Chinese direct investment in Australia has declined, according to a new report by the University of Sydney and KPMG. In 2017, the value of investment fell by 11% in US dollar terms, from $11.5 billion in 2016 (A$15.4 billion) to $10.3 billion (A$13.3 billion).

In early 2018, we also surveyed nearly 50 Chinese executives in Australia. The responses show Chinese investors are feeling apprehensive and reluctant to engage in a climate of insecurity created by current debate about China's role in Australia.

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The investment drop occurred in nearly all areas of Chinese investment in Australia, including:

- commercial real estate, where investment was down 22%
- infrastructure (-89%)
- food and agribusiness (-8%)
- renewable energy (-64%)
- oil and gas (-84%).

Growth occurred in mining and energy, with a 448% increase in investment, health care (20%), transport (2%) and smaller areas such as services and manufacture (38%).

The decline in Chinese investment does not come as a surprise. Chinese outbound investment in all countries was down 29% in 2017. Chinese investment in the United States fell by 35% and in the European Union by 17% after large increases in 2016.

Some of this is a result of actions by Chinese regulators since late 2016. They have targeted speculative "irrational" investment and capital flight, grouped outbound investment into three categories – prohibited, restricted and encouraged – and directly intervened in some high-profile international transactions. However, the new regulations and the curb on speculative investments only marginally affect Australia.

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The more important news is Australia did not pick up increased Chinese investment in the encouraged industries, namely services, agriculture and infrastructure. These are areas where Australia has strong competitive advantages and is highly complementary to Chinese economic interests.

Combined Chinese investment in Australia's agribusiness, infrastructure, renewable energy and services halved in 2017. Commercial real estate, the second-largest area behind mining in 2017, has fallen two years in a row.

The only two growth areas in the encouraged category were mining and health care. Lithium mining and Yancoal’s A$3.4 billion acquisition of Rio Tinto’s thermal coal assets boosted mining investment. Health-care investment rose by 20% with several large investments in health service providers and supplements.

Two structural trends have underpinned the decline in investment volume. First, private investors with smaller investment volumes are crowding out larger investments by state-owned enterprises. Second, investment by new entrants is declining in favour of repeat investors.

The report adds fuel to the debate about the Australian government's political stance towards China and its impact on economic relations. If the intent was to slow down Chinese investment in Australia, this has been achieved.

Feeling less welcome

In our survey, more than half of our respondents either agreed (48%) or strongly agreed (4%) that they felt less welcome in Australia, compared to just over one-third (35%) of respondents in 2014.

Asked about the level of support from major stakeholders, Australian media received the lowest rating overall. Business leaders were seen as the most supportive group. State governments and local councils were also given positive ratings.

Local communities were seen as less supportive, ahead of the federal government. The Foreign Investment Review Board (FIRB) received the lowest government rating.

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Two-thirds (67%) of respondents strongly agreed (17%) or agreed (50%) agreed that the federal government was less supportive of Chinese investment than previously. A slightly higher number (70%) stated that the political debate about China had made their company more cautious about investing in Australia.

Half of the respondents (52%) felt that Australia was a safer place to invest than many other countries, down from 63% in 2014. The majority view was in spite of problems such as higher business costs than in the United Kingdom, United States and Canada, difficulties in finding qualified staff, and communication issues with local staff and management.

The Chinese investors’ evaluation of business success over the past three years and the outlook for the year ahead confirms their overall positive attitude towards Australia. Growth in turnover and profitability was reported by 65% percent and 45% of respondents respectively.

For 2018, a similar number of respondents expect growth in turnover (64%) and profitability (42%). Half of the respondents (49%) expressed optimism about business prospects for the year ahead.

Politics plays into business

Personal interviews with a smaller number of local Chinese companies confirmed the prevailing feelings of insecurity and apprehension. Chinese investors discuss the political situation among each other and with head offices in China, which are concerned about negative reporting.

In the absence of positive signals from the federal government, larger investments by state-owned enterprises – in infrastructure building, for example – are unlikely to go ahead.

The report highlights the potential business implications of trying to separate business from politics in the relationship with China. Business co-operation between Australia and China is strategic rather than purely transactional. This means bilateral diplomatic relations have an important signalling function for long-term and large-scale investments.

Australia needs to build up supply chains and infrastructure to maintain its competitive advantage and to increase capacities in growing export industries such as agriculture and services. This in turn requires substantial investments.

So far, state governments and business are seen as supportive, but a more predictable diplomatic environment is indispensable for securing long-term strategic investment.

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