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Opinion

The resilience advantage in Australia's trade with China

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In 2011, Glenn Stevens, the Governor of the Reserve Bank of Australia quipped, 'The proverbial pet-shop galah can by now recite the facts on Australia's trade with China'.

While the Global Financial Crisis had wreaked havoc elsewhere, in the lead up to Stevens' remark ravenous Chinese demand for Australian resources, in particular iron ore, helped to stabilise the Australian economy, including by pushing the terms of trade (the ratio of export prices to import prices) to 'a level not seen in over a century'.

At the time, iron ore accounted for 62 percent of Australia's goods exports to China, and two years earlier China had overtaken Japan to become Australia's largest goods export market.

Since then, Chinese demand for iron ore has only expanded, from $44 billion in 2011 to $104 billion last year.

This has a fueled a perception that while Australia's trade with China might be big in value, it is one-trick pony – with the relationship viewed through the prism of a single good like iron ore, or perhaps a single sector like minerals and fuels.

But this perception stems from a superficial reading. Digging deeper reveals a reality that not only is Australia's trade with China big, but it is also more diverse than with any other major partner.

It is certainly true that the sector of minerals and fuels dominate Australia's good exports to China. Last year, it accounted for 79 percent of the total. But this is reflective of the structure of Australia's goods export basket more generally. In the case of Japan, Korea, Taiwan and India, Australia's next largest international customers, the ratio was 86 percent, 78 percent, 85 percent and 85 percent, respectively.

It's when Australia's exports are disaggregated, and imports are also brought into the mix, that the diversity of trade engagement with China stands apart.

In the year to April, Australia's customs data show that when it comes to trade with China there were 189 categories (using the Standard International Trade Classification System at the 3-digit level) worth $A50 million or more.

And despite the pandemic and a range of Australian goods losing access to the Chinese market in 2020 due to a geopolitical falling out between Canberra and Beijing, this was up from 179 categories in 2019.

The 189 categories with China compared with just 68, 63, 51 and 54 for Japan, Korea, Taiwan and India. By this metric, which homes in on diversity, second to China was the US, with 158. Australia's total goods trade with China was, of course, 4.5 times larger than with the US – $296 billion versus $65 billion.

Last year, China was also Australia's second-largest trading partner in services, worth $12 billion. This followed only that with the US, worth $23 billion.

Why does the diversity of engagement with a given trading partner matter?

In one sense, it doesn't. At a macroeconomic level, it's the aggregate that counts. Even if the US had a greater number of trade connections with Australia worth $50 million or more, no-one would mistake it for being more important than China given the gulf in total value between the two.

But where it becomes relevant is in forming assessments about the resilience of a trading partner's importance.

Specific categories of traded goods can be vulnerable to sectoral shocks or adverse structural trends. For example, against the backdrop of a global energy transition towards carbon net zero, beyond a 10-year time horizon it is difficult to imagine a bright future for Australia's coal exports.

Last year, coal contributed nothing to total goods exports to China worth $175 billion. In contrast, it accounted for 79 percent, 48 percent, 46 percent to India, Japan and Taiwan, respectively. The energy transition, therefore, foreshadows a significant drag on the importance of these markets as sources of demand for the Australian economy.

Sticking with the energy transition, but flipping the lens to the import side of the equation, Japan's importance to Australia as a supplier is under pressure because its once mighty car manufacturers missed the rapid consumer-driven shift to electric vehicles (EV) and are now scrambling to catch up. In their place, China has emerged as the global hub of EV production. This is why Australian imports of passenger vehicles from China doubled last year, while the value of those from Japan stagnated.

To be sure, the energy transition is only one unfolding development, albeit a major one affecting both Australia's exports and imports.

Others, such as increasing geopolitical rivalry between China and the US, might provide a headwind to Australia's trade with China but a tailwind with other US allies and partners. To date, however, the evidence is clear that despite geopolitical tensons between Canberra and Beijing worsening since 2016, the spillover to trade has been minimal – and for straightforward reasons, such as the economic complementarities between Australia and China being so deep that major disruptions to trade would inevitably inflict a sharp cost on both sides.

Yet another consideration is the purchasing power that China will add to its economy versus that of Australia's other trading partners. For the time being, the International Monetary Fund's baseline forecast is that China will contribute more to global economic growth out to 2028 than any other country. That said, China's tepid recovery from the COVID pandemic and doubts around whether Beijing remains committed to pragmatic economic reform means that the uncertainty around these forecasts is high.

That some factors push in one direction while others push in another only reinforces the fundamental point: the unusual diversity of Australia trade with China provides an overall resilience that few other partners can match.

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