THREE ROCK
Capital Management

Australia Vulnerable to China Slowdown

The Chinese economy appears to have weakened sharply in November and December - "China economy downward pressure rises - Premier Li Keqiang" (Jan 15th). The authorities are acting to counteract this through fiscal and monetary policy. How successful they will be remains to be seen. Ken Rogoff of Harvard argues today in the Australian Financial Review that growth could slow dramatically.

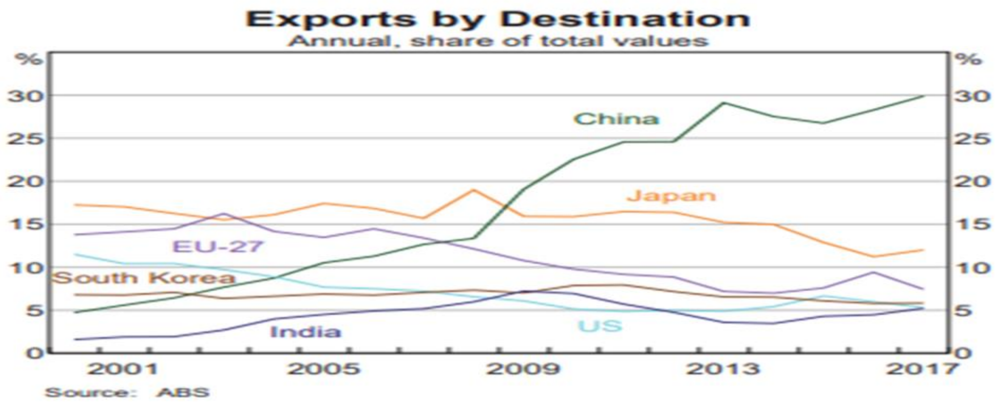
https://www.afr.com/news/economy/the-markets-fear-of-populism-is-a-threat-to-world-economy-20190116-h1a4ff

Australia is vulnerable in this scenario. Thirty percent of Australia's total exports go to China (see chart below). Roughly one third of these are service exports, primarily Chinese tourists and students coming to Australia. The price of iron ore and coal, Australia's two most important commodity exports, have held up well to date but with China's fiscal stimulus efforts focused more on tax cuts than infrastructure projects that may not last.

Australia's residential property market is already correcting sharply. Sydney property prices fell 15 per cent on an annualised basis in Q4 and Melbourne prices by 12%. These are the fastest rates of decline in 35 years. Building approvals fell 32% in December year on year.

Consumption is 60% of the economy and has been supported by a strong labour market but for how long? Data overnight showed consumer confidence falling sharply in January. According to ShopperTrak, which measures footfall in shopping centres, customer traffic fell 15% in the week ending December 23rd and 23% in the week ending December 30th, dragging traffic for the month down 12.2%, well below the 12-month average decline of 2.2%. James Stewart, lead retail partner at Ferrer Hodgson in Sydney commented "the ShopperTrak data confirmed a lot of anecdotal stories I'd heard from my contacts in retail, particularly in apparel and general merchandise…in my 20 years in retail I can't think when people had a Christmas like that."

The RBA cash rate has been at 1.50% since 2016, an historic low. In mid-December the bank indicated the next move in rates was more likely to be up rather than down. When they next meet on February 5th we expect they will send a different message. We anticipate lower bond yields and a weaker currency.



Conor O'Mara, CIO
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