



The China effect

Why is China so important to our economy and how does it affect our investments? In a recently conducted interview, Richard Holden, Professor of Economics at UNSW Australia Business School, shared his views on demystifying the issues.

How has China become so important to us?

RH: For 30 years China has gone through a massive economic modernisation process, causing an extraordinary migration from country to city. Its scale has meant consistent and extraordinary growth to the order of 10% a year, compounding over that 30-year period. It has encouraged enormous demand for Australian products, particularly from our mining sector. It has also been good for Australia in the sense that China can produce things inexpensively and efficiently, lowering prices for Australian consumers.

What has now changed?

RH: You can't keep growing at a rate of 10% forever. If the Chinese economy continually grows even at 7%, as we're expecting this year, as an example that growth is more than the total economic output of the Netherlands.

Will this slowdown negatively affect Australia?

RH: The slowdown has been inevitable, so is not a shock. A concern is that 7% growth might actually be a bit high and perhaps the real number could be closer to 5%. That has a big impact on Australian exporters. If China's economic growth is 5% instead of 7% then the number of new buildings they need to build, for example, is potentially zero for a period of time and no imported materials would be required.

In addition, Chinese officials have stated certain individuals are not allowed to sell shares on the Chinese stock exchange. This is not disastrous, but it signals concern on the part of the Chinese that things could be worse than expected. That has been behind a lot of the recent volatility.

What was the recent currency issue?

RH: The Chinese currency, the yuan, has been linked to the US dollar by what economists call a 'crawling peg', meaning China announced daily a 'band' in which the currency floats around the US dollar. The question has been whether China is going to instead allow market forces to determine the exchange rate. Recently, when the US dollar rose China decided they were not going to ratchet up their own rate. So the peg did not 'crawl'.

You can look at this in two different ways. One is that they are devaluing their currency as it will make their exports cheaper and therefore increase demand. There is probably some truth in that.



But another possibility is that the International Monetary Fund (IMF) has a group of currencies in which it lends money. It contains four currencies – the US dollar, euro, yen and sterling. China wants the yuan in that group, but the IMF has said it cannot have a 'manipulated' currency because it would create problems. So this could have been an attempt to change the view of the IMF.

What does it all mean for Australian investors?

RH: The slowing growth in developed economies is evidence of what is known as 'secular stagnation', meaning there is too much money chasing too few productive investment opportunities globally, so growth is going to be lower. What does that mean for an investor? It means current extremely low interest rates will likely continue for an extended period. This can significantly affect asset allocation for retirees in Australia – for example, putting your money in a term deposit earns a lower yield than it did ten years ago.

In light of this, retirees may feel that they need to allocate more of their assets to higher yielding investments. And, say, for somebody in their early 40s this increases the importance of retirement planning. It's important to think more carefully than ever about one's financial plan, including retirement goals, when to retire, asset allocation and savings to help plan for the future.

Speak to us for more information If you would like to know more, talk to your Count financial adviser. They can give you more detailed information on the best approach for your situation. Important information