British Embassy
Beijing

China Economic Focus – October 2012

Overview:

1. Macroeconomic data for 2012 Q3 and September 2012 were published this month.

2. Headline year-on-year growth was 7.4 percent last quarter, the lowest since the height of the global financial crisis. However, quarter-on-quarter growth, a better way of looking at recent economic performance, rose to 2.2 percent, compared with 2.0 percent in 2012 Q2 (and 1.5 percent in 2012 Q1).

3. Most of the key indicators now appear to have stabilised, including the labour market, fixed asset investment and industrial production:
   - the number of jobs available continues to exceed the number of applicants, suggesting unemployment will not rise imminently;
   - real estate investment continues to decline gradually and is now growing at less than half last year's rate of expansion. Government investment is picking up slowly, as some of investment projects approved earlier this year have got going; and
   - 9.2 percent growth in industrial production is slightly higher than last month and in line with data released since April this year.

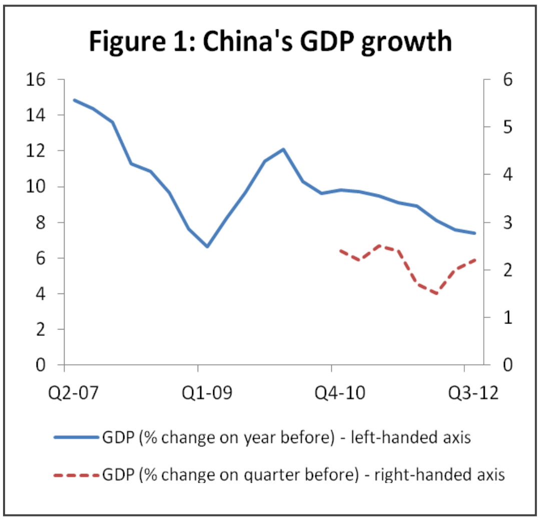
4. Data on consumption, incomes and sector-level growth provide some indication of economic rebalancing.
   - retail sales grew by a nominal 14.2 percent and, thanks to low inflation, real retail sales growth continues to be stronger this year than last year;
   - growth in both urban and rural incomes continues to outpace the overall economy, which implies households are benefiting more from economic growth; and
   - last quarter growth in the services sector picked up, while growth in the manufacturing sector dropped down.

5. If all these trends are sustained over many years, it will bring about the sort of economic rebalancing (from investment to consumption; from manufacturing to services; from corporations to household etc) that is needed for sustainable medium-term growth.

Headline economic growth is stabilising

1. Year-on-year growth was 7.4 percent in 2012 Q3, the lowest in over three years. However, quarter-on-quarter growth, a better way of looking at recent economic performance, rose to 2.2 percent, compared with 2.0 percent in 2012 Q2 and 1.5 percent in 2012 Q1. **See Figure 1**.

2. Mainstream forecasts for 2012 growth as a whole range from 7.5 percent to 8.1 percent. During the IMF annual meeting, PBoC (central bank) Vice Governor Yi Gang predicted that the economy would grow by 7.8 percent.



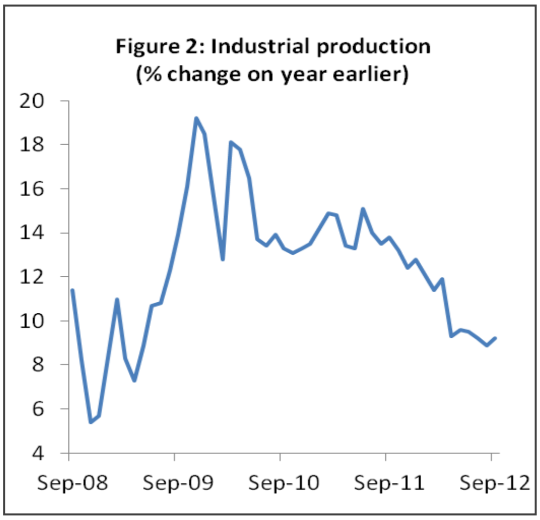
Investment and production indicators are largely unchanged

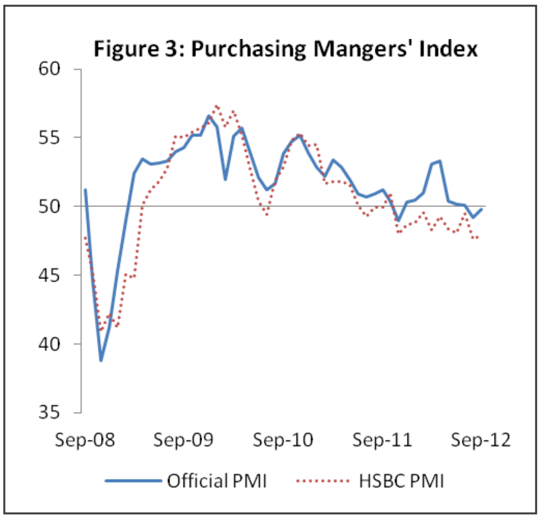
3. Fixed asset investment (FAI) grew by 20.5 percent in the first 9 months of 2012, slightly higher than expectations. Real estate investment continues to decline but government investment is slowly picking up, as some of investment projects approved earlier this year have got going.

4. Growth of industrial production (IP) was consistent with monthly figures since April this year – **see Figure 2**. This month steel and cement production accelerated slightly, while electricity production fell.

5. Forward looking manufacturing indicators are still weak – **see Figure 3**. September's official purchasing managers' index (PMI) improved to 49.8 in September (the first rise in 9 months) but remains below 50, implying continued contraction. The separate HSBC PMI, which provides an assessment of conditions facing firms of small sizes, improved marginally to 47.9 in September.

6. Corporate profitability remains weak. In August (the latest data), corporate profitability contracted by 6.2 percent (on a year earlier), down from -5.4 percent in July.

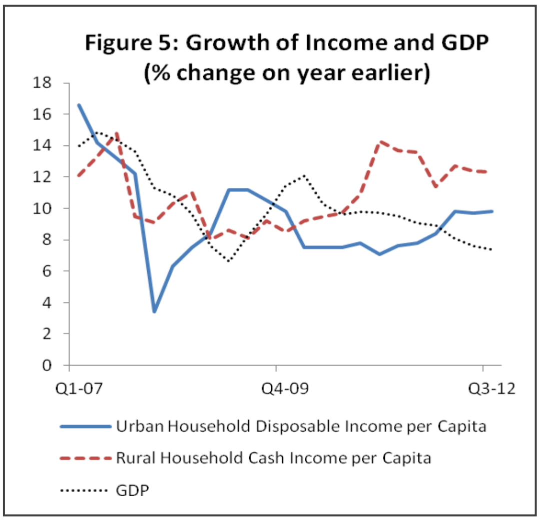




Labour market remains robust

7. The job/job seeker ratio was 1.05 in Q3, the same level in Q2. As **Figure 4** shows, the employment situation remains far better than during the financial crisis in 2008/2009.

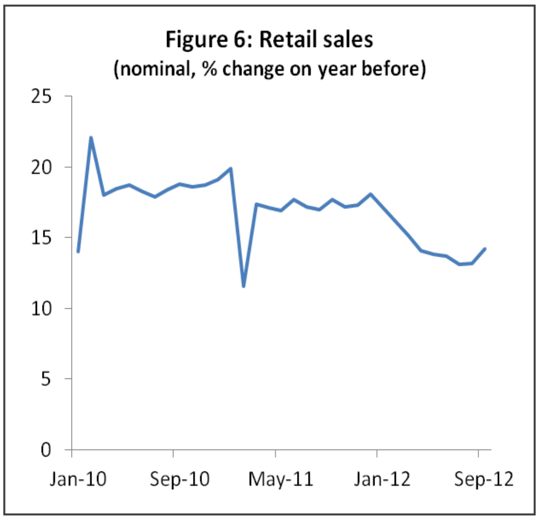
8. Incomes continue to rise rapidly. Growth in both urban and rural incomes continues to outpace the overall economy, which implies households are benefiting more from economic growth – **see Figure 5**.

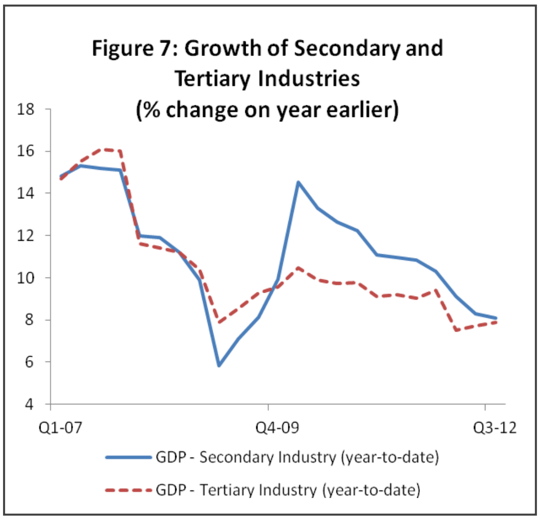


Consumption and services sector growth continue to perform well

9. Growth of retail sales increased by 14.2 percent in September, up from August's 13.2 percent – **see Figure 6**. Thanks to low inflation this year, real retail sales growth continues to be stronger this year than last year. Sales of clothing, medicine, furniture, telecommunications equipment, and building and decoration material saw quick increases.

10. Growth in the service sector picked up last month to 7.9 percent (up from 7.7 percent in Q2), while growth in the manufacturing sector fell back to 8.1 percent (from 8.3 percent over Q2) – **see Figure 7**.





Inflation falls back to 1.9 percent; overall lending rises

11. The consumer prices index (CPI) moderated to 1.9 percent in September, compared with 2 percent in August (both on a year earlier). This was mainly driven by food prices – food prices inflation slowed to 2.7 percent in September from 3.4 percent in August – **see Figure 8**. CPI is predicted to remain at a low level at 2 - 3 percent for the next six months. This is below the official target of 4 percent and allows scope for more stimulus, should the need arise.

12. Producer prices index (PPI), a measure of upstream inflation pressures, continued to contract by 3.6 percent in September, compared with a fall of 3.5 percent in August. The deflation in PPI indicates that producers are not in a rush to raise prices soon.

13. New bank lending totalled RMB 623.3 billion (£62.33 billion) in September, lower than August's RMB 703.9 billion (£70.4 billion) and market expectations of RMB 700 billion (£ 70 billion). However, total social financing (a measure of all forms of new financing, including corporate bonds etc) increased to RMB 1.65 trillion (£165 billion), up from RMB 1.24 trillion (£124 billion) in August – **see Figure 9**.

14. Money supply (M2) grew by 14.8 percent in September, compared with 13.5 percent in August (both on a year earlier). This registered the highest growth since July 2011, and the first time in 2012 that M2 growth reached the official target of 14 percent.

Figure 8: CPI and interest rates

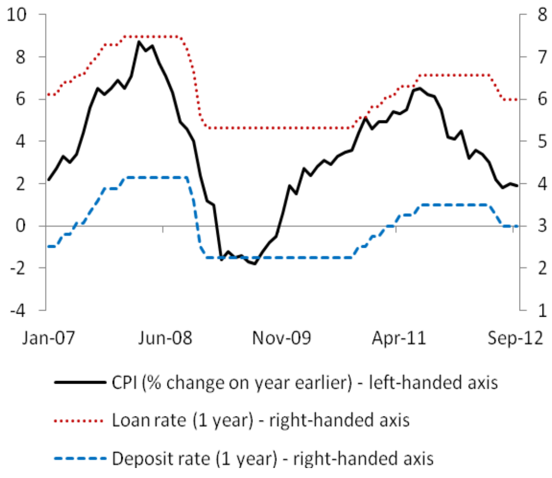
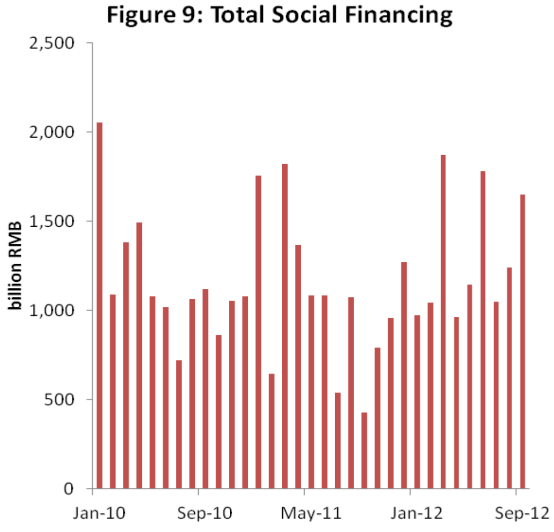


Figure 9: Total Social Financing

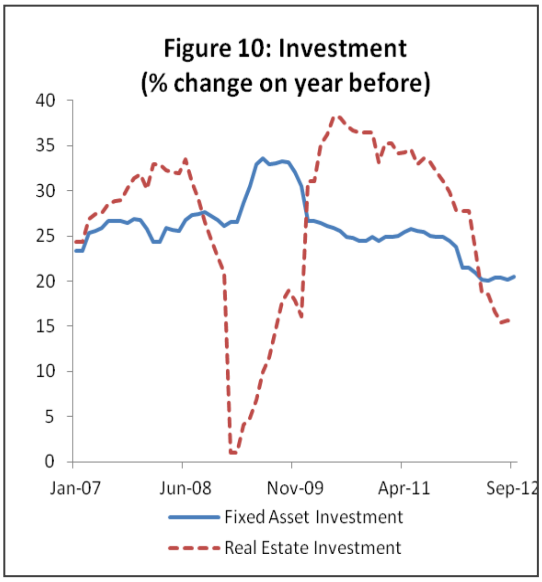


Property restrictions remain in place, suppressing real estate investment

15. Official figures show that 31 of 70 cities surveyed saw property prices increase (in month-on-month terms) in September (compared with 36 in August and 50 in July).

16. In mid-October, Premier Wen Jiabao urged the authorities to continue the implement tightening measures 'unswervingly'.

17. Growth of property investment continued to slow down. In the first 9 months, investment in property increased by 15.4 percent (on a year earlier), down marginally from 15.6 percent in the first 8 months – see graph opposite.

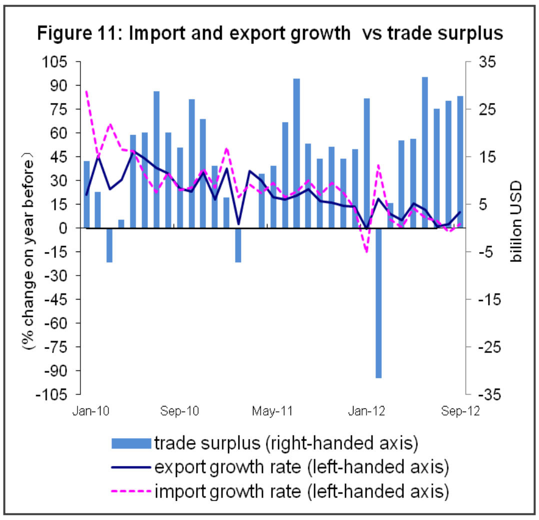


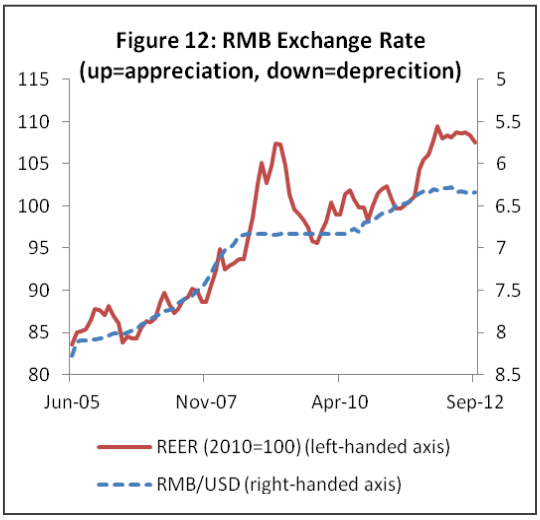
Temporary improvements in trade

18. Exports in September grew by 9.9 percent, compared with 2.7 percent growth in August. However, much of the increase can be explained by seasonal factors, and underlying export conditions remain weak. A decline in exports to the EU continued to be the major drag, but the rate of decline narrowed from July to September.

19. Imports increased by 2.4 percent in September, an improvement from a fall of 2.6 percent August (both on a year earlier). This was largely due to the continued decline in commodity prices.

20. The balance of exports and imports registered a trade surplus of $27.7 billion in September, expanding from $26.7 billion in August and above market consensus of $20.5 billion. Foreign exchange reserves totalled $3.29 trillion by the end of Q3, suggesting a $50 billion increase in Q3 (compared with a $65 billion decline in Q2).





RMB remains essentially flat

21. The RMB exchange rate against dollar has appreciated by 0.6 percent between 10 – 19 October and is now at the highest level for many years – **see Figure 12**. However, most forecasts are for the RMB to remain essentially flat against the dollar in the medium term.

22. Between June 2010 (when the currency was de-pegged) and 19 October, the RMB has appreciated by 8.1 percent against the dollar and by 5.6 percent against the RMB's real-effective exchange rate (REER – trade-weighted and inflation-adjusted)

23. RMB deposits in Hong Kong, an offshore market for the Chinese currency, decreased to 552.3 billion (£55.2 billion) in August, down 1.9 percent from July. RMB cross-border trade settlement totalled RMB 254.2 billion (£25.4 billion) in August, down 13.8 percent on a monthly basis.

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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