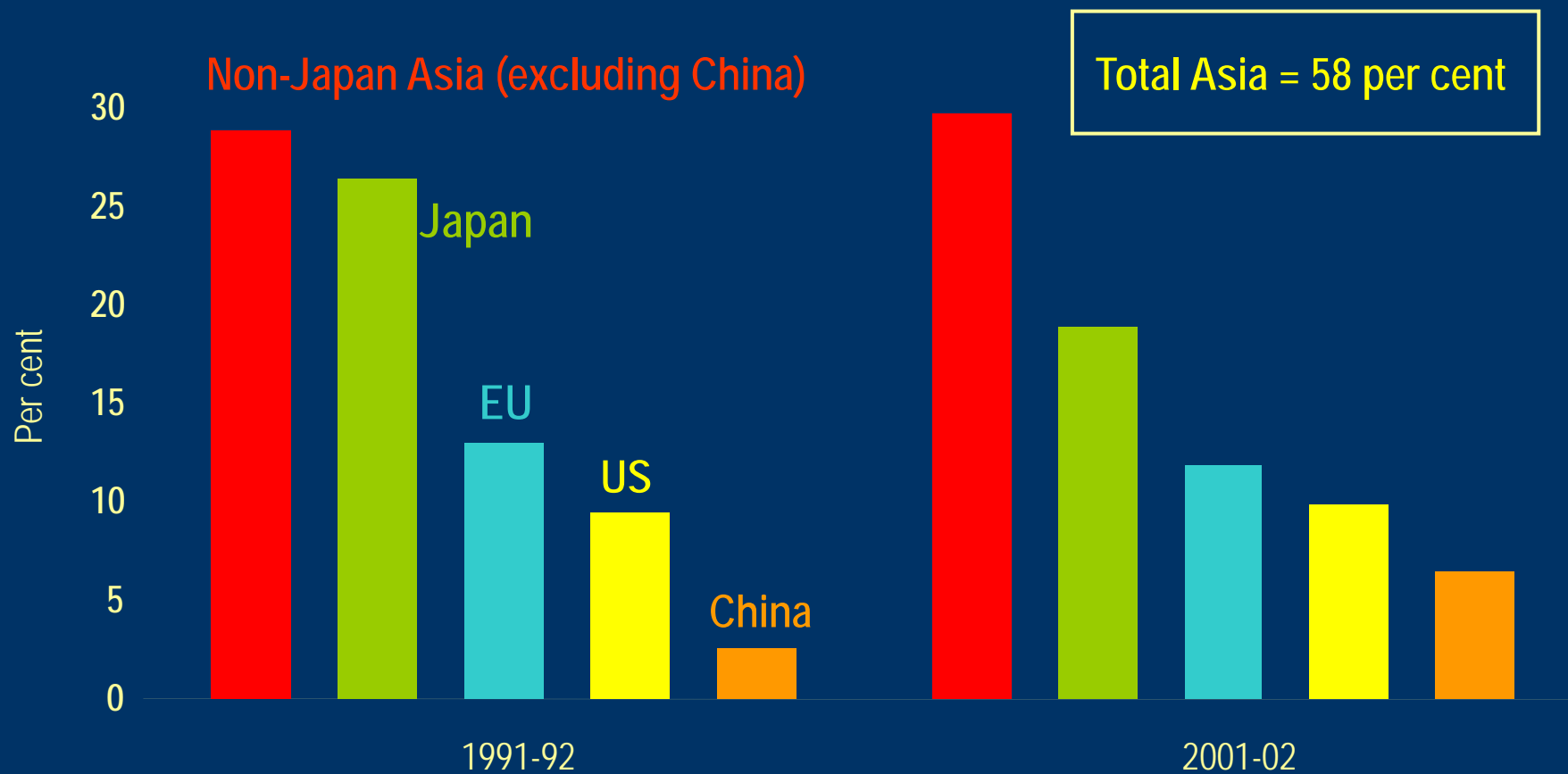
Structure of economy will change



Studying overseas



Australia's merchandise exports (shares)



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China's economy, imports and exports are booming

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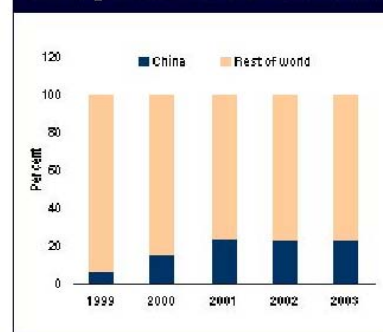
In this issue...

China: the implications of the policy tightening

China is now a major player in the world economy and its economy has been booming. Last year imports grew by 40 per cent. China has accounted for over 20 per cent of global growth over the last three years. Last year China's real GDP grew by 9.1 per cent. Bank credit is up 21 per cent, inflation is rising and some economists believe the true inflation rate is above 5 per cent.

Authorities have moved to cool the economy. They are likely to succeed. The key questions are whether the economy is in for a hard or soft landing and what does that mean for other Asian and world economies.

World growth: China's contribution



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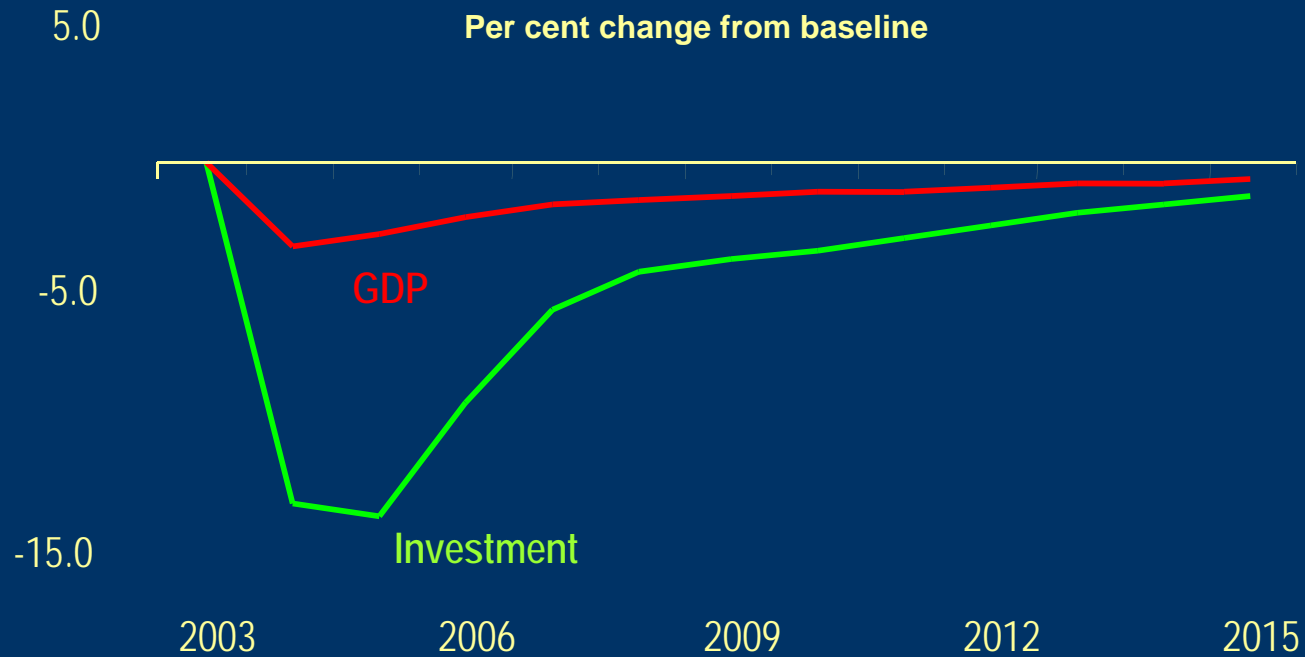
Previously only available to a limited group with modeling expertise

The underlying models used here have been used by international agencies, central banks, governments, fund managers and financial institutions around the world for more than a decade. But running the models and designing scenarios requires considerable investment in expertise and this has limited availability to those with modeling expertise. Due to popular demand, we now provide access to the valuable insights from the model by making available results from typical scenarios directly to clients.

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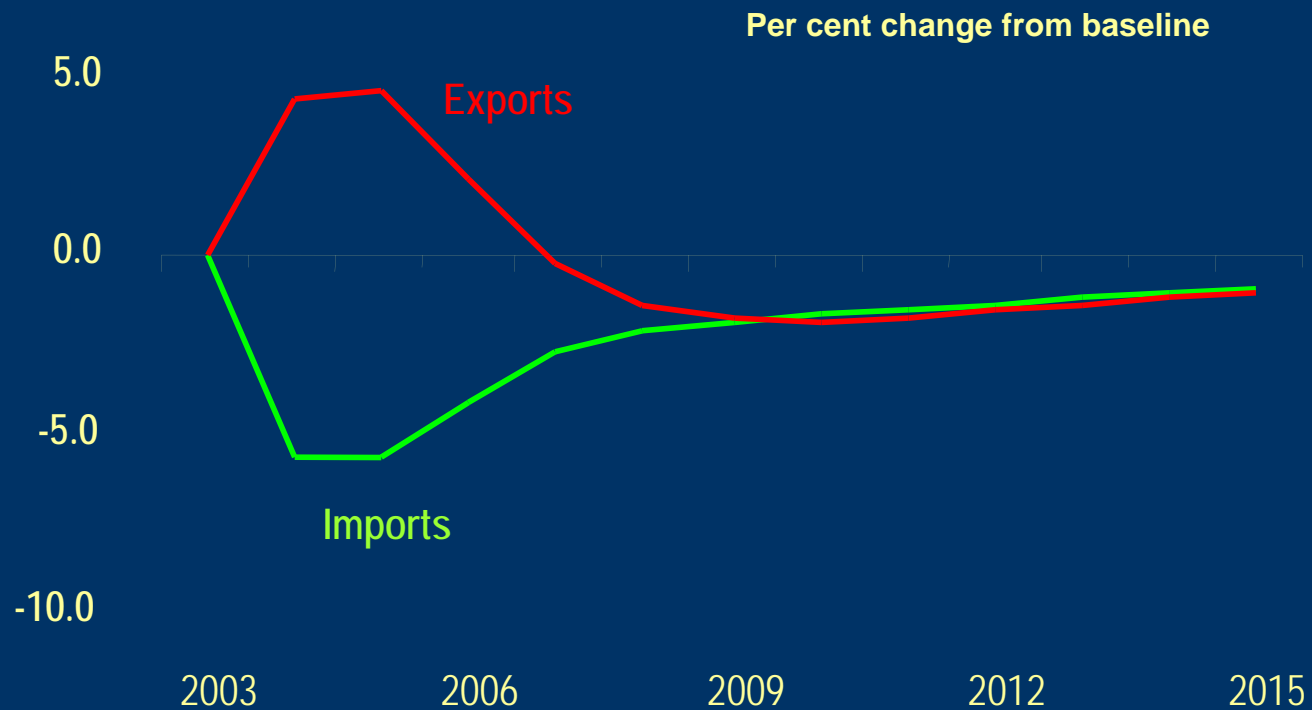


What if ...? Slowdown in economy



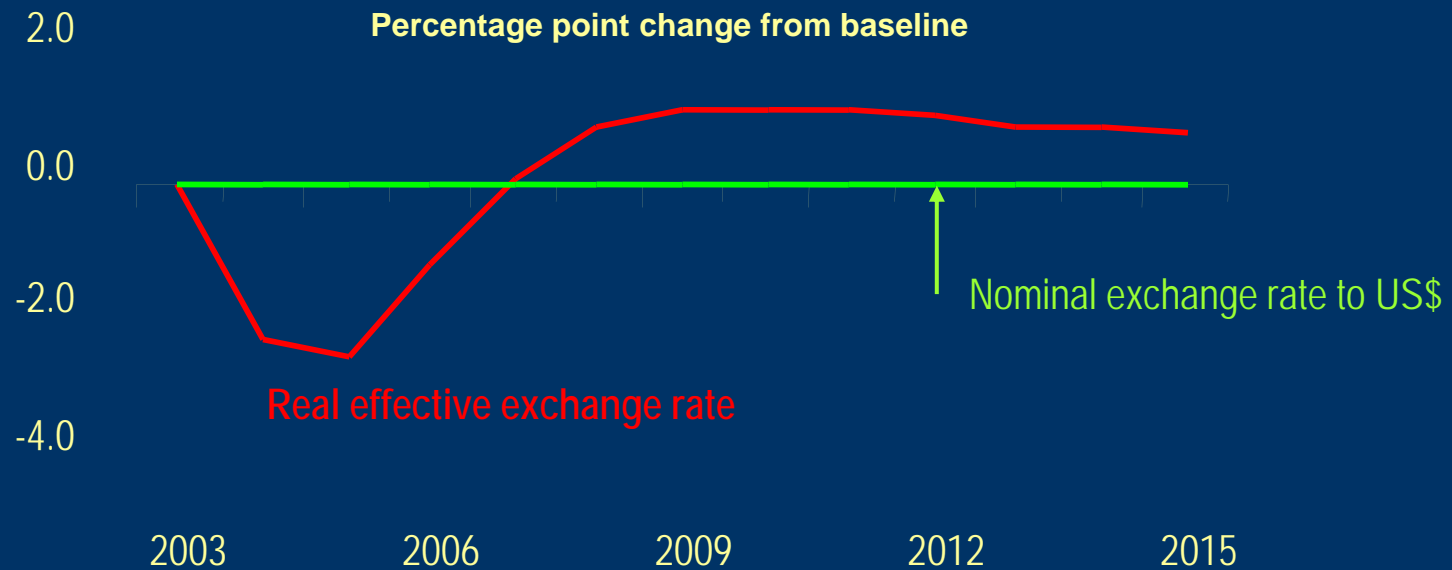
Source: www.economicsscenarios.com

What if ...? Slowdown in economy (continued)



Source: www.economicsscenarios.com

What if ...? Slowdown in economy (continued)

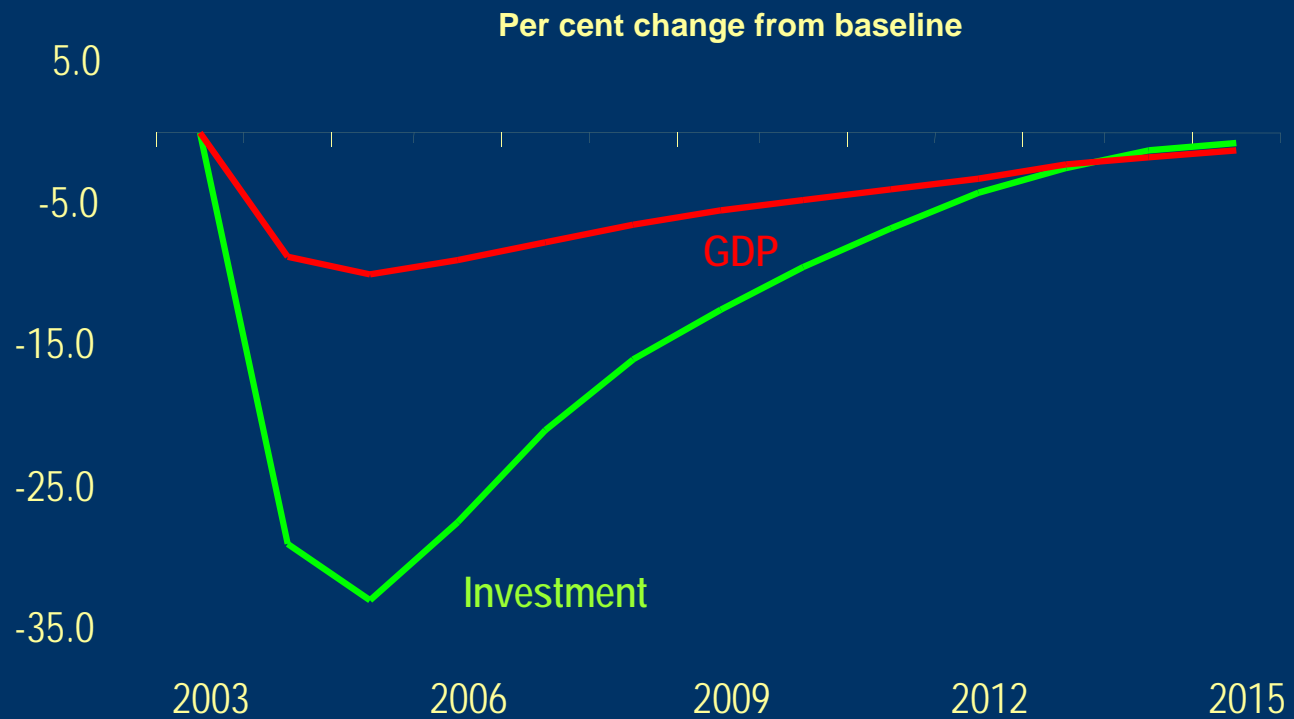


Source: www.economicsscenarios.com

What if ...? Banking crisis

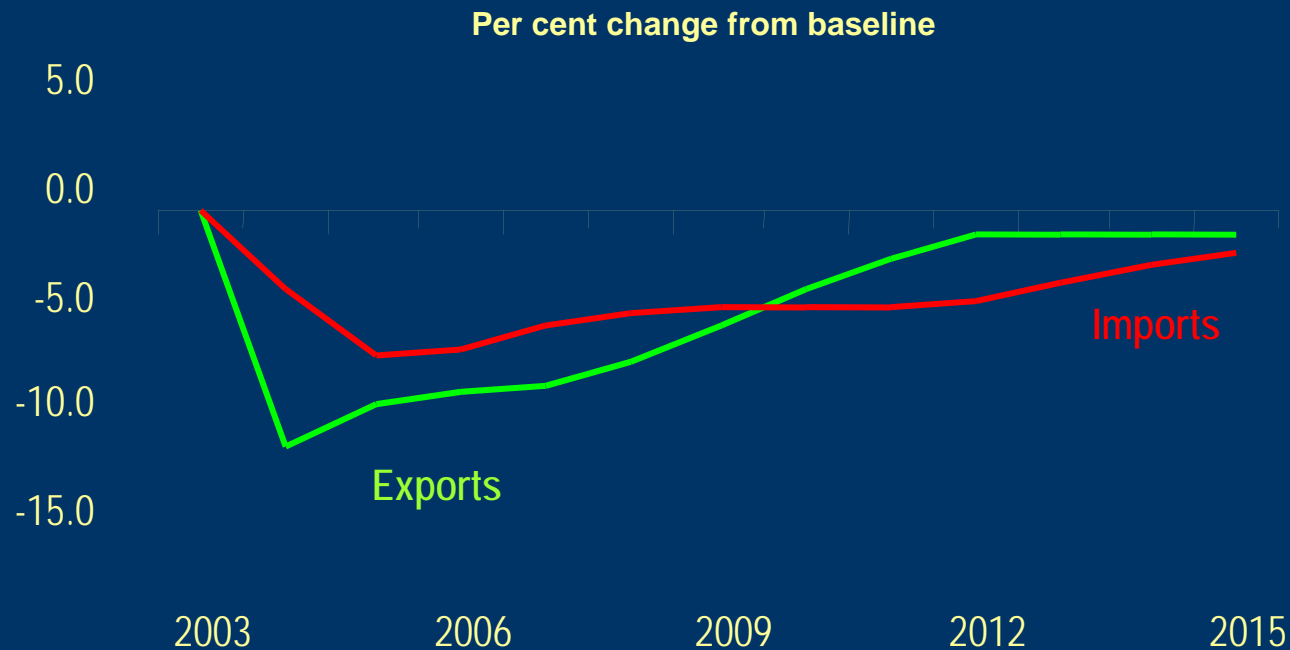
- Banks insolvent
- Four state-owned banks account for 86 per cent assets
- NPL's 32 per cent of GDP
 - some cite 45 per cent
- Most loans to SOE's
- Bank bailout would lead to fiscal crisis
 - already deficit 3 per of GDP
 - prospect for contagion around Asia

What if ...? Banking crisis (continued)



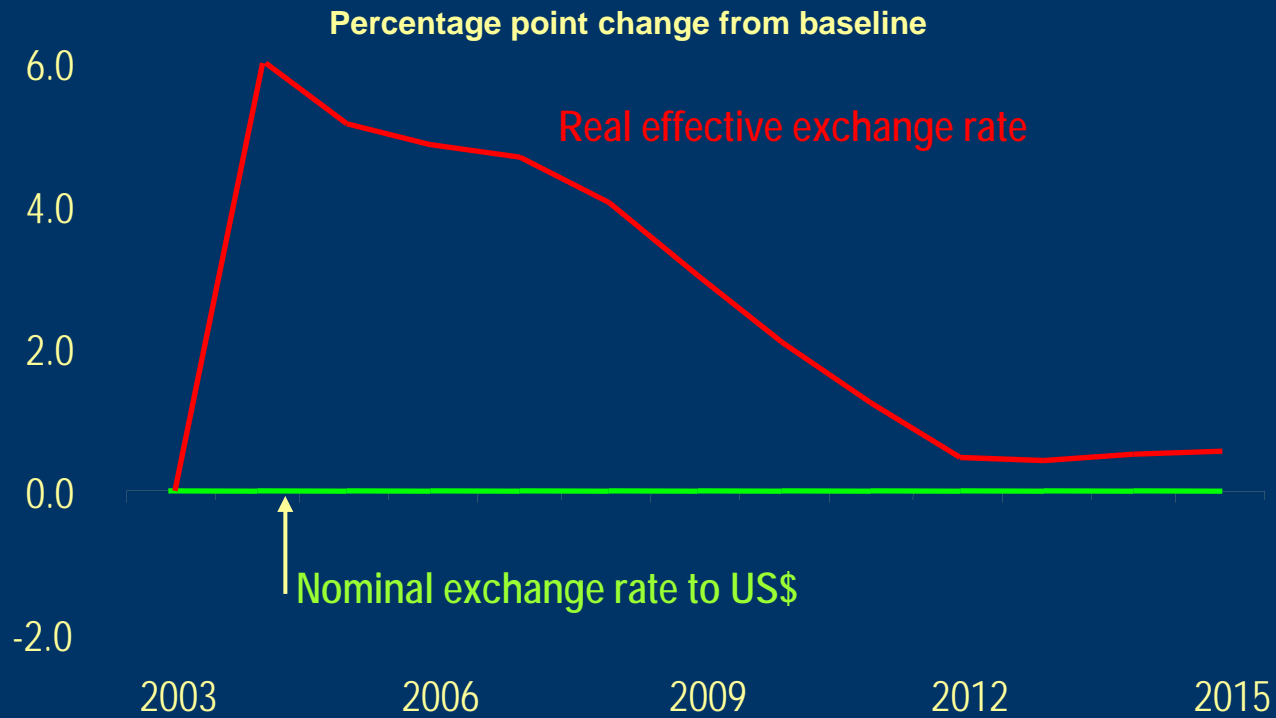
Source: www.economicsscenarios.com

What if ...? Banking crisis (continued)



Source: www.economicsscenarios.com

What if ...? Banking crisis (continued)



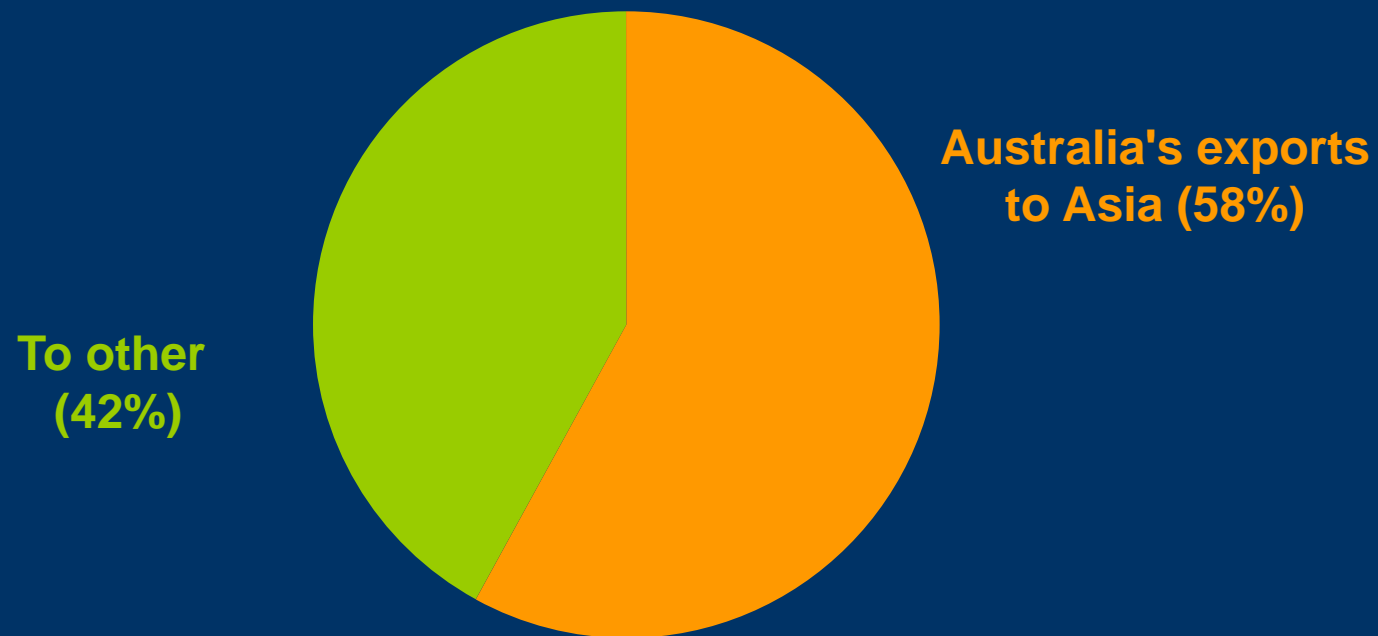
Source: www.economicsscenarios.com

Effects of a banking crisis in China on the region in 2005

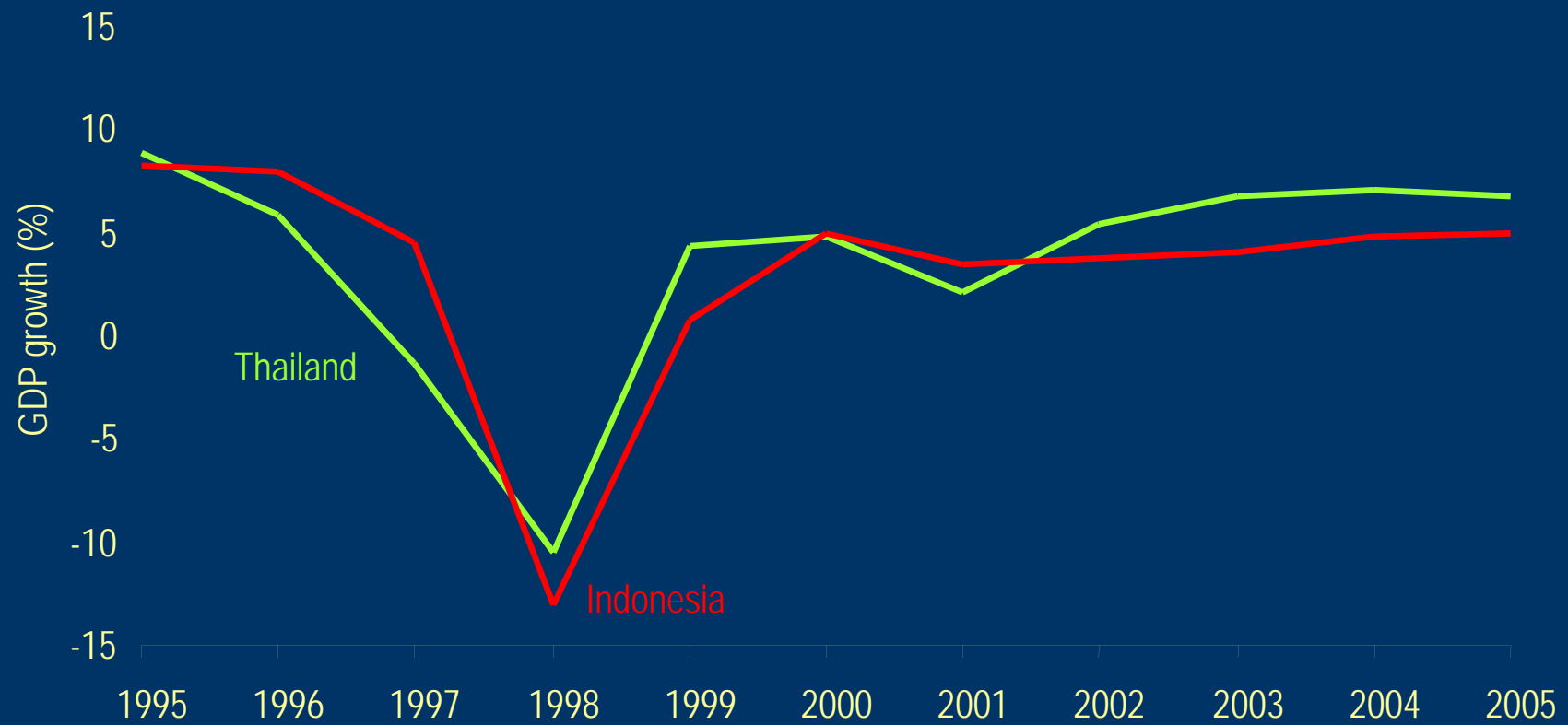
Country	Real GDP	Real exports
China	-10.0	-9.2
Japan	0.0	-1.3
Singapore	-0.7	0.2
Thailand	-1.1	1.8
Taiwan	-0.6	1.5
Korea	-1.4	1.5
Australia	0.0	-0.5

Source: www.economicsscenarios.com

Why use economy-wide models: an example



1997-98 Asian financial crisis



Why use economy-wide models: an example

Australia's economic performance
Asian Financial Crisis: 1997-98

But lower interest rates boost construction and consumer durables

Exports hit hard

Net effect predicted by APG-Cubed model borne out by experience



Summary



- China now 2nd largest economy
- Authorities are slowing boom
- Productivity is low
 - ample scope for growth
 - growth driven by fundamentals
- High growth needed to keep employment up
- Banking and SOEs a drain on system



Summary (continued)



- China is not another Asia crisis ‘waiting to happen’
 - capital controls
 - abundant foreign exchange reserves
 - fiscal accounts, SOE reform led worker layoff and political instability the issues
- A banking crisis would become a fiscal crisis
 - could set off contagion
- Bad scenarios not necessarily bad for Australia
 - have to follow financial flows as well as real flows