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FCO COUNTRY UPDATES FOR BUSINESS

China: Economic Focus: May 2013

British Embassy Beijing

May 2013

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China Economic Focus – May 2013

Overview

- There have been no big developments in the Chinese economy this month. The data was basically stable, with all the main indicators consistent with forecasts and previous months' outturns. Inflation remains benign. No major new economic policies were introduced.
- The bigger picture remains that China is gradually transitioning between growth models, pushed by growing evidence that the investment-driven growth model is running out of steam and pulled by an incremental approach to structural reform. The question is whether the pace of reform will be sufficient to prevent a rapid deceleration of growth in the coming years.
- Speculation that China's growth foundations may be deteriorating too quickly was fuelled by last month's unexpectedly weak data for 2013 Q1. It is certainly puzzling that growth this year hasn't been higher, given the relatively loose policy conditions that have prevailed since 2012 Q3.
- But we're not particularly concerned, primarily because we think that the pace of economic reform will gradually accelerate in the coming period, allowing China to sustain annual growth of around 7.5 for the next few years. Such growth is likely to be fast enough to generate enough jobs, maintain stability and avoid the so-called 'middle-income trap'.
- This view was supported by a communiqué issued this month by Premier Li Keqiang, which re-iterated the high-level objective of reducing the government's role in the economy, including by liberalising prices and financial sector reform.
- Admittedly, the only specific measures introduced this month were a modest reduction in central approvals required for domestic investments. But it is encouraging that the unexpectedly weak data in 2013 Q1 hasn't pushed the reform agenda off course. Barring a deterioration in the labour-market, we do not anticipate a change in policy direction any time soon.
- Li's statement also re-iterated a pledge to publish this autumn a detailed 'road-map and timetable' for economic reform. This is likely to provide the framework for economic policy-making during the next five or ten years of Li's Premiership.
- Further information about many of these topics can be found at: <http://www.ukti.gov.uk/export/countries/asiapacific/foreast/china/fcouupdates.html>. Please get in touch if you have any questions or comments.

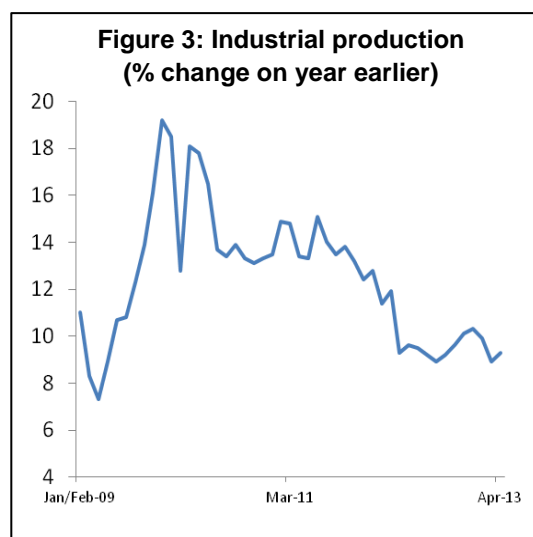
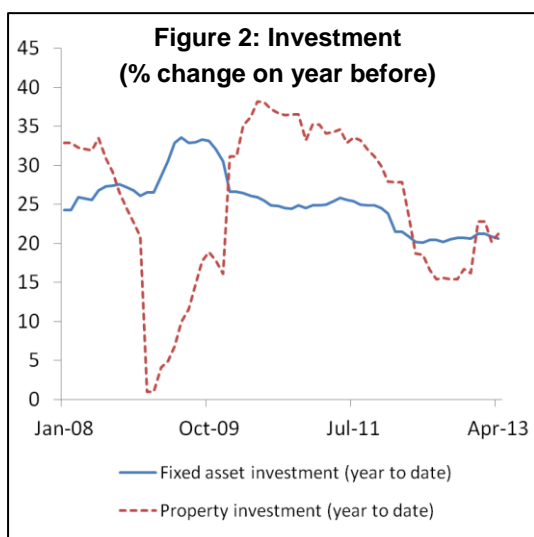
Despite Q1's poor outturn, overall growth for 2014 is still likely to remain above the official target.

1. The Chinese economy grew by 7.7 percent (on a year earlier) in 2013 Q1, registering a lowest growth since 2009 Q1. But it is still above the official target of 7.5 percent. The decline in growth surprised the markets. As a result, many economists have downgraded their growth forecasts, but all forecasts remain above the official target. **See Figure 1.**

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)
Standard Chartered	7.7 percent (revised on 10 May, down from 8.3 percent)
Bank of China	8 percent
'Official Target'	7.5 percent

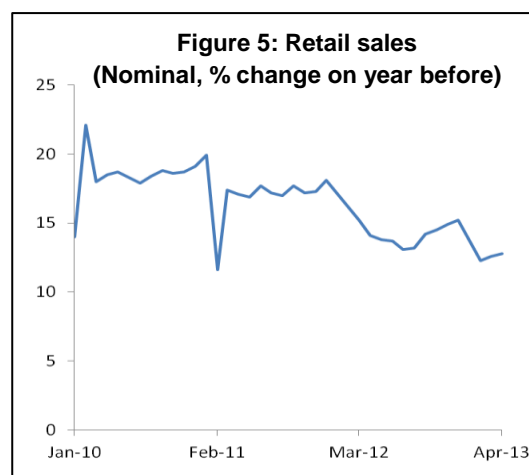
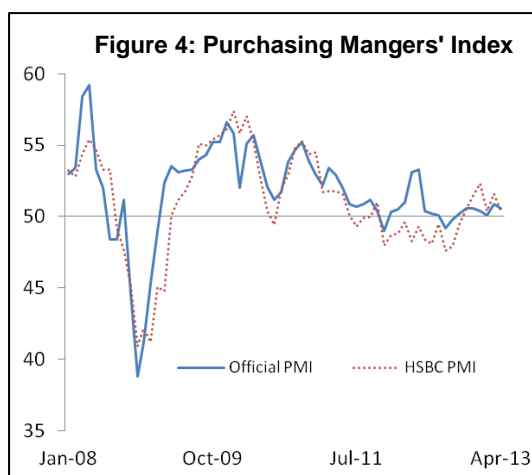
Most indicators for April were essentially stable

2. Headline fixed asset investment (FAI) growth slowed slightly to 20.6 percent in the first four months (on a year earlier), 0.3 percentage points slower than the first three months but higher than 20.3 percent in 2012 as a whole. Central government-led investment growth eased to 8.5 percent in the first four months, from 11.6 percent in the first three months, but remaining higher than 2012's 5.9 percent.
3. Property investment growth accelerated slightly to 21.1 percent in the first four months (on a year earlier), up from 20.2 percent in the first three months. Growth of residential property investment, which accounts for 68.4 percent of property investment, also picked up by 0.2 percentage points to 21.3 percent in the first four months from the first three months. **See Figure 2.**



4. Industrial production (IP) grew by 9.3 percent in April (on a year earlier), picking up from 8.9 percent in March. IP growth in both light and heavy industries improved. Growth of production of electricity, cement, and automobile accelerated; whereas that of steel and crude oil processing slowed. **See Figure 3.**
5. The official purchasing managers' indices (PMI) slowed slightly to 50.6 in April, compared with 50.9 percent in March. This was the 7th consecutive month in the expansion zone (above 50). PMI for big corporates (51) was stronger than medium-sized firms (50.7) and small ones (47.6). Consistent with this, the separate HSBC PMI, which is seen as a better measure of business

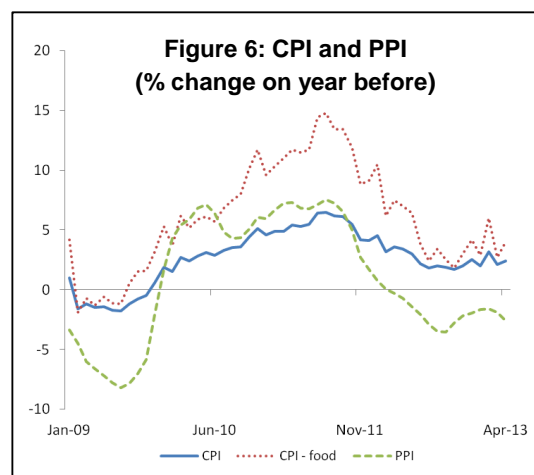
conditions for small enterprises, was weaker than the official one – 50.4 in April, down from 51.6 in March. **See Figure 4.**



- Retail sales, the best official measure for consumption, increased by 12.8 percent in April (on a year earlier), slightly stronger than 12.6 percent in March, but slower than the average growth rate of 15 percent seen in the past two years – **see Figure 5.** Growth of gold and jewellery sales was particularly strong (72.2 percent in April, compared with 26.3 percent in March), offsetting a deceleration of growth in the sale of food, garment, sports equipment, furniture, and telecommunications devices.

Outlook for inflation remains benign

- Consumer prices index (CPI) rose by 2.4 percent in April (on a year earlier), higher than March’s 2.1 percent. Food price inflation continued to be biggest contributor: food prices increased by 4 percent in April, compared with 2.7 percent in March. Pork prices continued to drop.

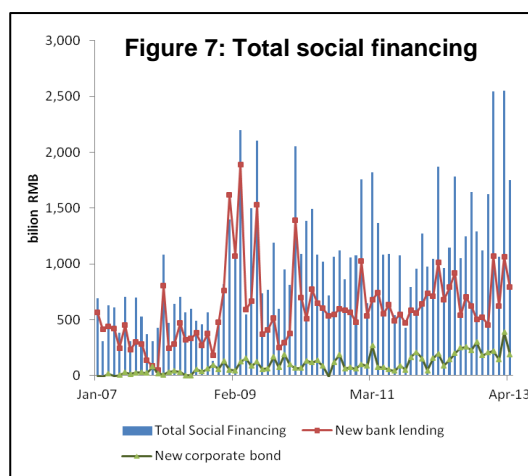


- The contraction of producer prices index (PPI), a measure of upstream inflation pressures, widened to -2.6 percent in April (on a year earlier), compared with -1.9 percent in March. This was the 14th consecutive month of decrease. The decline in PPI is largely attributable to the fall in international commodity prices. **See Figure 6.**

Credit growth remains strong

- Money supply (M2) grew by 16.1 percent in April (on a year earlier), compared with 15.7 percent in March and 13.8 in 2012 as a whole. This was the highest growth since March 2011. In the first four months of 2013, the M2 growth rates were all above the official target of 13 percent.
- New banking lending totalled RMB792.9 billion (£83.5 billion) in April, lower than March’s RMB 1.06 trillion (£111.6 billion) but higher than market expectations of RMB755 billion (£79.5 billion). Loans to the corporate sector saw a reduction from March to April.

11. Total social financing (TSF), a measure of all forms of new credit, dropped to RMB 1.75 trillion (£184.2 billion) in April from 2.54 trillion (£267 billion) in March. This was still higher than the RMB 963.7 billion (£96 billion) of TSF issued in April 2012 (see Figure 7).

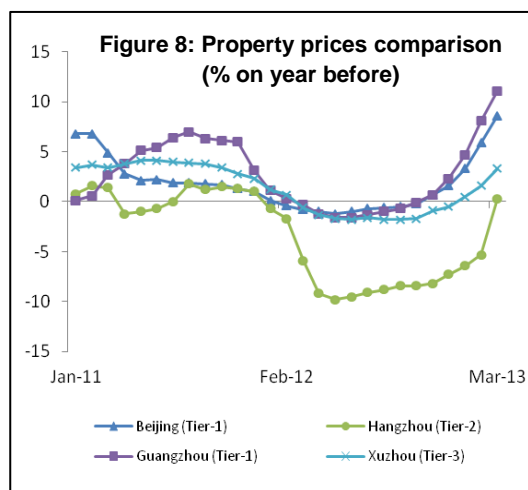


12. The recent spike in TSF issuance has attracted the authorities’ attention. In late March, the CBRC’s (the banking regulator) announced they would more stringently manage Wealth Management Products (WMP). Echoing this concern, on 9 May the PBoC (Central Bank) warned the risks of WMPs for the first time. Writing in their Q1 Monetary Policy Report, the PBoC stated that although overall financial market conditions were ‘essentially stable’, recent months had seen a ‘relatively quick’ increase of credit and social financing.

13. As this rhetoric feeds its way into policy, it is likely that the rate of credit growth will moderate in the coming months.

Property sector remains quite buoyant, despite continued efforts to control prices.

14. In early March and late February this year the State Council issued a range of measures to control the property market (see here). Recent data suggests these measures are either not having an effect, or people are accelerating their purchases to avoid being affected by them.



15. The latest surveys show that 68 out of a sample of 70 cities saw higher property prices in March (in month-on-month terms), compared with 66 in February and 53 in January. Prices in China’s tier 1 cities (e.g. Beijing or Guangzhou) are rising particularly fast; price increases in China’s 2nd or 3rd tier cities (e.g. Hangzhou or Xuzhou) are much more modest. See Figure 8.

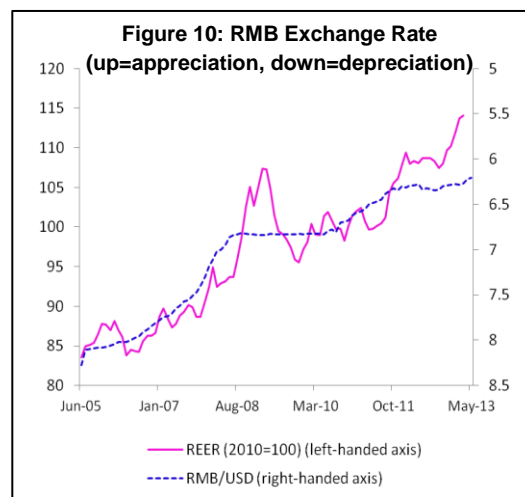
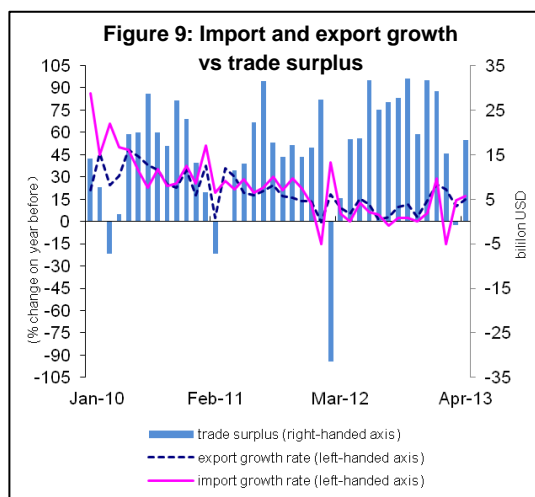
Export figures come under increasing scrutiny

16. According to the official data, China’s exports grew by 14.7 percent in April (on a year earlier), compared with 10 percent in March. China’s shipment to G3 markets continued to drag headline export growth down: exports to Japan grew by -2.9 percent in April (-10 percent in March), to the EU by -6.4 percent in April (-14 percent in March) and to the US by -0.1 percent in April (-6.5 percent in March). By contrast, exports to non-G3 markets increased by 27.2 percent in April, compared with 24.6 percent in March.

17. Rapid growth in China’s official exports to Hong Kong has raised concerns about fake trade

invoicing. On 6 May, SAFE (foreign exchange regulator) announced new restrictions to scrutinise capital inflows disguised as trade bills. This is expected to normalise export figures in the coming months.

18. Imports data are more credible. April's imports grew by 16.8 percent (on a year earlier), compared with 14.1 percent. Growth of imports of iron ore and crude oil saw a relatively quick increase (in volume terms).
19. The balance of exports and imports registered a surplus of \$18.2 billion in April, compared with a deficit of \$0.9 billion in March. **See Figure 9.**



RMB continues to appreciate against both the dollar and in REER terms.

20. The RMB has appreciated against the US dollar by 1.39 percent since the start of the year (0.6 percentage points in the past month). Since the currency was de-pegged in June 2010, the RMB has appreciated by 10 percent. The latest figures (as of 16 April) from The Bank of International Settlement show that the RMB's real effective exchange rate has appreciated by 11.9 percent since June 2010. **See Figure 10.**
21. Yi Gang, Deputy Governor of the PBOC, made it clear at the recent IMF meetings in Washington that further action to liberalise China's exchange rate regime was likely in the coming months.
22. RMB deposits in Hong Kong, an offshore market for the Chinese currency, totalled RMB 668.1 billion (£70.3 billion) in March (latest data), compared with RMB 651.7 billion (£68.6 billion) in February. RMB cross-border trade settlement totalled RMB 340.8 billion (£35.9 billion) in March, increasing 54 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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