British Embassy
Beijing

China Economic Focus – April 2014

Overview

- 2014 Q1 data were published this month. GDP expanded by 7.4 percent (y-on-y), relative to 7.7 percent growth in 2013Q4. This was slightly higher than market expectations of 7.3 percent growth and compares to the overall growth target for 2014 of 'around 7.5 percent'.

- The main cause of the slow-down is a decline in the growth of credit and hence investment. In particular, property investment fell significantly last month, as the volume of inventories continue to rise. Many expect the property sector to continue to drag economic growth in the coming quarters.

- This will have spill-over affects. Further defaults are likely among smaller property developers and firms in the steel and cement industries (sectors that enjoy an unhealthy combination of over-indebtedness, significant over-capacity and a high reliance on the property sector). However, the systemic implications are unlikely to be severe. Taken as a whole, China still faces strong structural demand for property and levels of mortgage debt among Chinese householders is low.

- Recent weeks have seen the introduction of some mildly stimulatory measures, including tax-cuts for small businesses, accelerated infrastructure and social housing investment and a small cut in the required reserve ratio (RRR) for rural financial institutions, allowing them to lend more in support of the agrarian economy.

- But these measures won't have a big macro impact and in general the authorities appear comfortable with the slowdown in the economy. At a press conference on 24 April, the NDRC (China's central planning ministry) said the economy is 'stable and healthy' and that they didn't foresee the need to roll out stimulus measures.

- This shouldn't be a surprise. The authorities have consistently emphasised that inflation and the labour market are more important indicators than the growth rate itself. Both appear resilient:
  - inflation edged up to 2.4 percent in March, from 2.0 percent in February, driven by an increase to food prices. But inflation is forecast to remain comfortably below the target level of 3.5 percent.
  - the labour market strengthened between 2013Q4 and 2014Q1, as measured by the ratio of job applicants to vacancies, which edged up to 1.11 from 1.10. Wage growth continues to be strong, particularly for migrant workers.

- We therefore expect the authorities to continue to push ahead with their reform programme, as set out earlier this year at the National People's Congress.

- Further examples of our recent reporting can be found at: https://www.gov.uk/government/collections/fco-political-and-economic-updates#china. Please get in touch if you have any questions or comments.

Headline GDP slightly above consensus

1. China's economy grew by 7.4 percent in 2014 Q1 (on a year earlier), down 0.3 percentage points from the last quarter and the same as in 2013 Q1. This was below the official target of 7.5 percent, but slightly above the market consensus of 7.3 percent. On quarterly basis (seasonally adjusted), the economy increased by 1.4 percent in 2014 Q1, slowed from 1.7 percent in 2013 Q4. **See Figure 1.** Most analysts are forecasting a growth rate of below 7.5 percent in 2014. **See Figure 2**.

Figure 1: China's GDP growth (% change on year before)

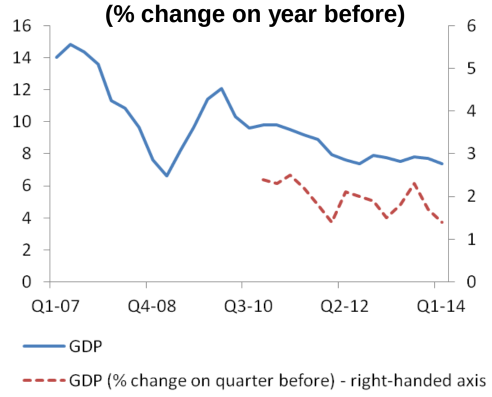


Figure 2: External growth forecasts for 2014

Institute	2014
World Bank	7.6%
IMF	7.5%
HSBC	7.4%
Standard Chartered	7.4%
UBS	7.5%
Goldman Sachs	7.3%
JP Morgan	7.2%
CICC	7.3%
CASS	7.4%
'Official Target'	7.5%

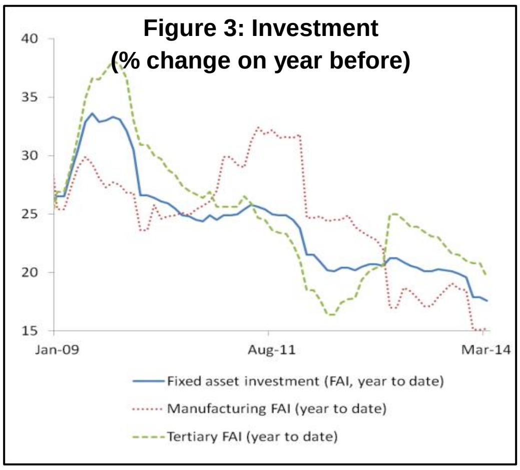
2. Growth of agricultural, industrial and tertiary sector all slowed in Q1 from last quarter. But growth of tertiary sector (7.8 percent) continued to outpace that of industrial sector (7.3 percent).

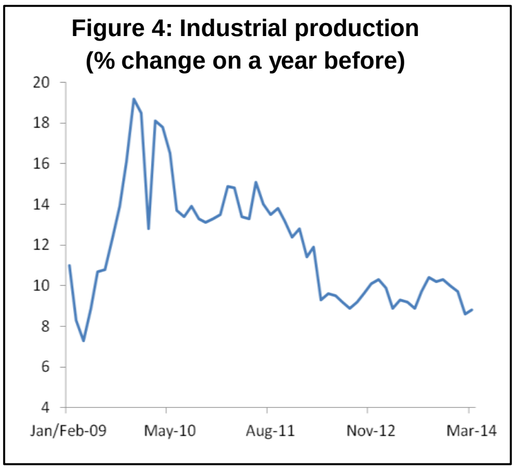
3. On 16 April, Premier Li Keqiang led a State Council (Cabinet) meeting to analyse the economy in Q1. The authorities believe that the economy remained stable. The key indicators, including GDP, employment and CPI were all within the 'reasonable range'. However, the authorities recognised the downward pressure for the economic growth. To stabilise the growth was still the top priority.

4. In order to support the growth, a series of targeted mini stimulus have been announced in the past month. Key ones include:
   - Financial support for slum renovation;
   - Accelerate railway construction, especially the ones in Western China;
   - Tax cut for small and medium enterprises; and
   - Encourage private capital to participate in public infrastructure projects.

Slight improvement for key economic indicators

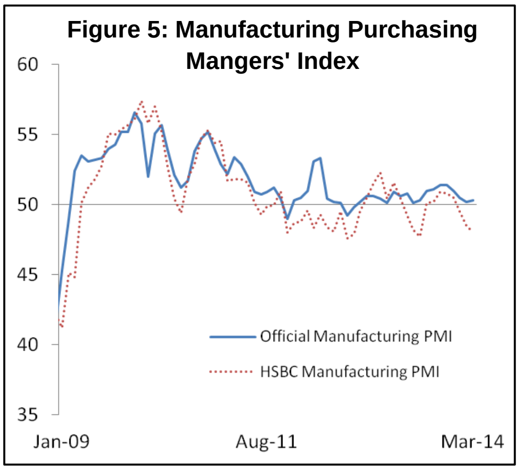
5. Headline fixed asset investment (FAI) growth dropped to 17.6 percent in the first three months (on a year earlier), lower than 17.9 percent in the first two months. This was below market expectations of 18 percent. **See Figure 3.** On monthly basis (seasonally adjusted), FAI growth slowed to 1.24 percent in March, compared with 1.28 percent in February and 1.36 percent in January. The weak FAI was mainly dragged down by slower property investment growth. Manufacturing investment growth remained steady. Infrastructure investment picked up.

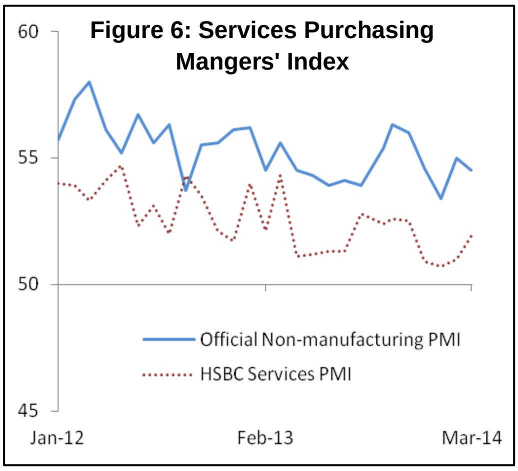




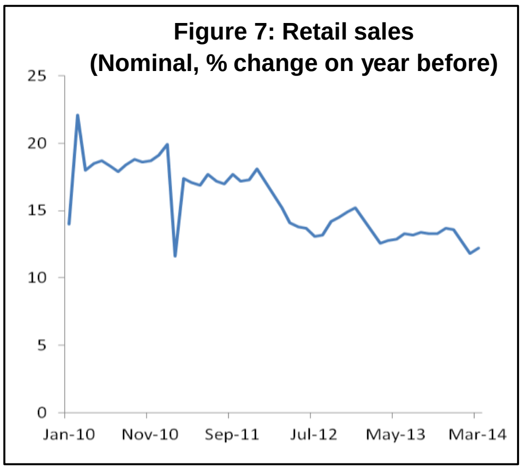
6. Industrial production (IP) growth rebounded marginally to 8.8 percent in March (on a year earlier), compared with 8.6 percent in January and February combined. On monthly basis (seasonally adjusted), IP growth picked up to 0.81 percent in March from 0.61 percent in February. Growth of production of steel, cement, electricity, and crude oil improved; while that of automobile slowed. **See Figure 4.**

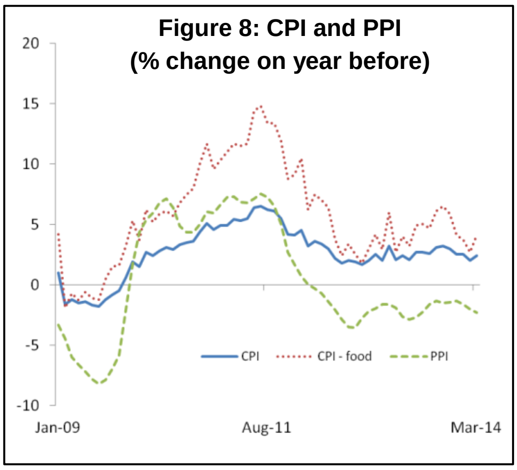
7. The official manufacturing purchasing managers' index (PMI), a forward-looking measure of business conditions, improved marginally to 50.3 in March, 0.1 percentages higher than in February. The separate HSBC manufacturing PMI, as a better measure of business conditions for small enterprises, contracted further to 48 in March, down from 48.5 in February. Official services PMI weakened slightly. The HSBC services PMI bettered off. **See Figure 5 and 6.**





8. Growth of retail sales edged up to 12.2 percent in March (on a year earlier), compared with 11.8 percent in January and February combined. On monthly basis (seasonally adjusted), retail sales grew by 1.23 percent in March, reaching a 12-month high. Sales of jewellery contracted; while the growth of sales of furniture, telecommunications equipment, and automobile accelerated. **See Figure 7.**





Low inflation risk

9. The consumer prices index (CPI) rose by 2.4 percent in March (on a year earlier), up from 2 percent in February. The rebound was mainly due to a low base in March 2013. Food prices inflation remained the main contributor to headline CPI growth. On monthly basis, CPI contracted by 0.5 percent – the lowest in the past 10 months. The National Statistics Bureau attributed the drop to food prices decreases after Chinese New Year.

10. The Producer Prices Index (PPI), an indicator for upstream inflation pressure, declined by 2.3 percent in March (on a year earlier), deepening from 2 percent in February. This was the 25th consecutive month of contraction. **See Figure 8.**

Total social financing and bank lending rebound

11. Total social financing (TSF), a measure of all forms of new credit, reached an amount of RMB 2.07 trillion (£207 billion) in March, much higher than RMB 938 billion (£93.8 billion) in February. But this does not reflect monetary easing. In fact, growth of TSF dropped slightly to 17.1 percent in March (on a year earlier) from 18.1 percent in February. By breakdown, bank lending, issuance of corporate bond, bank acceptance bill, and entrusted loans led the rebound of TSF. New trust loans remained weak, reflecting the government's measures in controlling risks in the trust sector. **See Figure 9.**

12. New bank lending in March rebounded to RMB 1.05 trillion (£105 billion), up from RMB 644.5 billion (£64 billion) in February. This was in line with seasonal pattern – bank lending usually increase in the first quarter, especially when towards the end of the first quarter (bank lending in Q1 normally account of over a third of the annual lending). The growth of bank lending remains stable.

13. Money supply (M2) grew by 12.1 percent in March (on a year earlier), lower than 13.3 percent in February. It was well below the official target of 13 percent.

14. On 22 April, the PBoC (Central Bank) announced to cut the required reserve ratio (RRR) for county-level rural commercial banks (by 2 percentage points) and rural cooperative banks (by 0.5 percentage points), effective on 25 April. This policy was aimed to support the agricultural sector growth. Most analysts believed this targeted RRR cut would have very limited impact on

lending, since rural banks only accounted for a very small proportion of the financial system. PBoC plans to continue its “stable” monetary policy and keep “proper” liquidity.

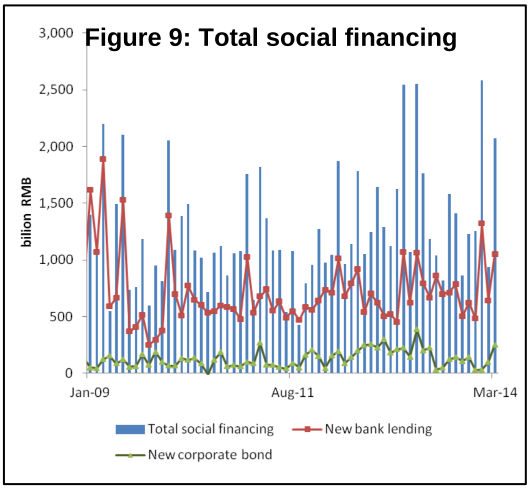


Figure 9: Total social financing

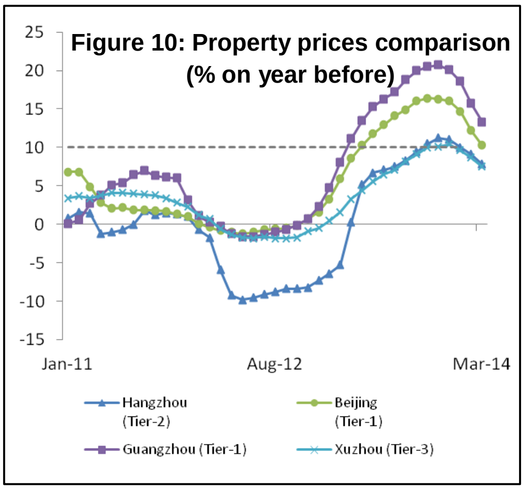


Figure 10: Property prices comparison (% on year before)

Pace of property prices increase continues to slow

15. According to the latest official figure, 56 out of 70 cities surveyed saw higher property prices in March (on a month earlier), compared with 57 in February. Property price growth in all Tier 1 cities (Beijing, Shanghai, Guangzhou and Shenzhen) continued to ease. The majority of Tier 2 and 3 cities surveyed saw a deceleration of their property prices. **See Figure 10.**

16. Property investment grew by 16.8 percent in the first three months, down from 19.3 percent in January and February combined. This was the lowest since February 2013. But the social housing project for 2014 (7 million new social houses) should support the growth.

Labour market remains stable

17. Income growth remained strong. Growth of rural income continued to outpace headline GDP growth. It grew by 10.1 percent in Q1, higher than 9.3 percent in 2013. Growth of urban income improved marginally to 7.2 percent in Q1, compared with 7 in 2013.

18. The labour market kept resilient. The quarterly job/job seeker ratio was 1.11 in Q1, reaching a historic high. Labour demand in Western China was particularly strong. **See Figure 11.** New urban employment totalled 3.4 million people in Q1, slightly higher than that in the same time last year.

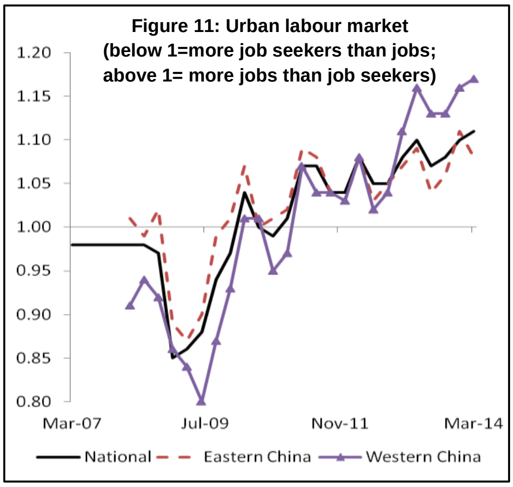


Figure 11: Urban labour market (below 1=more job seekers than jobs; above 1= more jobs than job seekers)

Trade figures are weak than expected

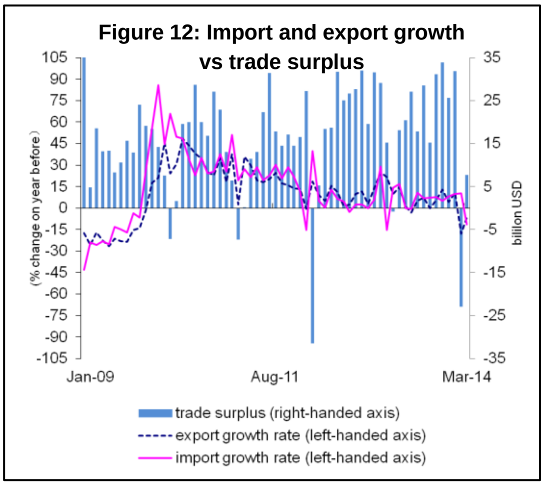
19. March’s export was well below expectation. China’s exports contracted by 6.6 percent in March (on a year earlier), improving from an 18.1 percent contraction in February but below the market consensus of a 4.8 percent increase. High base in March 2013 due to over-invoicing was

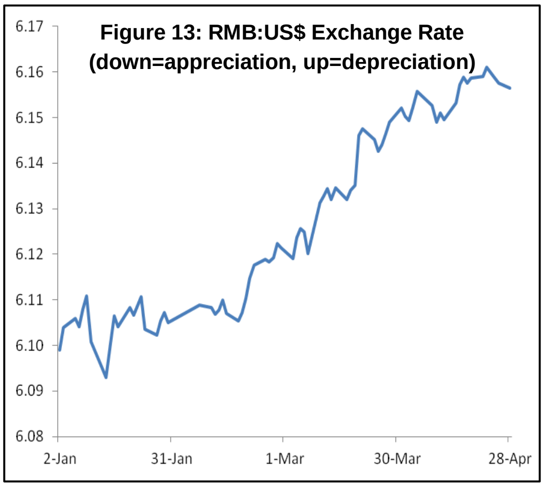
the main reason for weak export growth. Thus, China's Customs believe export decline was temporary and it should be back to increase after May.

20. Imports contracted by 11.3 percent (on a year earlier), compared with a 10.1 percent increase in February. This was partly due to the commodity prices decrease and weak domestic demand. Analysts expect the recent targeted stimulus measures will help improve import demand.

21. The exports and imports figures registered a trade surplus of USD 7.7 billion in March, compared with a deficit of USD 23 billion in February. **See Figure 12.**

22. China's foreign exchange reserves totalled USD 3.95 trillion as of end March 2014, USD 130 billion more than as of end 2013.





China's currency continues to depreciate

23. The RMB:US$ exchange rate has depreciated by 0.9 percent since the beginning of the year (0.1 percentage point deprecation in the past month). **See Figure 13.** According to the Bank of International Settlement, the RMB's real effective exchange rate (REER) depreciated by 2.8 percent from February to March. The currency has appreciated by 10.9 percent since it was de-pegged in June 2010.

24. During the Bo'ao Forum earlier this month, PBoC Governor Zhou Xiaochuan re-iterated that the Central Bank would continue liberalising exchange rate, and gradually stop 'constant intervention' of the rate.

25. RMB deposits in Hong Kong, an offshore market for the Chinese currency, totalled RMB 920.3 billion (£92 billion) in February (latest figure), compared with RMB 893.4 billion (£89.3 billion) in January. RMB cross-border trade settlement totalled RMB 394.1 billion (£39.4 billion) in February, compared with RMB 492.3 billion (£49.2 billion) in January.

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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