British Embassy
Beijing

China Economic Focus – June 2014

Overview

- Latest official monthly data have been broadly stable. Figures for investment, industrial production and retails sales were all largely as expected. Exports are starting to improve. More ominously, the property market continues to weaken and this will continue to present downward pressure on growth in the coming months.

- In recent weeks, and including during his recent visit to London, Premier Li Keqiang has become more vocal in defending this year's growth target of 'around 7.5 percent'. A raft of targeted stimulus measures have also been introduced, focussing on either accelerating investment or increasing the flow of credit to targeted parts of the economy, like farming or SMEs.

- The impact of the measures announced so far is unlikely to be large. They are not yet of comparable scale to the stimulus measures introduced in 2008 or 2011. But they will provide some support to growth in the coming quarters, and the most recent data shows that credit growth, which had been declining in recent quarters, has now stabilised.

- There is a lively debate among commentators about whether recent stimulus measures represent a blow for reform. We continue to give the authorities the benefit of the doubt. It was always likely that the reform process would be gradual and not at the expense of short-term stability, and the steady stream of reform measures that have been implemented over the past year or so do suggest that progress on reform is being made.

- 'Walking and chewing gum' is how Standard Chartered Bank characterizes Li's approach of both structural reform and targeted stimulus. There is every possibility that Li can continue in this way. China benefits from strong governance, huge state assets and negligible foreign debt. The IMF has recently updated its growth forecasts, which assumes a continued but steady decline in growth.

- But recent developments do illustrate the challenge China's leaders are facing. Structural liberalisation is tricky at the best of times. China faces the additional complication of needing to centralise authority to drive through reforms but the reforms themselves require significant decentralisation of decision-making powers. And finally, of course, there is China's extraordinary diversity and continental size.

- 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.

Measures introduced to ensure targets are met

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)

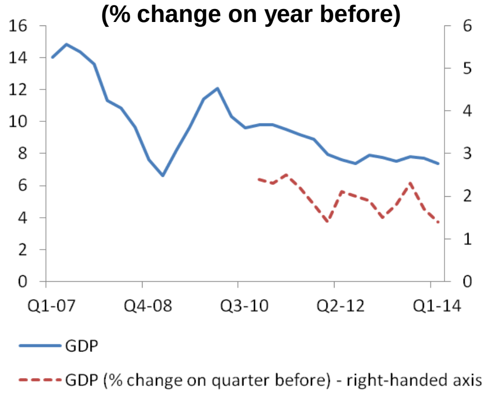


Figure 2: External growth forecasts for 2014

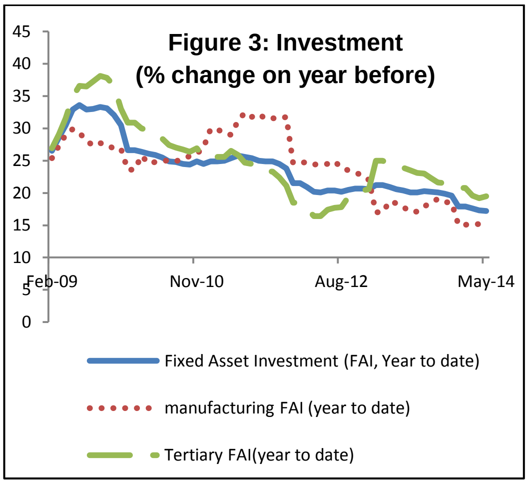
Institute	2014
World Bank	7.6%
IMF	7.5%
HSBC	7.4%
Standard Chartered	7.4%
UBS	7.5%
Goldman Sachs	7.3%
JP Morgan	7.2%
CICC	7.3%
CASS	7.4%
'Official Target'	7.5%

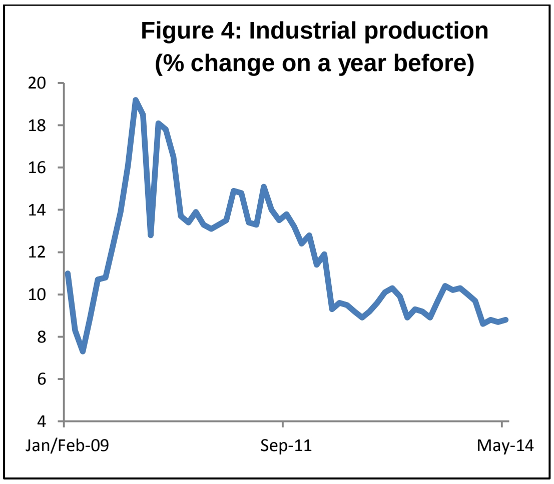
2. China's Premier Li Keqiang has made many important statements about economy recently. In a speech during his visit to London, he promised China's economy would not have a hard-landing, saying the government would not allow overall growth to fall below the target of around 7.5 percent and that CPI would not be allowed to rise more than 3.5 percent. Li also emphasised that China would not use strong economic stimulus.

3. A national meeting on economic reform was also held on 20 May. The resultant communiqué listed nine reform priorities in 2014: reform on investment regime; price reform; fiscal, tax and financial reform; SOE reform, establishing an open and transparent market rules; urbanization; investment and trade facilitation; reform of social courses such as education, health, income etc; and improving energy-saving and environmental-protection system. Detailed implementation measures are expected to be announced in the coming months.

Main economic indicators are broadly stable and in line with expectations

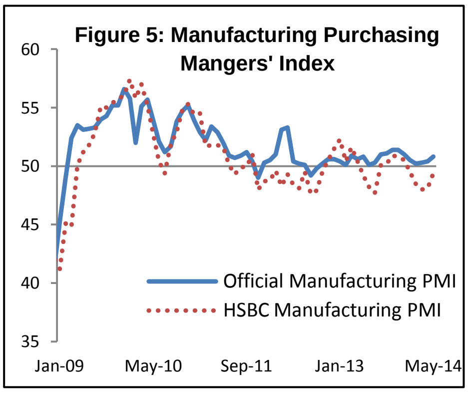
4. Headline fixed asset investment (FAI) growth was 17.2 percent in the first five months (on a year earlier), slightly lower than 17.3 percent in the first four months. This was in line with market expectations. **See Figure 3.** On monthly basis (seasonally adjusted), FAI growth rose 1.32 percent in May. The FAI was still mainly dragged down by slower property investment growth, but infrastructure investment improved rapidly. Manufacturing investment slowed to 14.2 percent. The increase of investment from government played a major role in stabilising FAI.

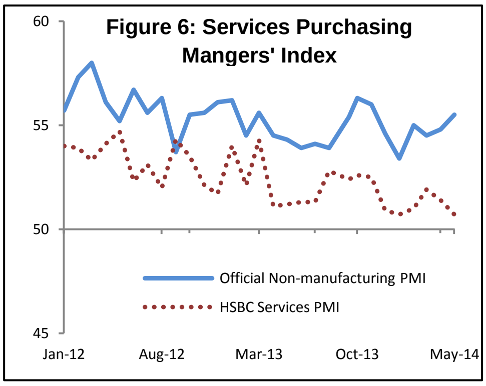




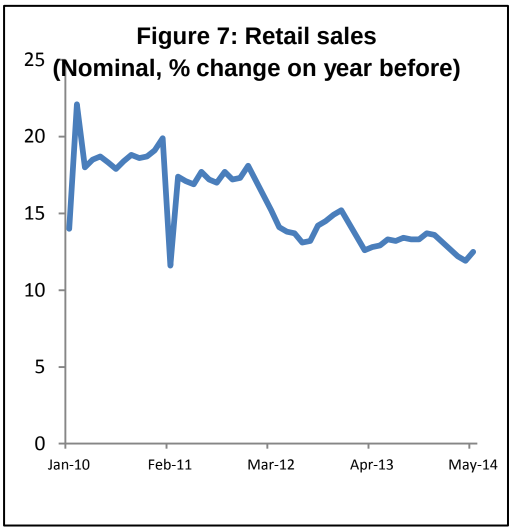
5. Industrial production (IP) growth was stable, increasing marginally to 8.8 percent in May (on a year earlier), compared with 8.7 percent in April and 8.8 percent in March. The increase is due to rapid growth of infrastructure investment and improvement of export. On monthly basis (seasonally adjusted), IP growth rose to 0.71 percent, slightly higher than 0.7 percent in April but still lower than 0.81 percent in March. Growth of production of steel, automobile, and electricity improved; while that of crude oil and cement slowed. **See Figure 4.**

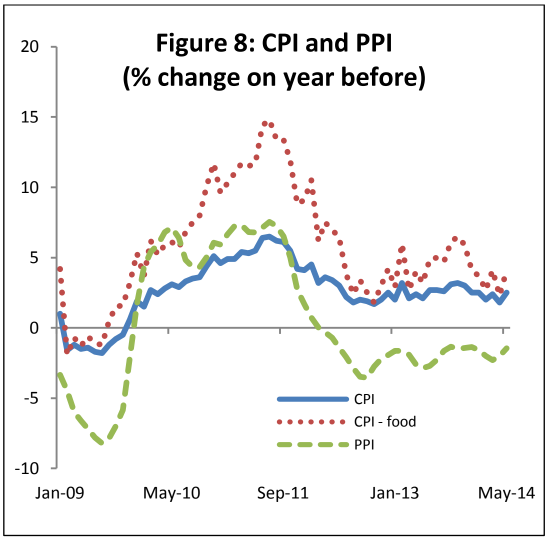
6. The official manufacturing purchasing managers' index (PMI), a forward-looking measure of business conditions, improved to 50.8 percent in May, 0.4 percentages point higher than April. This was improvement for the third consecutive months. The separate HSBC manufacturing PMI, as a better measure of business conditions for small enterprises, also improved to 49.4 percent in May from 48.1 in April. The official services PMI increased to 55.5 percent in May, the fastest growth since last November, while the HSBC services PMI contracted to 50.7 percent, the lowest in record, which showed services, especially from private sectors, were still struggling in a difficult market environment. **See Figure 5 and 6.**





7. Growth of retail sales edged up to 12.5 percent in May (on a year earlier), the highest growth in 2014, compared with 11.9 percent in April and 12.2 percent in March. Holiday effect contributed to this increase. On monthly basis (seasonally adjusted), retail sales grew by 1.16 percent in May. A majority of products saw sales increase, only sales of jewellery decreased. **See Figure 7.**





Inflation picks-up but remains manageable

8. The consumer prices index (CPI) rose by 2.5 percent in May (on a year earlier), rebounding from 1.8 percent in April but in line with market expectations. Rising food prices were the main cause of the increase. The prices of pork increased 5.6 percent than previous month and contributed 0.15 percentage point of CPI growth. On monthly basis, CPI increased marginally by 0.1 percent.

9. The Producer Prices Index (PPI), an indicator for upstream inflation pressure, declined by 1.4 percent in May (on a year earlier), compared with 2 percent decline in April. The PPI has now reached its highest level since January. The contraction was slightly better than market expectations. **See Figure 8.**

Credit growth stabilises on the back of stimulus measures

10. Total social financing (TSF), a measure of all forms of new credit, reached RMB 1.4 trillion (£140 billion) in May, less than RMB 1.55 trillion (£155 billion) in April, but increasing RMB 217.4 billion (£21.74 billion, up 18 percent) on a year earlier. Bank acceptance bill reduced RMB 9.6 billion (£0.96 billion) in May, compared with an increase of RMB 78.7 billion (£7.87 billion) in April. Compared with last year, the composition of TSF has changed, with the falling of non-banking financing and recovery of bank lending, and change from short-term financing to medium and long-term loans. **See Figure 9.**

11. New bank lending in May rebounded to RMB 870 billion (£87 billion), up from RMB 774.7 billion (£77 billion) in April, an increase of 12.3 percent. The percentage of new bank lending in TSF rose to 62.2 percent, up 5.8 percent on previous year. As Chinese government tightened controlling on shadow banking, non-banking financing was cooling down while bank lending was gradually increasing.

12. Money supply (M2) grew by 13.4 percent in May (on a year earlier), higher than 13.2 percent in April and higher than market expectations. The rise can be attributed to mini-stimulus measures taken by Chinese government recently.

13. On 30 May, the State Council (China's Cabinet) met to discuss strengthening financial sector development. Measures announced included targeted RRR cut, support for the financing of small and mini-enterprises, improving oversight on shadow banking, and optimizing social financing composition. This was the biggest move this year both in financial sector and in stabilising growth, and showed government's increasing concern for the downward pressure. It set direction for TSF development in the coming months and gave the market more confidence.

Figure 9: Total social financing

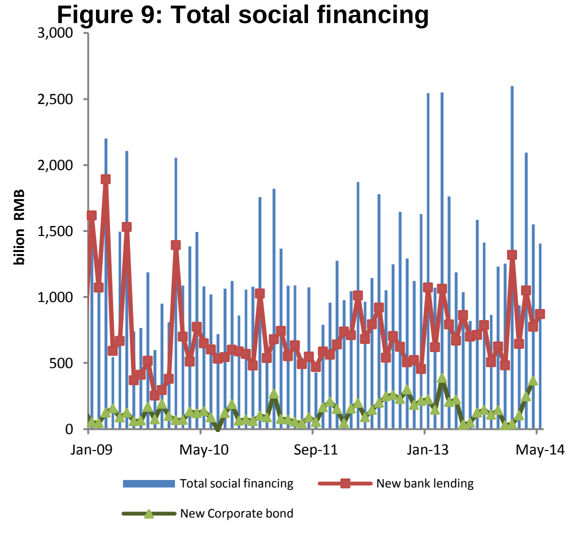
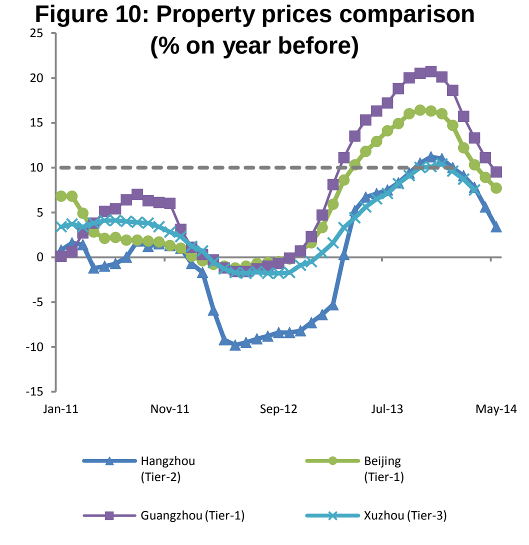


Figure 10: Property prices comparison (% on year before)



The property sector continues to weaken

14. Official data show that only 15 out of 70 cities surveyed saw higher property prices in May (on a month earlier), compared with 44 in April; and 35 out of the 70 cities saw declined property prices (on a month earlier), compared with only 8 in April. 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.** Causes of declined property prices include high pressure of inventory, unclear market expectations, waiting from buyers' side, and promotion from property companies.

15. Property investment grew by 14.7 percent in the first five months, declining further from 16.4 percent in April. This was one of the lowest in record.

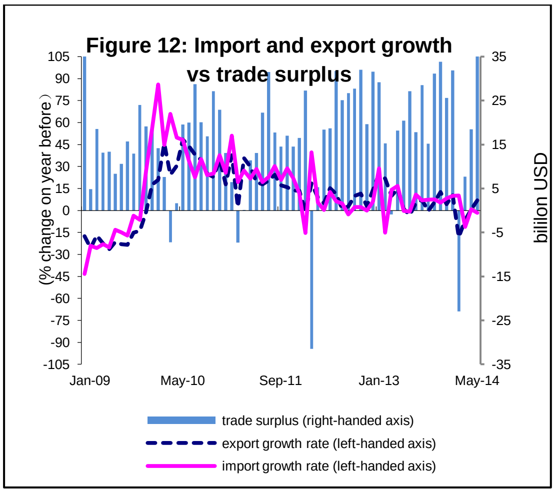
Exports are rebounding on the back of a strengthening global economy

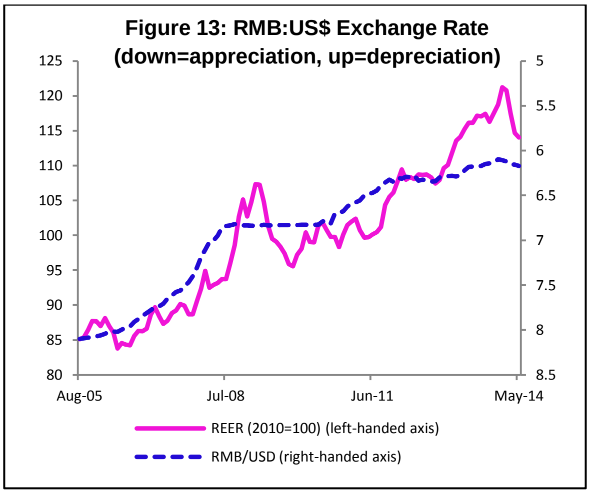
16. Exports increased by 7 percent in May (on a year earlier), compared with 0.9 percent growth April. Due to recovery of advanced economy, export of electronic products and high-tech products increased for the first time after several months' declining. Exports from China's central and western provinces increased rapidly in May.

17. Imports contracted by 1.6 percent (on a year earlier) in May, compared with a 0.8 percent increase in April. Growth of resource products import slowed, and import of electronic and high-tech products declined greatly. The contraction was due to weak domestic demand and strengthened measures on overseeing and regulating trade.

18. China registered a trade surplus of USD 35.9 billion in May, improving greatly from a surplus of USD 18.5 billion in April. **See Figure 12.**

19. On 15 May China' State Council (Cabinet equivalent) issued a guideline policy on stabilizing trade growth, aiming to improve import, stabilize trade in goods and support trade in services. The People's Bank of China announced its measures to implement the guideline policy, providing overall financial and banking support to trade. Further policies are expected to be announced under this guideline, and trade is expected to improve with this round of intensive policy support.





The pace of RMB depreciation slows.

20. As of 20 June, the RMB:US$ exchange rate has depreciated by 0.86 percent since the beginning of the year, though it has appreciated by 0.17 percent over the past month. **See Figure 13.** According to the Bank of International Settlement, the RMB's real effective exchange rate (REER) depreciated by 0.56 percent from April to 114.05 in May, the lowest since February 2013. In the first five month of 2014, the RMB's REER had depreciated by 3.96 percent.

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:

- Liu Qin | liu.qin@fco.gov.uk | (+86 10) 5192 4388
- Henry Bell | henry.bell@fco.gov.uk | (+86 10) 5192 4493

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