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HD **MYEFO: Opportunities with China beyond raw material sales could be key to long-term prosperity**

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Australia has hitched its economic wagon to a slowing China, but tapping into opportunities with China beyond raw material sales could be the key to long-term prosperity, writes China correspondent Stephen McDonell.

Australia has hitched its economic wagon to a slowing China, sparking fears the country could be in for some tough times ahead.

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But how worried should we be about the health of our largest trading partner?

There is fierce debate among economists and other analysts as to how much trouble the Chinese economy faces.

The pessimistic view: China is struggling with a debt crisis of an unknown size. Governments have borrowed heavily without necessarily having a way of paying it back.

This country has at times been building infrastructure for the sake of building it and while much of this infrastructure has generated activity it will not deliver a return.

Inflation is at a five-year low, leading to fears of deflation - while food prices are rising, alcohol and tobacco prices are dropping as the anti-corruption campaign churns along.

The optimistic view: the government wants slower, more sustainable growth. Beijing has described GDP growth of around 7 per cent as "the new normal" to try to get the whole world used to this.

Smaller, more polluting steel factories are being forced out of the market to try to wind back steel over-production.

An export-led economic model is being turned into a domestic, consumption-led model.

The government wants to push China into the realm of high-tech industries instead of being the cheapest producer of clothes and the like. Most importantly, this will all take some time.

Naturally, if the pessimists are right, this will have a considerable long-term impact on Australian commodity exporters. Less crappy steel mill production, less unwarranted infrastructure and less money to loan for projects all mean less need for Australian iron ore and coal.

But if the optimists are right, a slowing of demand will actually pave the way for stable, long-term Australian exports into the future.

Another concern here has been real estate. Chinese investors left with not many options have hopped into buying flats as a means of finding somewhere to park their money.

This has, at times, taken place whether or not there were enough available tenants in an area. There are many tales here of ghost towns full of residential towers that are not occupied.

So again, if less tower blocks are to be needed in the future, this would mean less requirement for steel and, as such, less demand for Australian raw materials.

Worse still, we have seen the impact of the United States housing loan crisis which spread around the globe.

And yet China is different.

According to Matthews Asia investment strategist Andy Rothman, China has avoided most of the US property traps.

While US homebuyers were operating on a down payment of 2 per cent of the purchase price, in China there is a minimum down payment of 30 per cent.

Mr Rothman has been arguing that those predicting doom and gloom for China don't understand the country?

He points out that there are no products here that broke Lehman Brothers and that China's banks have deposits of 140 per cent of GDP, when in the US that is 55 per cent.

He sees the Chinese economy changing before our eyes. He says that privately owned companies account for 80 per cent of urban employment now and more than 70 per cent of investment.

While net exports once contributed to about 1 percentage point of growth, now he says they're now posing "a negative drag on GDP growth".

On the other hand he points to data showing that most of what Chinese factories are producing is being consumed inside the country.

Finally, he says the services sector here became bigger than the industrial and construction sectors of the economy for the first time last year and that the same trend has continued in 2014.

While industrial employment shrank, the services sector created 20 million new jobs last year.

Yet in all this we should keep in mind the potential for China's statistics to be flawed. With GDP for example, it's thought that some provinces exaggerate their growth for the sake of prestige while others might down-play it to attract central government help.

Either way, for Australia, it does look like we are going to have to get used to less Chinese demand for our raw materials, though the volumes will remain significant well into the future.

However some would argue that the fall in iron ore prices is actually the fault of Australian mining companies who've simply produced too much. If that's the case, the government can blame the companies themselves for its own subsequent loss in revenue.

But, in the wash up of all this debate, one thing seems true: with the enormous urbanisation here there are plenty more opportunities for Australian companies opening up in China beyond raw material sales, and tapping into these could be the key to long-term prosperity.

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