



The Chinese Dragon still feasting on metals

When the Chinese economy began to slow at the start of this year, Australian investors had more reason to worry than most. Prices for mineral commodities soon fell and the mining boom was pronounced dead, along with the recovery in resources shares.

But the good news is that the Chinese Dragon is firing up and reports of the death of Australia's mining boom were exaggerated. Recent economic news out of China confirmed that recovery is on the way, led by investment in infrastructure.

Chinese spending on new roads, rail and power plants grew by 20.7 per cent this year, retail sales rose 14.5 per cent in October compared with the previous year and industrial production climbed 9.6 per cent. Plus, inflation continued to ease in October, down to 1.7 per cent, which makes it easier for the nation to increase spending.

Good news for shares

The importance of these numbers is that China appears to have avoided the hard economic landing some feared. That's great news for our economy.

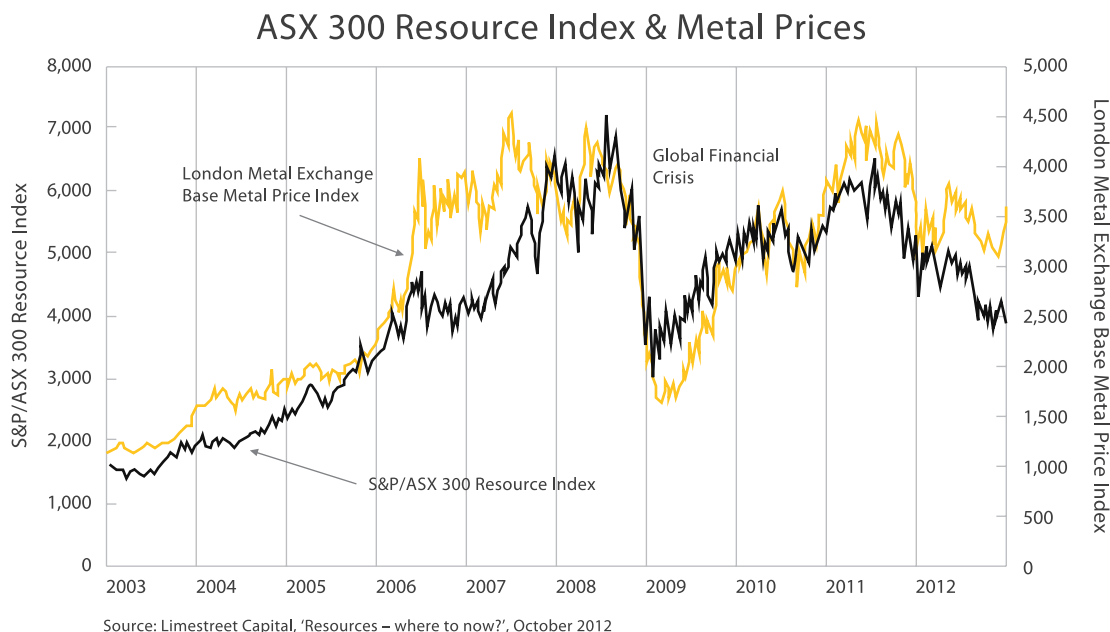
China is Australia's biggest customer of mineral resources. When demand for resources increases, commodity prices climb, boosting capacity to fund new mining projects. This in turn creates more jobs, consumption of engineering goods and services, more tax revenue and, in short, helps our economy grow.

China's decade of astonishing growth pushed commodity prices to record levels, but when demand for its products slumped after the financial crisis, even the mighty Dragon was forced to draw breath.

Economic growth in China slid to 7.4 per cent in the September quarter from 9.2 per cent in 2011. While growth of 7.4 per cent outpaces a euro zone in recession, a Japanese economy suffering stagflation or a United States with modest growth of 2 per cent, it represents a large fall in income for resource-rich Australia.

The perceived threat of a Chinese 'hard landing' sent commodity prices tumbling and halted the recovery in mining shares. The Reserve Bank of Australia's Index of Commodity Prices fell 16 per cent in the year to the end of October, led by major price slumps for metallurgical coal and iron ore – both key to China's steelmaking and two of Australia's biggest earners. Price instability for energy coal and base metals, such as copper – another two staples of our economy – also helped to subdue resources stocks.

The graph on the next page shows how closely these stocks follow global commodity price movements.



The power of one billion

This month, the Chinese Communist Party announced new leaders. In his first speech, incoming President Xi Jinping vowed to meet his people's aspirations for material wealth, personal happiness and national power.

To understand the significance of the potential economic power of China's one billion consumers, look no further than their love affair with the car.

In 2009, China assumed the crown as the biggest vehicle market on the planet. New car sales hit 18 million last year and experts predict this could double by 2018. That's a lot of raw materials being sucked into the Middle Kingdom every year from just one industry.

China's growth to continue

China's outgoing President, Hu Jintao, announced a target to double economic output by 2020, implying annual growth of 7 per cent. AMP Capital senior economist Shane Oliver says that figure is below recent record levels, but is still strong and China's catch-up potential remains immense. He adds China's infrastructure is still well below levels enjoyed by Australians.

Whichever way you look at it, the Chinese Dragon - the world's biggest metals consumer - still has an insatiable hunger. BlackRock Investment Institute recently forecast the country's consumption of copper, aluminium and nickel will double in the next decade. It argues that current mines cannot hope to meet demand after 2015, opening up supply gaps for many metals as well as investment opportunities.

The challenge to meet demand for coal, gas and iron ore has sparked big plans for new mines, not just in Australia but also in Mongolia, West Africa and even China itself.

While this poses a risk of oversupply and depressed commodity prices in years to come, it is theorised that as under-developed nations modernise their economies, demand will remain constant for generations.

So, while the short-term outlook for commodity prices – and by definition Australia's economic growth – faces some risks from a sluggish global economy, the longer-term view for resources appears bright in what has been labelled the Asian Century.



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