Irish Independent

What China's economic wobble means for Irish agri-business

The recent turmoil on global stock markets isn't all bad news, says **Simon McKeever**

To understand what is currently happening to the Chinese economy, think back to Ireland in 2007 and particularly in 2008 as the whole world went into economic meltdown.

Ireland had enjoyed an export-led period of strong growth up until the early 2000's, and as our competitiveness waned and the real economy slowed down, a cheap credit-fuelled binge on domestic property continued to produce strong annual growth figures; but this illusion masked the bubble that eventually burst in late 2008.

After five years of austerity we are beginning to see a rebound in the Irish economy once again driven by exports.

The situation in China is comparable, albeit on a far greater scale than our own. Like Ireland, China is a trading economy where exports have been a key driver of the sustained economic growth over the past 30 years.

However, as the world went into recession in 2008, the Chinese economy shifted to a credit driven property and asset boom. The economy has become overcooked and a cooling off looks inevitable.

With a GDP of $10.4 trillion (€9.3 trillion) in 2014, China is the world's second largest economy and a key player in world trade. China has been a voracious consumer of much of the world's commodities including copper and oil as the economy expanded.

With a population of over 1.34 billion people, it has 20pc of the world's population.

It is a market with huge potential, with a rapidly growing and urbanising middle class - a key target demographic for much of the western world's high value exports.

China's economy is as large as the combined economies of Germany, UK, France and Belgium - Ireland's four most important EU export markets.

The signs have been there for some time.

Commodity prices around the world have been falling for the last year as demand from China has stalled.

Shares on the Shanghai exchange at one stage this year were up 150pc - such a rapid rise in itself is normally the sign of a bubble - with all these gains wiped out since June.

Interest rates in China have been cut five times so far this year, with the most recent cut early last week, and earlier in August the Yuan was devalued by 2pc - typical measures a country takes in time of crises to stimulate the economy and make exports cheaper.

Most worrying is the amount of funds the state-owned China Securities Finance Corp is estimated to have spent, some $144bn (€128bn) (out of an estimated "pot" of $322bn) in attempting to prop up the stock market.

There is an old saying in financial markets "you can't buck the trend" and there are many historical examples of various governments' last-ditched efforts to intervene to prop up their own financial markets which have ultimately failed.

It is clear that all is not well in China, but what does this mean for us?

Directly about 2pc of our exports go to China, compared to 80pc that go to the EU, US and UK combined. In the overall scale of things a slowdown in China therefore will have less impact on us directly. However, China has been considered a high-growth market, and therefore were it suddenly to become a low or no growth economy, a lot of potential would be lost, and food is an area that could be hit.

Middle income families, a key target market for our produce tend to take a big hit in recessions. We may need to reconsider our ambitious plans for the region.

The main effects on the Irish economy could come from indirect factors.

Were any of our main trading partners to be adversely affected as a result of their own trading relations with China, and this is likely should the economy stall, this could have a knock on effect on our own exports to these countries as economic activity within them falls — this is the main threat to us.

Most recently Irish exports have benefitted from a combination of a weaker euro and a stronger US dollar and pound.

Though the market the exchange rates have reversed some of their gains over the last few weeks, it is unlikely that all of these gains will be reversed. A lot depends on whether the Fed will raise interest rates in September.

Speculation of a rate hike has been a main reason for the US dollar's strength as investors have poured into US assets.

With the turmoil in Asian markets and the uncertainty over the strength of the Chinese economy, combined with the upward revision on Thursday to US Q2 GDP from 2.3pc to 3.7pc, the decision on whether to raise rates remains finely balanced.

Should the Fed raise interest rates, the knock-on effect on China could accelerate its slowdown.

There are some positives for Ireland in all of this.

Lower commodity prices are likely to keep inflation low, with the potential for further deflation, this will keep interest rates low, and put downward pressure on fuel prices — all good for business — and the consumer.

As we head into the formation of this year's budget, perhaps we should be a little more cautious therefore and not let the looming election in 2016 drive our politicians into a giveaway budget.

Simon McKeever is Chief Executive of the Irish Exporters Association

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TRADE DEAL: Minister Simon Coveney and Minister Zhi Shuping of the Chinese Quarantine and Inspection Service pictured in Beijing during last year's trade mission to China. Last year, Irish agri-food exports to China increased to €620m, making China Ireland's second most important market after the EU whole.