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FCO COUNTRY UPDATES FOR BUSINESS

China Economic Focus: July 2013

British Embassy Beijing

July 2013

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China Economic Focus – July 2013

Overview

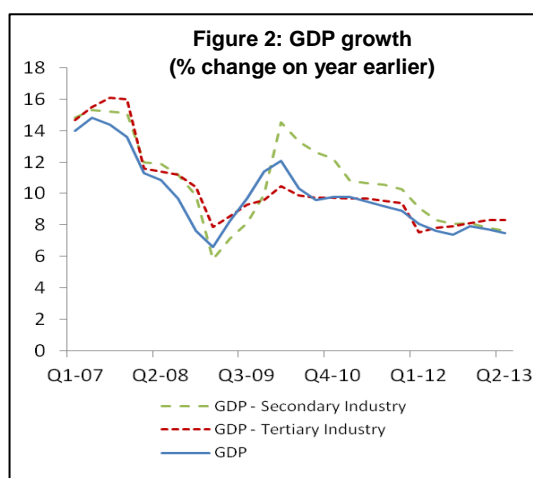
- China's economy grew by 7.5 percent (year-on-year) in the second quarter of 2013, down from 7.7 percent in the previous quarter. This was in line with forecasts, most of which have been steadily revised downwards since the start of the year.
- Other monthly data for June 2013 were broadly stable. Industrial production and fixed asset investment were both slightly below both last month's data and forecasts, while data for retail sales were slightly above. Trade data (both imports and exports) were surprisingly weak.
- The most significant change to economic policymaking this month was the policy-induced tightening of the interbank lending market. This has arguably been the most significant development in economic policymaking since China's leadership transition, and it has led to the downward revision of many external growth forecasts for both 2013 and 2014.
- In recent weeks, there have been further clear signalling that economic reform is more important than short-term economic growth:
 - President Xi Jinping said in a Party Organisation Department (HR-equivalent) meeting that GDP was no longer the main criterion for selecting cadres. Other factors, like improving people's livelihood and environmental protection, should be seen as just as important;
 - Finance Minister Lou said that while China is unlikely to experience a 'hard-landing', the structural reform process would be 'painful'; and
 - Premier Li Keqiang stated that provided inflation and unemployment remained at acceptable levels, no short-term stimulus measures would be introduced.
- This month's data should reassure Premier Li. Inflation is forecast to remain low and stable for the foreseeable future and the labour market appears to be stable. The services sector, the source of most new job creation, continues to expand rapidly, even as growth in manufacturing and agriculture both fall back slightly.
- Growth is likely to slow further in the second half of the year, provided the authorities continue to restrain credit growth. There is a lively debate about the lowest rate of growth the authorities will tolerate but we continue to assume that labour market stability is much more important than any particular growth figure.
- Further information about many of these topics can be found at:
<http://www.ukti.gov.uk/export/countries/asiapacific/fareast/china/fcouupdates.html>. Please get in touch if you have any questions or comments.

Q2 growth in line with forecasts

1. China’s economy grew by 7.5 percent in 2013 Q2 (on a year earlier). On quarterly basis (seasonally adjusted), the economy edged up by 0.1 percentage point to 1.7 percent in 2013 Q2. In recent weeks, many organisations have revised down their forecasts for 2013. **See Figure 1.**
2. Growth of tertiary sector continues to outpace that of manufacturing sector. Tertiary sector grew by 8.3 percent in 2013 Q2, unchanged from Q1. Manufacturing sector growth slowed to 7.6 percent, 0.2 percentage points lower than Q1 and the lowest since 2009 Q2. **See Figure 2.**
3. The authorities have repeatedly emphasised the importance of restructuring over a particular growth rate. For example, on 9 July Premier Li Keqiang stated that the key economic indicators remained in a ‘reasonable range’ as expected and that it was only by economic restructuring can the economy continues sustainable and health growth.

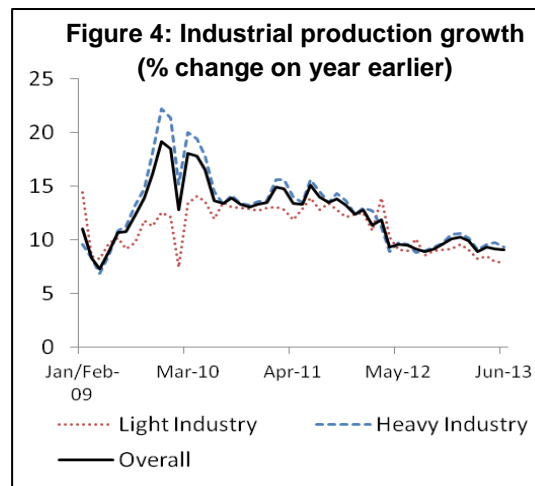
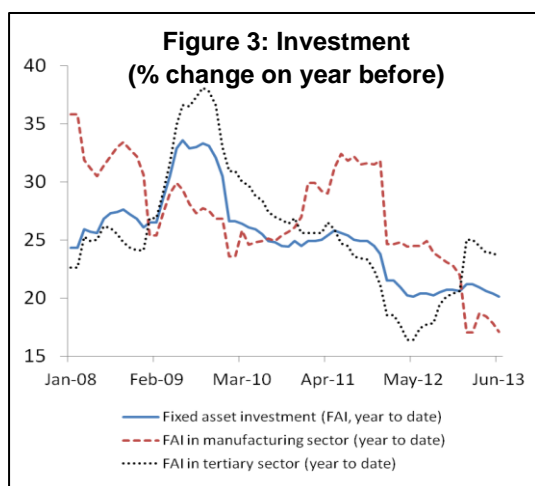
Figure 1: External growth forecasts for 2013

| Institute | Forecasts |
|--------------------|--|
| World Bank | 7.7 percent (revised on 13 June, down from 8.3 percent) |
| IMF | 7.75 percent (revised on 29 May, down from 8 percent) |
| HSBC | 7.4 percent (revised on 19 June, down from 8.2 percent) |
| Standard Chartered | 7.5 percent (revised on 15 July, down from 7.7 percent) |
| Goldman Sachs | 7.4 percent (revised on 22 June, down from 7.8 percent) |
| CICC | 7.4 percent (revised on 22 June, down from 7.7 percent) |
| ‘Official Target’ | 7.5 percent |

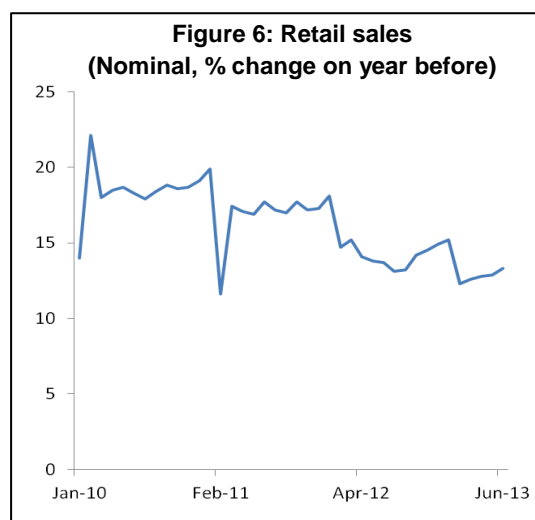
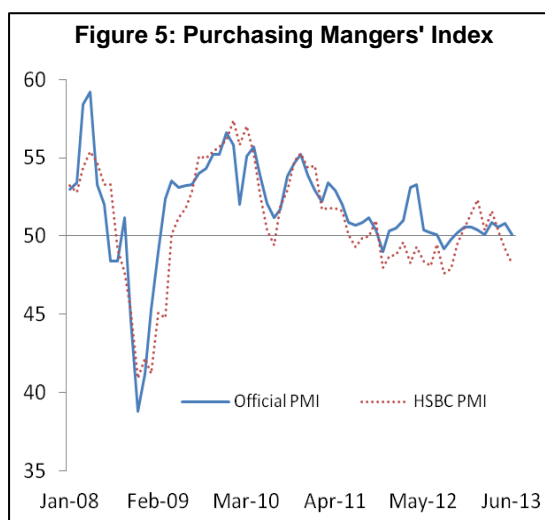


June’s key economic indicators remained broadly stable

4. Headline fixed asset investment (FAI) grew by 20.1 percent in the first 6 months (on a year earlier), compared with 20.4 percent in the first 5 months. Growth of investment in industrial sector eased marginally to 15.6 percent in the first 6 months, compared with 15.7 percent in the first 5 months. Growth of investment in tertiary sector also decelerated – 23.5 percent in the first 6 months, compare with 23.9 percent in the first 5 months. **See Figure 3.**



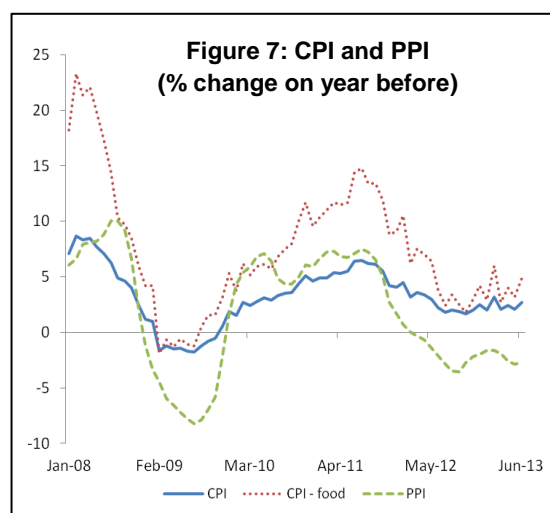
- Growth of industrial production (IP) eased to 8.9 percent in June (on a year earlier), lower than May's 9.2 percent and market expectations of 9.1 percent. Deceleration of heavy industry's growth was the main drag. Heavy industry growth slowed to 9.3 percent in June, compared with 9.8 in May. And light industry growth remained nearly unchanged at 7.9 percent in June, down 0.1 percentage points from May. **See Figure 4.**
- The official purchasing manager's index (PMI) declined to 50.1 in June, down from 50.8 in May and hitting a 5 months' low. This was the 9th consecutive month in the expansion zone (above 50). The separate HSBC PMI, which is seen as a better measure of business conditions for small enterprises, registered a 9 month low at 48.2. **See Figure 5.**



- Growth of retail sales edged up to 13.3 percent in June (on a year earlier), compared with 12.9 percent in May. This is the highest growth since the beginning of the year but remains below last year's growth rates – **see figure 6**. Growth of consumption in rural area (15.1 percent) exceeded that in urban area (13 percent). Sales from the catering sector, which is said to have been influenced by the central government's austerity campaign, continued to better off, increasing 9.5 percent in June, compared with 9.2 percent in May.

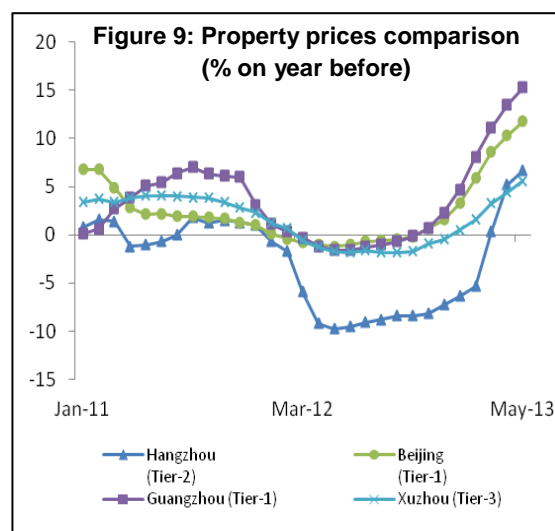
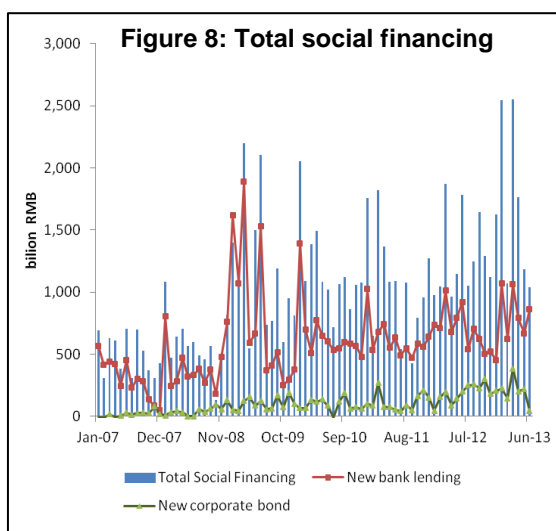
Inflation still not a concern

- Consumer prices index (CPI) rebounded to 2.7 percent in June (on a year earlier), compared with 2.1 percent in May, beating market expectations of 2.5 percent. Food prices remained the main contributor. Growth of producer prices index (PPI), a measure of upstream inflation pressure, improved marginally to -2.7 percent in June, compared with -2.9 percent in May. **See Figure 7.**



Credit growth slows, influenced by a policy induced tightening

9. Money supply (M2) increased by 14 percent in June (on a year earlier), down from 15.8 percent in May but above 13.6 percent in June 2012. M2 growth has slowed gradually since the beginning of year. The PBoC (Central Bank) has attributed the slowdown to its mandate for banks to deleverage and described it as in line with prudential monetary policy.
10. New bank lending totalled RMB 860.5 billion (£92.5 billion) in June, higher than RMB 667 billion (£70.2 billion) in May. Surge of corporate loans contributed to the lending rebound. Loans to corporate sector nearly doubled from May to June to RMB 514 billion (£55.3 billion).
11. Total social financing (TSF), a measure of all forms of new credit, decreased to a 14-month low of RMB 1.04 trillion (£112 billion), compared with 1.19 trillion (£125.3 billion) in May. In particular, new corporate bond issuance dropped significantly to RMB 44 billion (£4.7 billion) in June from RMB 216.7 billion (£23.3 billion) in May. And contraction of bank acceptance bill issuance doubled to – RMB 263 billion (–£28.3 billion). **See Figure 8.** This was mainly due to a decline in off-balance sheet lending, following the cash crunch in June.
12. In a recent interview with Xinhua News Agency, the PBoC iterated their aim to improve prudential policy framework, to adjust interbank liquidity and to direct stable growth of credit and TSF as the key of next steps. Most analysts expect TSF growth will not drop suddenly but ease gradually in the coming months.



Property prices in Tier 1 cities increase quickly

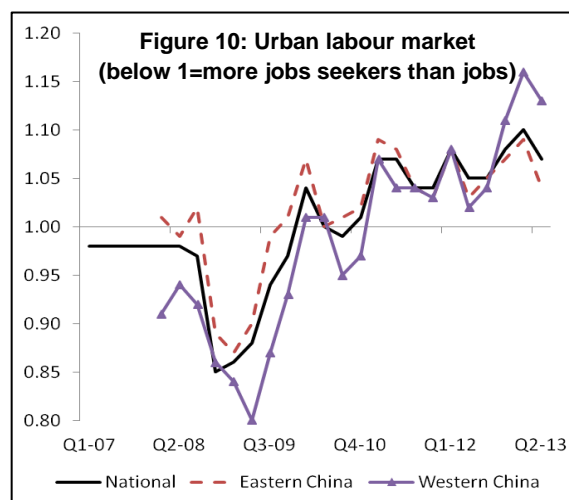
13. The latest data show that 65 out of 70 cities surveyed saw higher property prices in May, compared with 67 in April. Tier 1 cities (Beijing, Shanghai, Guangzhou and Shenzhen) are seeing a double digit property price increase, well ahead of Tier 2 and 3 cities. **See Figure 9.**
14. Property investment increased by 20.3 percent in the 6 months (on a year earlier), compared with 20.6 percent in the first 5 months. Growth of residential property, which accounts for 68.5 percent of property investment, decelerated by 0.8 percentage points to 20.8 percent in the first 6 months from the first 5 months.

The labour market remains stable, though urban income growth has slowed.

15. Official figures suggest that there were more jobs than job seekers in Q2, continuously, with the employment situation in Western China stronger than the national average. **See Figure 10.**

16. According to Yin Weimin, Minister of Human Resources, 7.25 million new jobs have been created in the first half year of 2013, 0.3 million more than the same time in 2012. Minister Yin estimated that 1 percentage growth in tertiary sector creates 700,000 jobs.

17. Q2's urban income grew by 6.5 percent (on a year earlier), down 0.2 percentage points from Q1, and significantly below the average annual growth rate of 9.6 percent in 2012. Rural income growth remained ahead of headline GDP growth at 9.2 percent in Q2, compared with 9.1 percent in Q1.

**Trade figures disappointing**

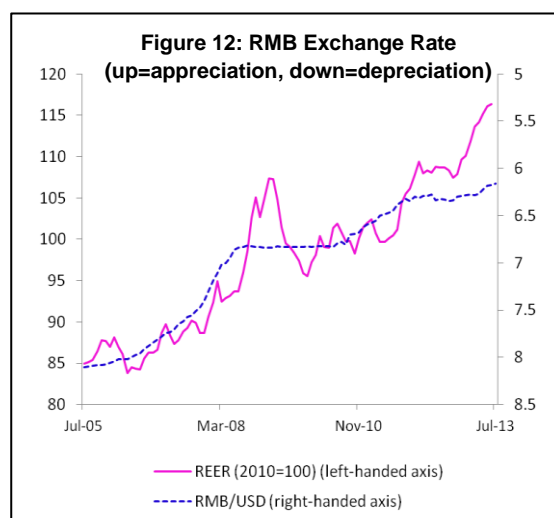
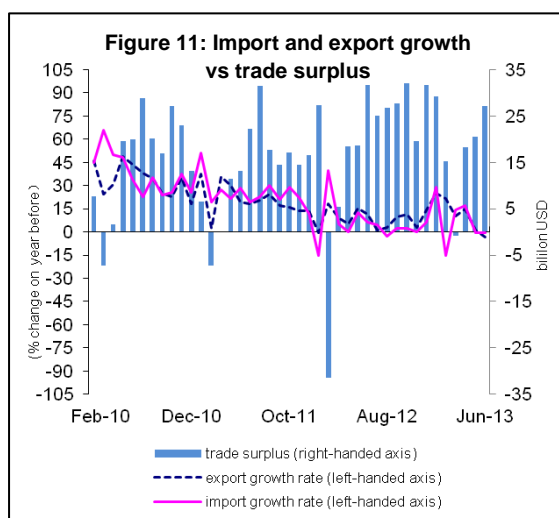
18. Trade figures were disappointing in June. China's export dropped by 3.1 percent in June (on a year earlier), compared with 1 percent increase in May. This was the first contraction since January 2012. Exports to G3 market continued to decline. Exports to US declined further to -5.4 percent in June from -1.6 percent in May. Contraction of shipment to EU and Japan improved moderately, with exports to EU dropping by 8.3 percent in June (-9.7 percent in May) and to Japan dipping by 5.1 percent in June (-5.7 percent in May).

19. Imports contracted for the second consecutive month. June's imports decreased by 0.7 percent (on a year earlier), down from -0.3 percent in May and much lower than market expectations of 6 percent. Key commodities, like crude oil, coal and iron ore saw a decrease in import prices. In volume terms, it was a mixed picture – growth of iron ore slowed and that of crude oil increased.

20. The Customs provided 5 main reasons for the weak trade data:

- Sluggish external demand;
- Decreasing competitiveness due to RMB appreciation and higher labour cost;
- Increasing complexity of trade conflicts which has constrained exports with comparative advantage;
- Decreasing demand due to slowdown of domestic industrial production;
- Decreasing global commodity prices.

21. The balance of exports and imports registered a trade surplus of USD 27.1 billion in June, higher than May's 20.4 billion. **See Figure 11.**



Further steps of RMB internationalisation

22. The RMB exchange rate (against dollars) was nearly flat in the past month, reaching a pause after quick appreciation in April and May. In the first half year, the currency has appreciated by 2 percent, much quicker than 2012's overall appreciation of 0.24 percent. The latest figures from the Bank of International Settlement show that the RMB's real effective exchange rate has appreciated by 5.7 percent in the first half year, compared with 2.1 percent in 2012 as a whole. **See Figure 12.**
23. On 22 June, PBoC and the Bank of England signed a bilateral currency swap agreement. The size of the swap line is £20 billion. This follows PBoC Governor Zhou Xiaochuan and then BOE Governor Mervyn King's agreement when they met in February. So far, PBoC has signed currency swap agreements with 20 countries, totalling RMB 2.2 trillion (£237 billion).
24. On 12 July, CSRC (the securities regulator), PBoC and SAFE (the foreign exchange regulator) jointly announced an increase in the amount of foreign 'portfolio' investment allowed into China's stock and bond markets via the Qualified Foreign Institutional Investor (QFII) Scheme. The total QFII quota was increased from \$80 billion to \$150 billion. Meanwhile, RMB QFII (RQFII) scheme was expanded geographically to London, Singapore and Taiwan (Hong Kong used to be the only place to pilot RQFII).
25. RMB deposits in Hong Kong, an offshore market for the Chinese currency, totalled RMB 699 billion (£73.6 billion) in May (latest data), compared with RMB 677.2 billion (£71.3 billion) in April. RMB cross-border trade settlement totalled RMB 318.1 billion (£33.5 billion) in May, increasing 15.5 percent from a month earlier.

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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