

The  
Economist

## Dependence on China

# The indispensable economy?

China may not matter quite as much as you think

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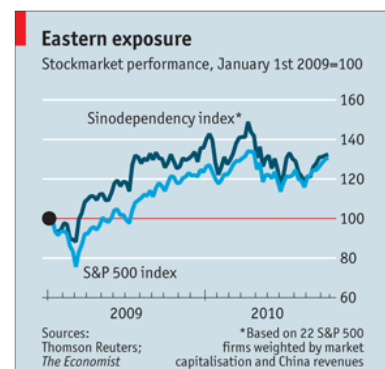
THE town of Alpha in Queensland, Australia, has only 400 residents, including one part-time ambulance driver and a lone policeman, according to Mark Imber of Waratah Coal, an exploration firm. But over the next few years it should quintuple in size, thanks to an A\$7.5 billion (\$7.3 billion) investment by his company and the Metallurgical Corporation of China, a state-owned firm that serves China's mining and metals industry. This will build Australia's biggest coal mine, as well as a 490km (300-mile) railway to carry the black stuff to the coast, and thence to China's ravenous industrial maw.

It is hard to exaggerate the Chinese economy's far-reaching impact on the world, from small towns to big markets. It accounted for about 46% of global coal consumption in 2009, according to the World Coal Institute, an industry body, and consumes a similar share of the world's zinc and aluminium. In 2009 it got through twice as much crude steel as the European Union, America and Japan combined. It bought more cars than America last year and this year looks set to buy more mobile phones than the rest of the world put together, according to China First Capital, an investment bank.

In China growth of 9.6% (recorded in the year to the third quarter) represents a slowdown. China will account for almost a fifth of world growth this year, according to the IMF; at purchasing-power parity, it will account for just over a quarter.

For the first 25 years of its rise, China's influence was most visible on the bottom line of corporate results, as it allowed firms to cut costs. More recently it has become conspicuous on the top line. Audi, a luxury German carmaker, sold more cars in China (including Hong Kong) than at home in the first quarter. Komatsu of Japan has just won an order for 44 "super-large dump trucks" from China's biggest coal miner.

*The Economist* has constructed a "Sinodependency index", comprising 22 members of America's S&P 500 stockmarket index with a high proportion of revenues in China. The index is weighted by the firms' market capitalisation and the share of their revenues they get from China. It includes Intel and Qualcomm, both chipmakers; Yum! Brands, which owns KFC and other restaurant chains; Boeing, which makes aircraft; and Corning, a glassmaker. The index outperformed the broader S&P 500 by 10% in 2009, when China's economy outpaced America's by over 11 percentage points. But it reconverged in April, as the Chinese government grappled with a nascent housing bubble.



China is, in itself, a big and dynamic part of the world economy. For that reason alone it will make a sizeable contribution to world growth this year. The harder question is whether it can make a big contribution to the rest of the world's growth.

China is now the biggest export market for countries as far afield as Brazil (accounting for 12.5% of Brazilian exports in 2009), South Africa (10.3%), Japan (18.9%) and Australia (21.8%). But exports are only one component of GDP. In most economies of any size, domestic spending matters more. Thus exports to China are only 3.4% of GDP in Australia, 2.2% in Japan, 2% in South Africa and 1.2% in Brazil (see map).



Export earnings can, of course, have a ripple effect throughout an economy. In Alpha, the prospect of selling coal to China is stimulating investment in mines, railways and probably even policing. But these “multipliers” are rarely higher than 1.5 or 2, which is to say, they rarely do more than double the contribution to GDP. Moreover, just as expanding exports add to growth, burgeoning imports subtract from it. Most countries outside East Asia suffered a deteriorating trade balance with China from 2001 to 2008. By the simple arithmetic of growth, trade with China made a (small) negative contribution, not a positive one.

China plays a larger role in the economies of its immediate neighbours. Exports to China accounted for over 14% of Taiwan’s GDP last year, and over 10% of South Korea’s. But according to a number of studies, roughly half of East Asia’s exports to China are components, such as semiconductors and hard drives, for goods that are ultimately exported elsewhere. In these industries, China is not so much an engine of demand as a transmission belt for demand originating elsewhere.

The share of parts and components in its imports is, however, falling. From almost 40% a decade ago, it fell to 27% in 2008, according to a recent paper by Soyoung Kim of Seoul National University, as well as Jong-Wha Lee and Cyn-Young Park of the Asian Development Bank. This reflects China’s gradual “transformation from being the world’s factory, toward increasingly being the world’s consumer,” they write. Gabor Pula and Tuomas Peltonen of the European Central Bank calculate that the Philippine, South Korean and Taiwanese economies now depend more on Chinese demand than American.

Trade is not the only way that China’s ups and downs can spill over to the rest of the world. Its purchases of foreign assets keep the cost of capital down and its appetite for raw materials keeps their price up, to the benefit of commodity producers wherever they sell their wares. Its success can boost confidence and productivity. One attempt to measure these broad spillovers is a paper by Vivek Arora and Athanasios Vamvakidis of the IMF. According to their estimates, if China’s growth quickened by 1 percentage point for a year, it would boost the rest of the world’s GDP by 0.4% (about \$290 billion) after five years.

Since the crisis, China has shown that its economy can grow even when America’s shrinks. It is not entirely dependent on the world’s biggest economy. But that does not mean it can substitute for it. In April the Bank Credit Analyst, an independent research firm, asked what would happen if China suffered a “hard landing”. Its answer to this “apocalyptic” question was quite “benign”. As it pointed out, Japan at the start of the 1990s accounted for a bigger share of GDP than China does today. Its growth slowed from about 5% to 1% in the first half of the 1990s without any discernible effect on global trends. It is hard to exaggerate China’s weight in the world economy. But not impossible.

Finance and Economics



