

# China's future growth and its impact on Australia

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China's remarkable economic growth since 2003 has become increasingly important to the global economy, and particularly to the Australian economy. This article discusses the following points:

- Why is China's growth so important and why is it sustainable?
- What does the nature of China's growth mean for the global economy?
- What does China's rise mean for the Australian economy and financial markets?

## Why is China's growth so important and why is it sustainable?

Despite the rapid growth of the emerging market economies recently, led by China, non-OECD countries still account for only 25% of global Gross Domestic Product (a measure of an economy's output) despite being 82% of the global population. In these non-OECD countries, the average income is US\$2,300, compared with US\$32,000 in the OECD or "Western" nations.

Despite these low comparative incomes, the importance of emerging market growth is its high material and energy intensity relative to the Western world. Because of a relatively large share of industry in GDP, and also because of inefficiencies, non-OECD economies use three times the energy and materials to produce \$1000 worth of GDP compared to developed OECD economies.

So what drives this materials intensive growth in emerging markets like China? The answer is the power of urbanisation.

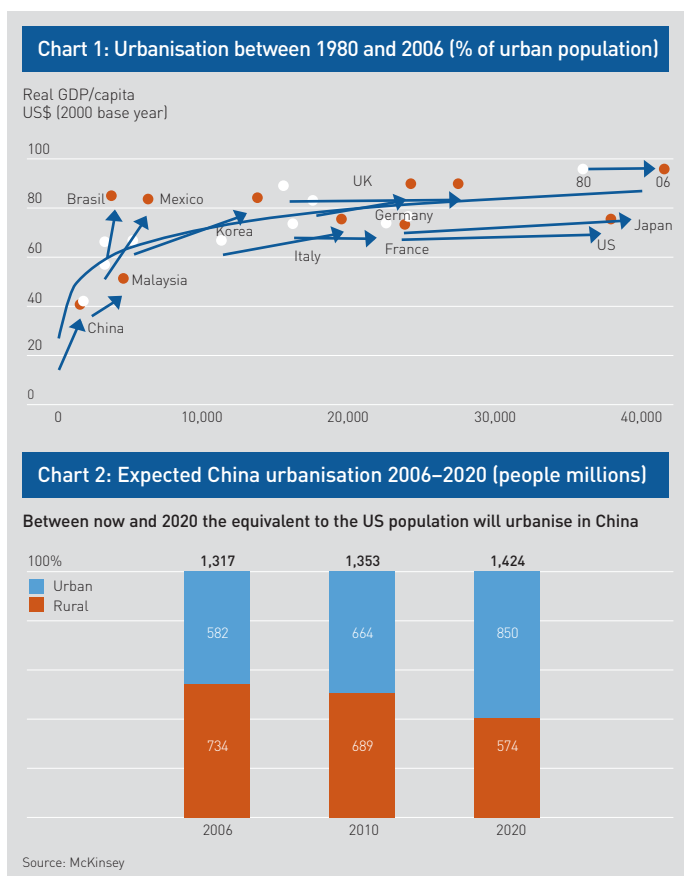


Chart 1 below left highlights that, as urbanisation increases, incomes rise. It also highlights that China is at a very early stage of urbanisation relative to the Western world. Chart 2 highlights the scale of urbanisation in China. Only 13% of China's land mass is arable (ie: suitable for growing crops). This can provide decent sustenance to perhaps 200 million people, but not the present rural population of over 700 million.

What China is experiencing now is similar to the Industrial Revolutions that took place in the West in the last two centuries. Driven by poverty and the attraction of urban incomes at three times rural levels, people are migrating from the country to the city.

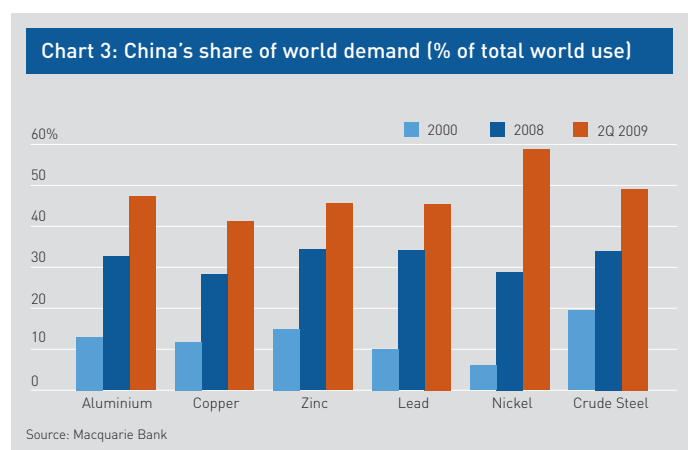
What makes China so different and so important is the sheer scale of this urbanisation. Every year, somewhere between 15-20 million people per annum are moving into urban areas. This means that, over the next decade, a population equivalent to the US will urbanise.

This urbanisation creates an enormous demand for infrastructure, housing, industrialisation and commercial development. In the next 5 years, the Chinese government plans to spend US\$450 billion on railways (4 times the past 5 years), US\$70 billion on airports (2 times the past 5 years) and US\$710 billion on roads (1.5 times the past 5 years). China's expected growth in coal fired power generation in the next 5 years is the equivalent of 6 times the entire Australian national power generation network.

China's installed floor space is expected to double by 2025, an annual construction of 2.5 – 3.0 billion sqm, which is the equivalent of building Canada every year. Over 65% of this growth will come from the development of residential real estate to meet the urbanisation demand.

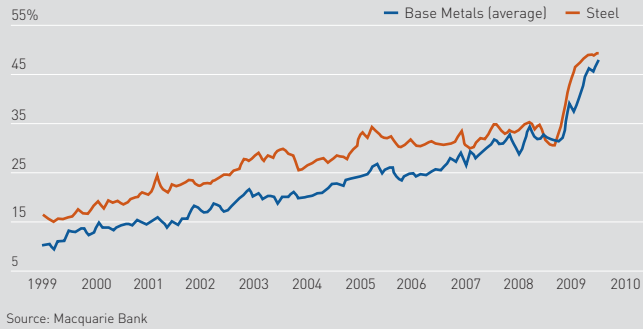
## What does the nature of China's growth mean for the global economy?

China's growth is driven more by internal factors (urbanisation) than external (export demand), so this means that the majority of the steel and copper consumed in China is used there and not exported. The materials intensive nature of China's urbanisation and industrialisation means that China now dominates global commodity demand growth.



**Chart 4: China's share of global demand (% of total world use)**

Monthly to June 2009

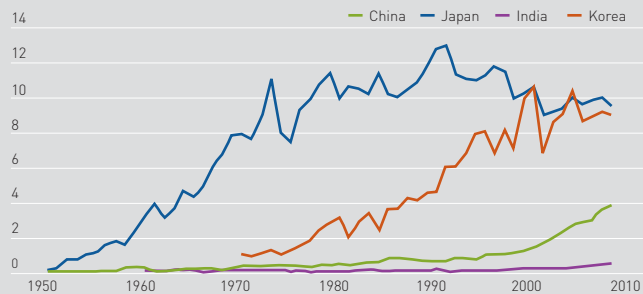


Source: Macquarie Bank

The charts 1–4 above and on the previous page illustrate the dramatic changes that China's growth has had on commodity markets in the past decade. These high levels of demand from China were unexpected and the global commodity supply infrastructure has been unable to keep up. This has led to strong price rises in the majority of commodities, many of which remain at high levels despite the impacts of the Global Financial Crisis.

The long expected duration of China's urbanisation and the rise in incomes and consumption that will result implies a prolonged period of strong demand for commodities. Chart 5 below highlights the relationship between rising incomes and rising commodity consumption in two Asian economies that have previously experienced strong growth that was important to Australian economic growth, namely Japan and Korea.

**Chart 5: Copper consumption per capita since 1950 (kg/person)**



Source: Macquarie Bank

This chart illustrates that despite the huge growth in China's total consumption of commodities, its consumption on a per capita basis remains low relative to other more developed Asian nations. It is interesting to note that the Japanese and Korean population of approximately 270 million is dwarfed by the Chinese population of 1.3 billion. Also, India's population of 1.1 billion remains at a very early, but fast growing, stage of development.

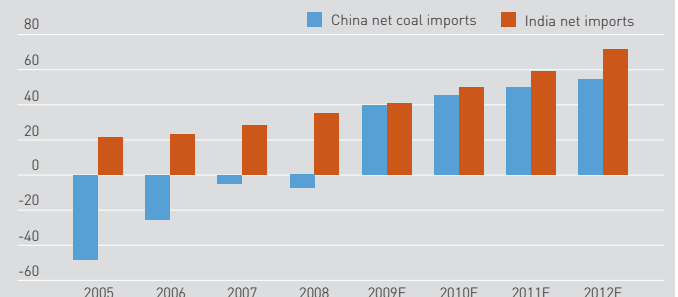
So it is clear that we are experiencing a phase of strong growth in demand for commodities. China is short of the raw materials required and reliant on imports. How can Australia benefit from this?

**What does China's rise mean for the Australian economy and financial markets?**

Australia can benefit from the rise of China as we supply many of the resources that China needs to support its growth, such as iron ore, coal, gas, and copper.

Thermal coal, which is used for power generation, is a great example of how China's growth has had a positive impact on Australia. Chart 6 below shows how China, unable to meet its own insatiable demand for energy despite having the world's largest coal resource, has changed from an exporter to an importer of coal. This has led to higher exports from Australia as prices have risen from US\$25/tonne to US\$75/tonne. The chart also highlights how increasing growth in India, which lacks domestic energy resources, will be positive for coal export growth from Australia.

**Chart 6: China net coal imports and India net imports**



Source: UBS

Chinese commodity demand creates many positive influences for Australia such as higher levels of investment, employment, consumption, exports and wealth. It is not just mining and energy companies that benefit, but also engineers, contractors, retailers and the banks.

Our exposure to China has allowed our economy and markets to recover from the global financial crisis without reaching the depths plumbed by other Western nations.

The prominence of resources and energy in the Australian economy and financial markets means that an understanding of China and its impact on commodities is critical for future investment decision making.

Robin Young, who visits China regularly, is a Senior Analyst for BlackRock's Australian Equity Fundamental Team and is involved in running the Australian Equity Funds. For further information regarding BlackRock's products and services, please contact your financial adviser or contact BlackRock's Investor Services Centre 1300 366 100 or visit our website: [www.blackrock.com/au](http://www.blackrock.com/au).

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