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FCO COUNTRY UPDATES FOR BUSINESS

China Economic Focus: December 2013

British Embassy Beijing

December 2013

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China Economic Focus – December 2013

Overview

- Economic data this month were stable. The main policy events were the two set-piece meetings in early December: the long standing 'central economic work conference (CEWC)' and the newly established 'central urbanisation work conference (CUWC)'. These were the first set-piece policy meetings since last month's 'Third Plenum', whose resultant 'Decisions' document exceeded expectations about the new leadership's commitment to address China's long-standing structural economic weaknesses.

- The communiqués issued following the CEWC and the CUWC don't tell us which specific policies will be enacted in the coming year and next year's economic targets have not been released, as has occasionally happened in the past. However, this lack of specificity may not matter. The lengthy 'Decisions' document provided clear direction for overall policy. China doesn't need further high-level reform plans. It needs previously announced policies to be effectively implemented to suit often wildly diverging local circumstances.

- Such implementation is underway. Recent weeks have seen progress on a number of small but important policies, including an expansion of a VAT reform; further progress towards interest rate liberalisation; more abolition or relegation of central-government approvals; and new guidance on encouraging private investment into competitive sectors of the economy. Individually, these aren't very exciting. But if the pace of implementation is maintained, on aggregate such changes should have a significant impact, allowing China to maintain relatively fast growth for some years.

- Official media coverage has emphasised that reform cannot come at the expense of stability. This means stable inflation and unemployment. The current economic context is favourable: inflation is forecast to remain low and the labour market is healthy. But the implication is that if either metric move in the wrong direction we should expect the pace of reform to slow.

- Much attention has focused on what next year's growth target will be. Various Chinese commentators are arguing for maintaining the current target of 7.5 percent (to emphasis stability); lowering it to 7 percent (to signal a commitment to reform); or abolishing the target altogether (to signal that growth itself no longer matters). The official answer on growth will be revealed at March's meetings of the National People's Congress.

- Given China's leadership's emphasis on stability and gradualism, another year of targeted 7.5 percent growth seems most likely (and is also consistent with the current consensus external forecast for 2014). This would imply a pace of reform that is lower than some, e.g. the IMF, would choose, but it shouldn't be cause for concern: we remain cautiously confident that the pace of reform will be sufficient to avoid big economic problems in the coming years.

- Further examples of our recent reporting 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.

The Central Economic Work Conference delivers few surprises

1. The economy grew by 7.8 percent in 2013 Q3 (on a year earlier), picking up from 7.5 percent in 2013 Q2. Most analysts are confident that the authorities will be able to meet their annual growth target of 7.5 percent. Many analysts have revised up their forecasts for the next year, due to the stronger economic figures since July.

Figure 1: External growth forecasts for 2013 & 2014

Institute	2013	2014
World Bank	7.5 percent	7.7 percent
IMF	7.6 percent	7.3 percent
HSBC	7.7 percent	
Standard Chartered	7.5 percent	7.4 percent
JP Morgan	7.6 percent	7.4 percent
CICC	7.6 percent	7.5-8 percent (until 2014Q2)
CASS	7.7 percent	7.5 percent
State Council DRC	/	7.5 percent
'Official Target'	7.5 percent	TBC

2. The annual Central Economic Work Conference (CEWC) was held on 9 - 12 December. 6 areas were set as the economic priorities in 2014:
   - To secure national food security;
   - To largely adjust industrial structure;
   - To control government debt risks;
   - Proactively to coordinate regional development;
   - To focus on welfare system and to improve people's livelihood; and
   - To improve trade openness.

3. No official growth target for 2014 was given (this is likely to be announced in the National People's Congress meeting in March 2014). Analysts are expecting a 7-7.5 percent target. **See Figure 1.**

November investment and production soften, retail sales stay strong

4. Headline fixed asset investment (FAI) growth moderated to 19.9 percent in the first 11 months (on a year earlier), down 0.2 percentage points in the first 10 months. This was slightly below market expectations of 20.1 percent. On monthly basis (seasonally adjusted), FAI growth picked up to 1.47 percent in November, compared with 1.42 percent in October. Manufacturing FAI growth slowed to 14.1 percent in November, dropping from 23.5 percent in October. Infrastructure FAI growth rebounded to 24.2 percent in November, up from October's 16 percent. **See Figure 2.**

Figure 2: Investment (% change on year before)

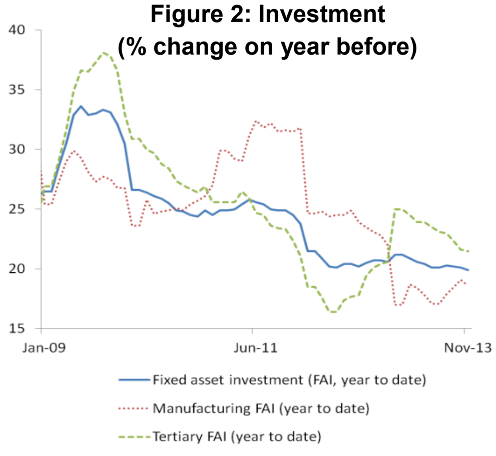
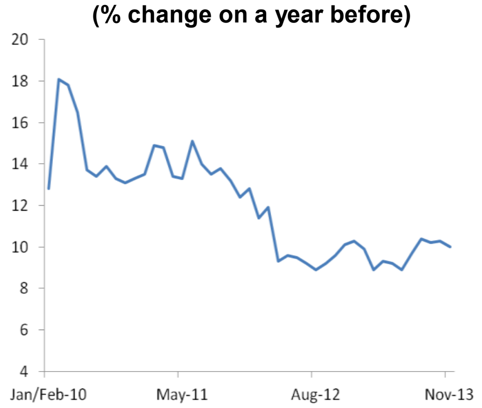


Figure 3: Industrial production (% change on a year before)



5. Industrial production (IP) growth slowed to 10 percent in November (on a year earlier), down from 10.3 percent in October. In month-on-month terms (seasonally adjusted), IP growth also slowed in the past month – it grew by 0.76 percent in November, compared with 0.85 percent in

October. Growth of production of electricity ad steel slowed, whereas that of cement picked up. Crude oil production was back to contraction in November, after a small expansion in October. Growth of production of automobile stayed resilient. **See Figure 3.**

6. The purchasing managers' index (PMI), a forward-looking measure of business conditions, indicated steady growth. The official manufacturing PMI remained unchanged at 51.4 from October to November, the 14th consecutive month in the expansion zone (above 50). The separate HSBC Manufacturing PMI, seen as a better measure of business conditions for small enterprises, slowed marginally to 50.8 in November, compared with 50.9 in October. Both of the official and HSBC services PMI softened a little but remain higher than the manufacturing indices. **See Figure 4 and 5.**

Figure 4: Manufacturing Purchasing Mangers' Index

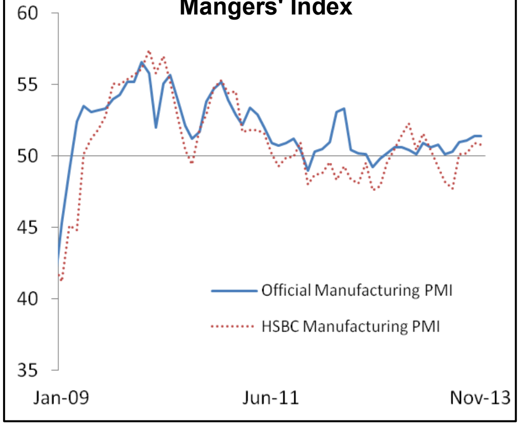
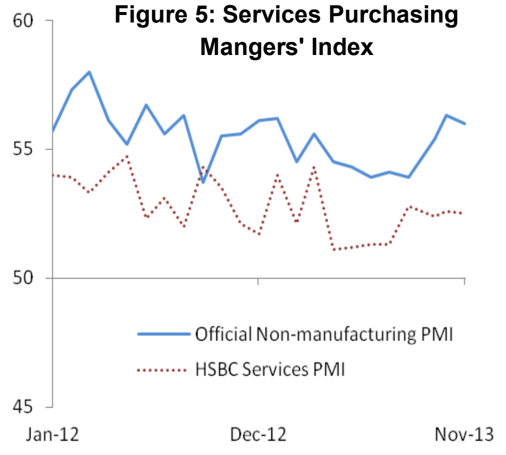


Figure 5: Services Purchasing Mangers' Index



7. Retail sales remain strong, increasing by13.7 percent in November (on a year earlier), picking up from October's growth of 13.3 percent. On monthly basis (seasonally adjusted), retail sales grew by 1.32 percent in November, higher than 1.18 percent in October. Sales of daily necessities, sports and entertainment equipment, home appliance, furniture, and telecoms equipment saw an accelerating growth. Catering sales continue to do badly. **See Figure 6.**

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

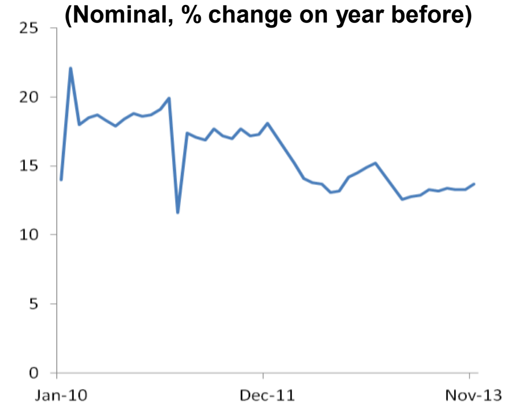
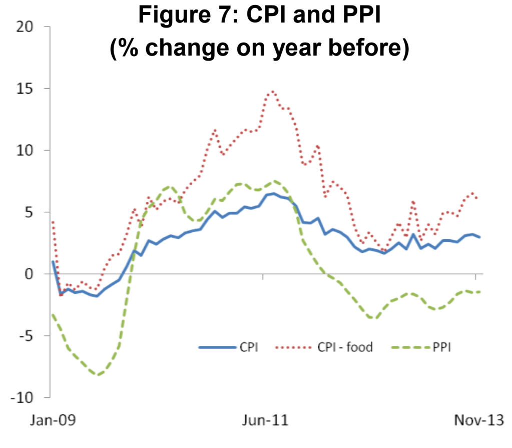


Figure 7: CPI and PPI (% change on year before)



Inflation remained manageable

8. The consumer prices index (CPI) fell to a three-month low of 3 percent in November (on a year earlier), down from 3.2 percent in October. On monthly basis, CPI contracted by 0.1 percent in November, compared with a 0.1 percent increase in October. Growth of food prices, the main

contributor, slowed to 5.9 percent in November, compared with 6.5 percent in October. Most analysts believe inflation pressure will remain modest for the foreseeable future. This means that the yearly CPI will stay below the official target (ceiling) of 3.5 percent. The authorities are expected to keep a neutral policy stance to manage inflation expectations.

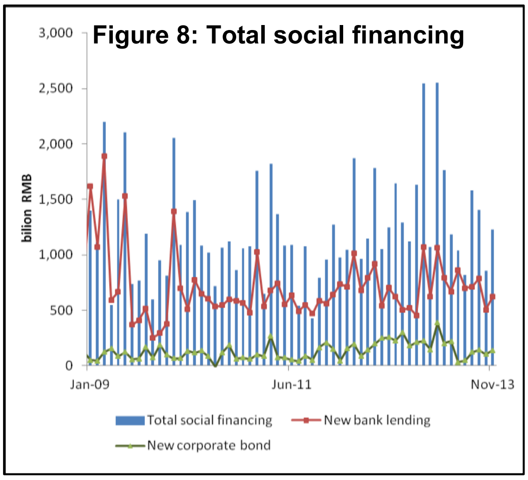
9. The contraction of producer prices index (PPI) narrowed marginally to -1.4 percent in November (on a year earlier), compared with -1.5 percent in October. This indicates upstream inflation pressure should remain manageable. **See Figure 7.**

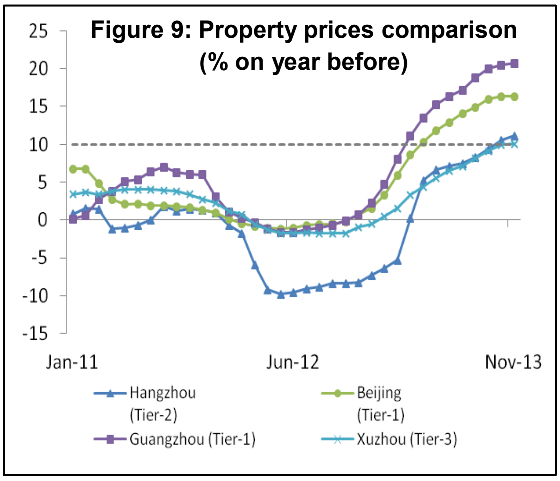
Total social financing rebounds

10. Total social financing (TSF), a measure of all forms of new credit, picked up to RMB 1.23 trillion (£123 billion) in November, from RMB 856.4 billion (£85.6 billion) in October. All the sub-components of TSF increased in the past month. Analysts attributed the surge to the confidence boosted by better economic performance in Q3 and to confidence induced by reforms announced in the Third Plenum. **See Figure 8.**

11. New bank lending rebounded to RMB 624.6 billion (£62.5 billion) in November, up from RMB 506 billion (£50.6 billion) in October. This was mainly led by an expansion of lending to the household sector and corporate sector.

12. Money supply (M2) grew by 14.2 percent in November (on a year earlier), down marginally from 14.3 percent in October. M2 growth has kept above the official target of 13 percent since the beginning of the year.





Property prices continue to increase rapidly

13. Property prices continued increasing quickly. The official data show that 66 out of 70 cities surveyed saw higher property prices in November (on a month earlier), compared with 65 in October. Property prices growth in all Tier 1 cities (Beijing, Shanghai, Guangzhou and Shenzhen) exceeded 15 percent in November (on a year earlier) – prices in Guangzhou and Shenzhen, in particular, grew by 20.7 and 20.6 percent respectively. **See Figure 9.**

14. Property investment remains strong, growing by 19.5 percent in the first 11 months (on a year earlier), 0.3 percentage points higher than that in the first 10 months. Residential property,

which accounts for 68.6 percent of property investment, increased by 19.1 percent in the first 11 months, also higher than a 18.9 percent growth in the first 10 months.

15. In the CEWC, the authorities emphasised to secure welfare housing, including social housing construction and shanty-town renovation. This is the first time that the CEWC has not mentioned property control since 2011.

Exports grow rapidly on the back of global recovery

16. China's export growth in November was strong, accelerating to a seven-month high of 12.7 percent (on a year earlier), doubling the growth figure in October (5.6 percent) and beating market expectations (7 percent). The improvement was likely attributable to the global recovery. Exports to the US and the EU rose to 17.7 percent and 18.4 percent in November, up from 8.1 and 12.7 percent in October respectively. Exports to ASEAN countries also accelerated – it grew by 16.7 percent in November, compared with 10.7 in October. Growth of shipment to Japan slowed. According to the Customs, exports of labour intensive goods, accounted for nearly 20 percent of total exports, continued a healthy growth.

17. China's imports grew by 5.3 percent in November (on a year earlier), lower than October's 7.6 percent. This was a five-month low. Imports growth of crude oil and soybean accelerated in volume terms, whereas that of iron ore and copper slowed.

18. The balance of exports and imports registered a trade surplus of USD 33.81 billion in November. This was the highest amount since January 2009. **See Figure 10.**

Figure 10: Import and export growth vs trade surplus

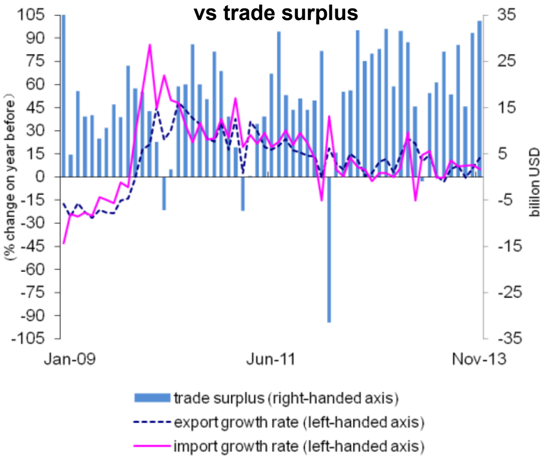
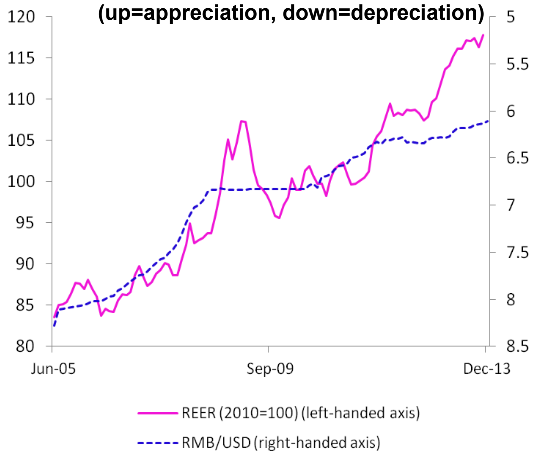


Figure 11: RMB Exchange Rate (up=appreciation, down=depreciation)



RMB becomes the 2nd largest trade currency

19. The RMB:US$ exchange rate (as of 18 December) continued to appreciate in the past month. The exchange rate is now standing at a historic high against the US dollar. The currency has appreciated by 2.9 percent since the beginning of 2013, compared with a 0.24 percent appreciation in 2012 as a whole. According to the Bank of International Settlement, the RMB's real effective exchange rate (REER) appreciated by 1.3 percent from October to November. The RMB's REER has appreciated by 6.9 percent in the first 11 months, compared with 2.1 percent in 2012 as a whole. **See Figure 11.**

20. According to the Society for Worldwide Interbank Financial Telecommunication (SWIFT), the RMB has overtaken the Euro to become the second most widely used currency in world trade in 2013. The share of the RMB in world trade finance reached 8.7 percent as of October 2013, compared with 1.9 percent in January 2012. Nearly 80 percent of the RMB users are Chinese and Hong Kong companies. The US dollar remained the dominant trade currency, account for over 80 percent of the world trade payments.

21. RMB deposits in Hong Kong, an offshore market for the Chinese currency, totalled RMB 781.6 billion (£78.2 billion) in October (latest figure), compared with RMB 730 billion (£73 billion) in September. This RMB deposits rose by the biggest margin since April 2011. RMB cross-border trade settlement reached RMB 315 billion (£31.5 billion) in October, down from September's RMB 331.7 billion (£33.2 billion).

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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