British Embassy
Beijing

China Economic Focus – April 2013

Overview

- Data for 2013 Q1 was surprisingly weak. The economy grew by 7.7 percent, below the consensus forecast for 8.0 percent growth (and compared with the 7.9 percent growth registered in 2012 Q4).

- Views are mixed on what caused the slowdown. Official data show growth in most indicators moderated. Growth in industrial production fell to an average of 9 percent over the first quarter, compared with an average of around 13 percent in the previous two years. Consumption has also been unusually weak since the start of the year, likely to be attributable to a combination of much weaker-than-usual urban income growth and the recent crack-down on corruption.

- We do not think the latest data will change the overall policy stance. The new leadership has repeatedly emphasised that the era of 'super-fast' growth is over and that policy must focus on improving the quality, rather than the pace, of growth (see here). An example of their long-term approach to reform is the recently announced nationwide expansion of an important VAT pilot, effective from 1 August 2013.

- There are also some encouraging signs in the recent data, for example continued rapid growth in the services sector; stable inflation; positive recordings from the purchasing managers' indices; and relatively fast growth in rural incomes.

- The latest data does, however, suggest that Chinese growth going forward will be more volatile as the economy undergoes its structural transition. In the long-run this will obviously be a good thing, but it will make for a significant departure to the remarkably stable growth figures China has registered over the past 35 years.

- Finally, the latest data shows that rapid credit growth continued during March. The major increases are coming in areas like trusted loans and bank-acceptance bills, rather than bank lending. While the diversification of China's financial system is welcome, the pace of the developments is concerning, particularly given China's dispersed system of financial regulation. Responding to the expansion of credit, last week Fitch Rating Agency lowered China's sovereign long-term local credit rating from AA- to A+, the first credit-rating revision to China since 1999.

- Further information about many of these topics can be found at: http://www.ukti.gov.uk/export/countries/asiapacific/fareast/china/fcoupdates.html. Please get in touch if you have any questions or comments.

Growth slows unexpectedly in 2013 Q1

1. The Chinese economy expanded by 7.7 percent (year-on-year) in 2013 Q1. This is above the authorities' growth target of 7.5 percent but below the consensus forecast of 8.0 percent growth and the 7.9 percent growth registered in 2012 Q4. **See Figure 1.**

2. The decline in growth surprised the markets. As a result, many economists have downgraded their growth forecasts – **see Figure 2** – though even after the downward revisions all forecasts remain above the official target of 7.5 percent.

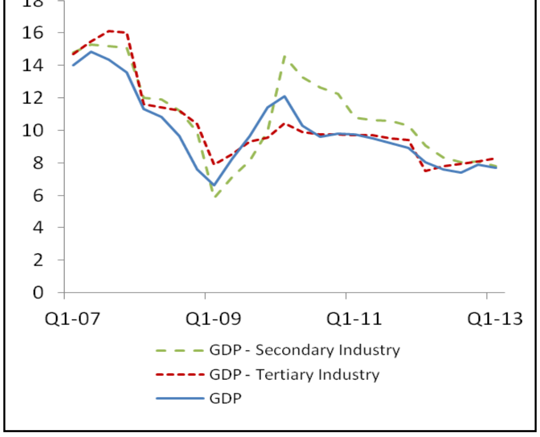


Figure 1: China's GDP growth

Figure 2: External growth forecasts for 2013

Institute	Forecasts
World Bank	8.3 percent (revised on 15 Apr, down from 8.4 percent)
IMF	8 percent (revised on 16 Apr, down from 8.2 percent)
HSBC	8.2 percent (revised on 15 Apr, down from 8.6 percent)
JP Morgan	7.8 percent (revised on 15 Apr, down from 8.2 percent)
RBS	7.8 percent (revised on 15 Apr, down from 8.5 percent)
UBS	8 percent
Bank of China	8 percent
State Council DRC	8-8.2 percent

Growth in most indicators moderated

3. Headline fixed asset investment (FAI) growth slowed slightly to 20.9 percent in the first quarter (on a year earlier), 0.3 percentage points slower than January and February's average. Central government-led investment grew by 11.6 percent over the first quarter, compared with 5.9 percent across 2012 as a whole. Infrastructure investment remained robust.

4. Property investment increased by 20.2 percent in the first quarter (on a year earlier), higher than the 16.2 percent growth seen in 2012 as a whole. **See Figure 3.**

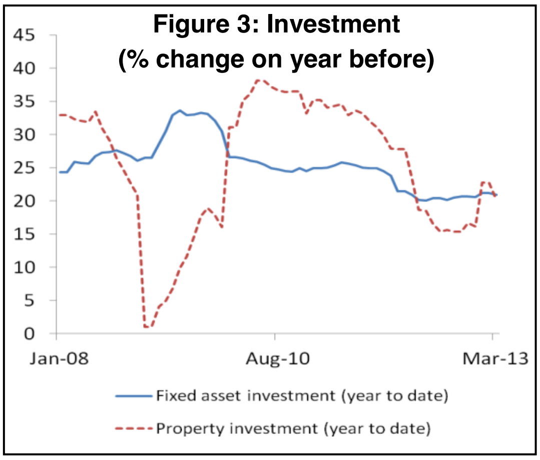


Figure 3: Investment (% change on year before)

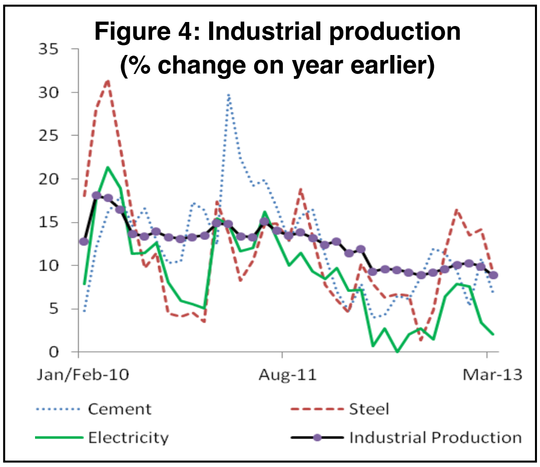


Figure 4: Industrial production (% change on year earlier)

5. Growth of industrial production (IP) moderated to 8.9 percent in March (on a year earlier), 1 percentage point lower than in February, and registering a 6-month's low. Growth of heavy and light industries continued to slowdown. Production of electricity, steel, cement all experienced a slower growth. **See Figure 4.**

6. Data from the purchasing managers' indices (PMI) are more upbeat, suggesting that manufacturing activity will pick-up in the coming months. March's official PMI picked up to 50.9, from 50.1 in February. This was the 6th consecutive month in the expansion zone (above 50). The separate HSBC PMI, seen as a better measure of business condition for small enterprises, increased to 51.6 from February's 50.4. **See Figure 5.**

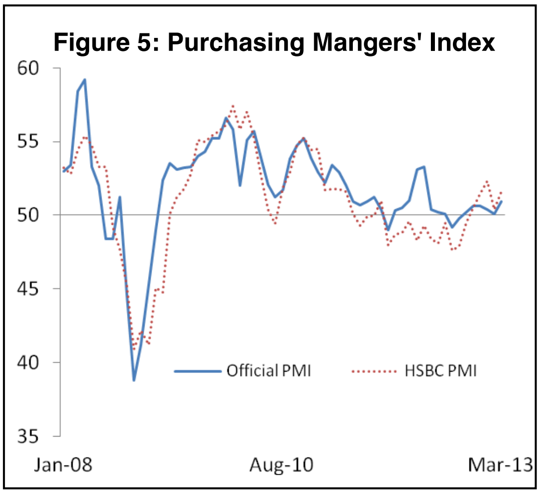


Figure 5: Purchasing Mangers' Index

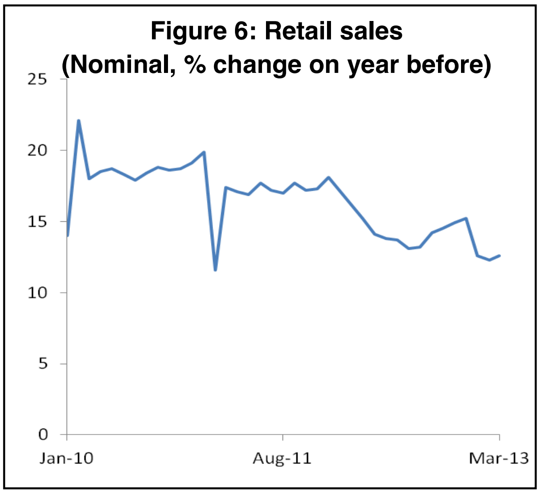


Figure 6: Retail sales (Nominal, % change on year before)

7. Retail sales, the best official measure for consumption, grew by 12.6 percent in March (on a year earlier), 0.3 percentage points higher than January and February's average, but slower than the average growth rate of 15 percent seen in the past two years – **see Figure 6**. Relatively weak recent retail sales figures are likely to be influenced by surprisingly slow growth in urban wages and President Xi Jinping's crack-down on corruption and ostentatious consumption.

Inflationary pressure eases

8. Consumer prices index (CPI) increased by 2.1 percent in March (on a year earlier), down from 3.2 percent in February. This fall mainly reflects a normalisation of conditions following Chinese New Year, which typically sees a spike in food prices: food prices grew by 2.7 percent in March, down from 6 percent price increases in February.

9. Producer prices index (PPI), a measure of upstream inflation pressures, decreased by 1.9 percent in March (on a year earlier), compared with -1.6 percent in both January and February. This was the 13th consecutive month of contraction. **See Figure 7.**

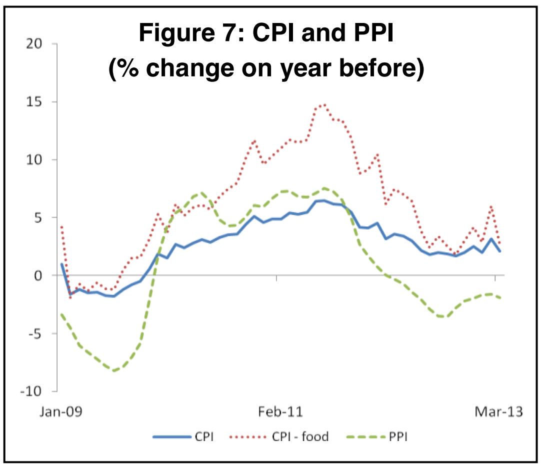


Figure 7: CPI and PPI (% change on year before)

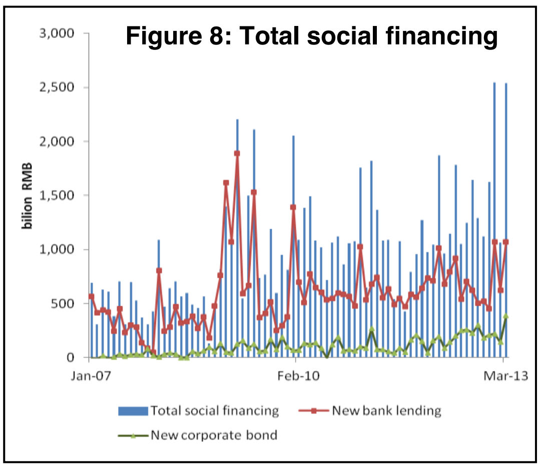


Figure 8: Total social financing

Strong credit growth at the start of the year revives concerns about the accumulation of bad debt

10. The first three months of the year have seen rapid growth in credit supply. Total social financing (TSF), a measure of all forms of new credit, grew by RMB2.54 trillion (£267 billion) in March, up significantly from February's RMB 1.07 trillion (£113 billion) – **see Figure 8,** on the previous page. Bank lending, which traditionally comprised the majority of new credit, made up only 40 percent of March's TSF, with the remainder coming from trusted loans, bank-acceptance bills and, to a lesser extent, corporate bonds.

11. While the diversification of China's financial system away from bank-lending is welcome, the rate of credit growth in these other channels is potentially concerning, particularly given China's dispersed system of financial regulation. Responding to the expansion of credit, Fitch Rating Agency recently lowered China's sovereign long-term local credit rating from AA- to A+, the first credit-rating revision to China since 1999.

12. There are some signs that the authorities are getting a grip on the situation. On 25 March, CBRC (the banking regulator) introduced new requirements for regulation of Wealth Management Products, following the recent default of two such products in different Chinese banks. If the regulations are effectively implemented they may put downward pressures on non-bank financing in the coming months.

13. Money supply (M2) grew by 15.7 percent in March (on a year earlier), compared with 15.2 percent in February and 13.8 in 2012 as a whole. This remains higher than the official M2 target of 13 percent.

Local governments announce measures to control property prices

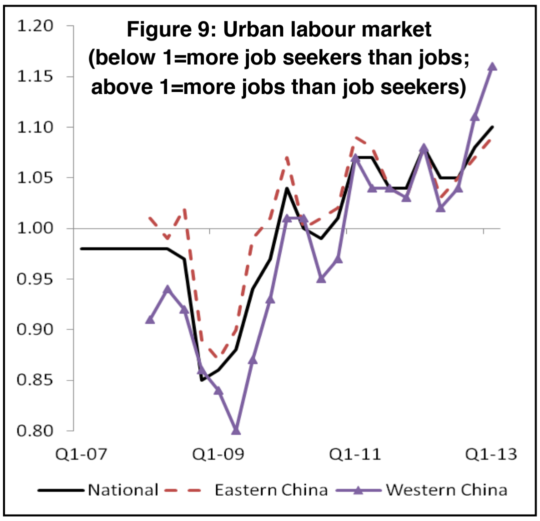
14. The latest official figures show that 66 of 70 cities surveyed saw property prices increase (in month-on-month terms) in February (latest data) - 13 more cities than in January. Year-on-year property sales continue to increase rapidly: in 2013 Q1, property sales increased by 61.3 percent (on a year earlier), 51.3 percentage points higher than in 2012 as a whole. Such rapid increases are partly due to a low base effect and but also due to efforts to avoid the recently announced capital gains tax (see here).

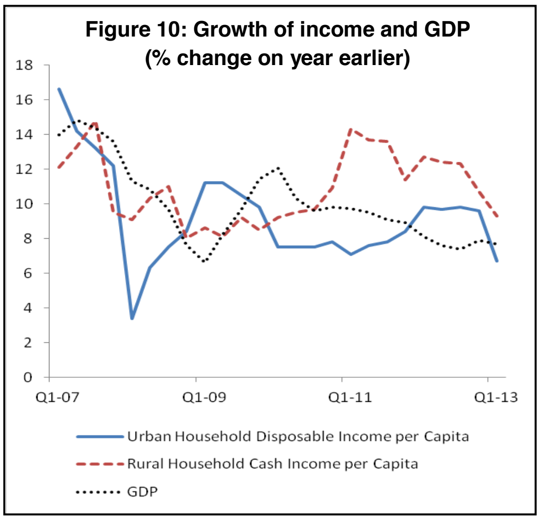
15. In February the Central Government made new announcements about efforts to contain price increases. This month, over 15 local governments (including all Tier 1 cities) have issued their own new measures. The main objective of these measures is to tackle speculative investments, with common measures including differential mortgage rates, a ban on third home purchases, increase land supply for property construction and a 20 percent capital gain tax on existing homes.

Labour market remains tight

16. China's labour market remains tight. In 2013 Q1, over 3 million new jobs were created in cities, nearly the same amount as in 2012 Q1. Official statistics confirm the demand for labour remains strong, especially in Western China. **See Figure 9**, on the following page.

17. Income growth of urban and rural residents slowed in Q1. Q1's urban income increased by 6.7 percent (on a year earlier), compared with 9.6 percent in 2012. This was a big surprise and may be attributed to low corporate profitability in the second half of 2012. Rural income growth continued to outpace headline growth, at 9.3 percent in Q1, compared with 10.7 percent in 2012. **See Figure 10.**





Week external demand continues but trade likely to be better in 2013 than 2012

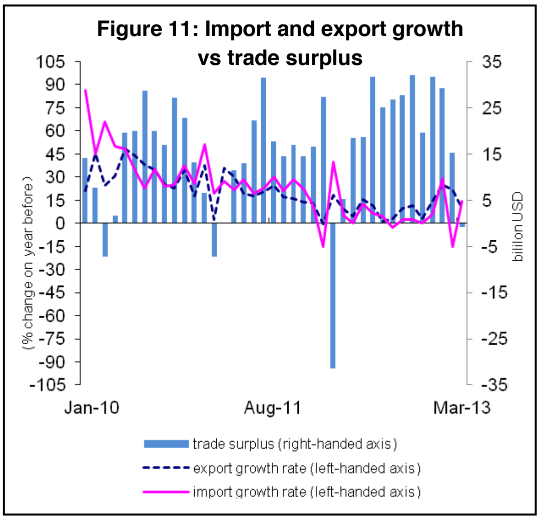
18. China's exports' growth slowed to 10 percent in March (on a year earlier), compared with 21.8 percent in February and January and February's average of 23.6 percent. The exports' growth was mainly dragged by shipment to G3 markets – China's exports to the EU declined by 14 percent, followed by Japan (-10 percent) and the US (-6.5 percent). China's exports to ASEAN countries remained strong. Exports to Hong Kong increased rapidly, though there are concerns about the validity of the trade data between Mainland China and Hong Kong.

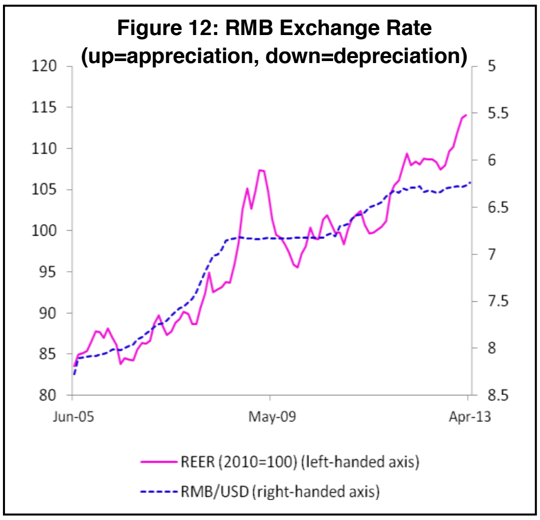
19. Imports grew by 14.1 percent in March (on a year earlier), beating the market consensus and much higher than February's contraction of -15.2 percent.

20. In the press conference to release 2013 Q1 data, the authorities expressed confidence that China's trade performance in 2013 would be stronger than that of 2012. That said, four risks to the outlook for exports were identified: weak external demand, higher domestic costs (including rising wages and appreciation of the RMB), rising competitiveness of China's neighbours, and rising trade protectionism.

21. The balance of exports and imports registered a small deficit of $0.9 billion in March, compared with a surplus of $15.25 billion in February. **See Figure 11**, on the following page.

22. As of end March, China's foreign exchange reserves totalled $3.44 trillion, an accumulation of $130 billion in the past quarter. The increase in reserves is attributable to renewed upward pressure on the RMB. China's foreign exchange reserves are now larger than the GDP of all but the top three countries (US, China and Japan).





RMB appreciated a little in the past month

23. The RMB exchange rate appreciated 0.5 percent against the dollar over the past month, and by 0.78 percent since the start of the year. Since the currency was de-pegged in June 2010, the RMB has appreciated by 9.4 percent. As of 16 April, RMB exchange rate stood at a historic high at 6.241.

24. According to the Bank of International Settlement, the RMB's real effective exchange rate appreciated by 3.5 percent since the beginning of the year and by 11.9 percent since June 2010. **See Figure 12.**

25. RMB deposits in Hong Kong, an offshore market for the Chinese currency, totalled RMB 651.7 billion (£68.6 billion) in February (latest data), increasing 4.4 percent from January. RMB cross-border trade settlement totalled RMB 221.7 billion (£23.3 billion) in February, declining 17.4 percent from a month earlier.

26. On 9 April, the China Foreign Exchange Trade System announced (with Central Bank's authorisation) the launch of direct trading between RMB and the Australian dollar in the inter-bank foreign exchange market. Australian dollar is the third currency that can trade directly with RMB (after USD and JPY).

We encourage readers to get in contact for further information on any points covered in this note, or to suggest ways of improving the note for next month. Our details are:

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