



Thornhill Capital



China Newsletter - June 2013

Inside this issue:

Why is Australia Important to China?	1 - 5
Endnotes	5 - 6

Why is Australia Important to China?

At first thought, you wouldn't believe that Australia and China would be closely aligned. After all, Australia, the land of the barbie (barbecue to Americans), and China, the land of Confucius, aren't aligned by language, culture, or politics. But, as it turns out, they are aligned by trade. China is Australia's largest trading partner ² and trade between the two countries has grown four-fold in the last ten years.

Chinese people have migrated to Australia since the late 1700s, especially from Guangdong province in southern China. The Chinese population in Australia boomed for a short period of time during the Victorian gold rush, between 1851 and the late 1860s, when the Australian population nearly tripled in response to the discovery of gold in Victoria, Australia. However, except for this brief period, Chinese migration to Australia wasn't remarkable. Australia, from the 18th to the early 20th century, was a colony and later a dominion of the United Kingdom and was more focused on Europe and the U.S. than on China. ⁵

All that changed with President Nixon's trip to China. Gough Whitlam, the Prime Minister of Australia at that time, followed the Americans lead and established diplomatic relations with China in December 1972, later formalizing it in 1975. With the establishment of





diplomatic ties with China, both the U.S. and Australia subsequently downgraded their relationships with the Republic of China on Taiwan.

Even though a formal relationship between Australia and China started less than four decades ago, there are today large numbers of Australian-born Chinese and Chinese-born migrants/Australian citizens in Australia. Ethnic Chinese are today a significant minority group in Australia. Domestically, Chinese living in Australia primarily occupy the major cities of Melbourne, Sydney, and Brisbane. However, you can usually find a Chinatown in every Australian capital city throughout the country.

China and Australia have linked themselves not only by trade but by education. Mainland Chinese like to send their children to be educated in Australia and, consequently, Chinese students studying in Australia have rapidly increased from the several thousand studying in 1987 to more than 150,000 as of September 2011. They now comprise 26% of all foreign students in Australia.⁵ The number of university agreements between the two countries has risen by 75% in less than 10 years from 514 to 885. Most of these agreements, 89% in fact, involve academic and research

collaboration, while approximately 5% involves staff exchanges, and the remaining 6% a study abroad component. However, there are only 3,000 Australian students now studying in China, although the Australian government has established a goal of raising that number to 10,000.¹²

Trade is the dominant basis for Australia-China relations. As Australia's largest trading partner, most of the imports from Australia to China are minerals. They account for about 79% of all imports from Australia to China. Nationally, 15% of all Chinese mineral imports now come from Australia.

China exports over \$37 billion USD of goods to Australia annually,⁹ primarily machinery and electrical equipment, which account for 38% of Chinese imported goods. Total trade between China and Australia is steadily increasing and reached \$122.3 billion USD in 2012, up 4.9% from the previous year.⁹ Currently, as of 2011, China had a \$50 billion trade deficit with Australia.⁴

In addition, according to Stewart Partners, a strategic advice and wealth management company, trade with China has resulted in the following:³



- Chinese exports account for 4.6% of Australia's GDP.
- In the last 10 years Australian exports to China have increased from 5% to 25%.
- The exporting of resources to China now accounts for 58% of Australia's total exports, up from 35% ten years ago.
- \$58 billion of goods were shipped from Australia to China in 2012, \$34 billion was iron ore primarily loaded onto ships in Western Australia.
- Capital expenditures for Australian businesses between 2011 and 2012 were estimated at \$140 billion, with \$83 billion invested in the mining sector.
- Demand for Australia's natural resources has contributed to the Australian Treasury's assumption that the Australian dollar will hold at \$1.07 USD for two years and then decline by .9 cents per year. This is a contributing factor to a projected increase in tax revenue from \$240 billion in 2012 to an estimated \$300 billion by 2014 to 2015.

Australia is becoming increasingly important to China, who is struggling to meet its energy needs to sustain its economic growth.

Subsequently, China is continually seeking additional sources of energy since domestic supplies are unable to meet current demands. Australia, with huge natural resource reserves, especially iron ore, is an ideal energy partner. Moreover, it's closer than Brazil, another supplier of natural resources to China, and can therefore deliver the ore faster and cheaper. In addition, Australia's coking coal, used in the manufacture of steel, is of a very high grade and highly sought after. Similar quality iron ore is mostly found only in Africa. ¹

Since China requires increasing amounts of natural resources, on January 1, 2012 it reduced import tariffs on over 730 products. Import tariffs were reduced to 4.4%, 50% less than the Most Favored Nation tariff rate. ¹³ Natural resources, including coal, coking coal, granite, natural rubber, rare earth metals, copper, aluminum, and nickel are included on this tariff reduction list. ⁸ Australia's natural resources industries, and economy, benefited to a great extent from this tariff reduction.

Today, Australia has enjoyed 21 years of uninterrupted economic growth thanks in large part to China's voracious appetite for the country's natural resources. ⁶ It's estimated that



trade and investment with China brought benefits of about \$4,000 per Australian household in 2009, which has since risen to \$10,500 per household per year in 2011.⁵

In Australia, according to Hilary Inglis, Senior Investment Consultant for iPAC, Australia, since resources and energy companies comprise 38% of the S&P/ASX 300 index, the income produced by these companies have a trickle-down effect on the economy. Subsequently, a stronger Australian dollar makes their imports cheaper and puts downward pressure on inflation. This allows the Reserve Bank of Australia more leeway on how they manage interest rates and ultimately enables the lowering of interest rates.¹

China is also a significant investor in Australia. According to the *Australian Financial Review*, apart from Hong Kong, and tax havens such as the Cayman Islands and the British Virgin Islands, Australia is the largest recipient of China's overseas direct investment.⁴ In a report released by KPMG and the University of Sydney, between September 2006 and June 2012 there were 116 transactions completed totaling an investment of \$45.1 billion by Chinese enterprises in Australian businesses.⁷

Investment between both countries is not a one-way street. Australia also invests in China and in 2007 Australia's investment into China was on par with Chinese investment into Australia. But in each year since China has increased its investment in Australia so that now, for every dollar Australia seeks to invest in China, China seeks to invest \$21 back.¹⁰

Although Australia exports large quantities of iron ore and coal to China, the country doesn't rely on the sale of just minerals to maintain its economic relationship with China. As China modernizes, there's been a growing demand for liquid natural gas (LNG), something that Australia possesses in abundance. China's demand for LNG is expanding rapidly and, in 2011 alone, it increased its demand for LNG by one-third. To meet China's increased demand for LNG, as well as that of other countries, Australia is expanding its LNG capabilities which is expected to quadruple by 2017.¹⁰

In addition, Australia plans to expand its food imports into China's growing market. Agriculture minister Joe Ludwig estimates that by 2050 world food consumption is expected to be 75% higher than in 2007, with almost half of that increased demand



coming from China alone. Australia has set a national goal to increase its agriculture and food-related exports 45% by 2050. Australia currently exports 55% of its food production.¹¹

With so much of Australia's resource-based economy dependent on China, any change in China's growth significantly impacts the Australian economy. Yet most Australian government officials are optimistic about their increasing economic ties with China since China's growth is projected by most economists to make China the world's largest economy by 2027, shifting economic dominance to the East for the first time in 100 years. Moreover, by 2050 China's economy is projected to be the size of both the U.S. and India combined.¹⁰

In addition, China and Australia continue to get closer. In April 2013 both countries signed a landmark currency agreement allowing the

Australian dollar and the Chinese yuan to be directly converted for the first time thereby eliminating the need for companies and currency traders to translate into U.S. dollars first.⁶ China has also committed to annual leadership talks with Australia. Australia now joins Russia, Germany and Britain as the only four countries with whom China has committed to have these annual talks. China and Australia have also agreed to hold annual military exercises, although limited only to humanitarian assistance, disaster relief exercises, and maritime engagement and peacekeeping.⁷

Thornhill Capital's newsletters and blogs can be obtained by visiting our web site's at www.thornhillcapital.net and <http://thornhillcapital.info/>. If you have any questions on this, or other newsletters or blogs, please e-mail us at info@thornhillcapital.net.

Endnotes:

1. <http://www.ipac.com.au/blog/why-china-is-important-to-australia>
2. Wang, Yi. Australia-China Relations post 1949 (Burlington: Ashgate Publishing Company, 2012)
3. <http://www.stewartpartners.com.au/why-china-is-so-important-to-australia-our-stockmarket>
4. http://www.afr.com/p/lifestyle/review/australia_china_challenge_mfKFhXBmoPloDIURjy33yN

June 2013 China Newsletter



5. http://en.wikipedia.org/wiki/Australia%E2%80%93China_relations
6. <http://online.wsj.com/article/SB10001424127887324766604578460172320683626.html>
7. <http://www.atimes.com/atimes/China/CHIN-02-030513.html>
8. <http://www.australianbusiness.com.au/international-trade/export-markets/china/china---a-gold-mine-for-consumer-goods-exporters->
9. <http://english.cntv.cn/program/china24/20130409/107022.shtml>
10. <http://www.shell.com.au/products-services/solutions-for-businesses/inmotion/library/inmotion3/china.html>
11. <http://english.sina.com/business/2013/0526/593832.html>
12. http://news.xinhuanet.com/english/indepth/2012-12/03/c_132016258.htm
13. http://www.e-to-china.com/tariff_changes/data_tariff_changes/2011/1219/99065.html

Alan Refkin

David Dodge

© 2013 Thornhill Capital. All Rights Reserved



Thornhill Capital provides onsite due diligence; assistance with negotiations; expert witness testimony; financial reconstruction in compliance with IFRS, US GAAP, PRC GAAP, and Hong Kong GAAP; audit preparation and process management; internal control design and testing; reconciliation of Chinese tax reports to audited financial statements; bi-lingual CFOs; translation services; and a variety of other accounting, compliance, and administrative services for companies around the globe.

A full list of services can be found at www.thornhillcapital.net

This publication is for informational purposes and reflects the personal opinions of Thornhill Capital. This publication is not intended to convey any legal, accounting, or investment advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer, investment advisor, certified public accountant, or other relevant professional.