British Embassy
Beijing

China Economic Focus – May 2015

Overview

- The economic data published this month were the first of 2015 to have not been distorted by the unusually early Chinese New Year this year. They showed growth continues to slow, largely as a result of a slow-down in the growth rates of investment (especially property investment) and credit. Other aspects of the economy, including retail sales and services' activity, continue to hold-up well and the available data show the labour market remains tight.

- Further small amounts of economic stimulus were introduced this month, including a 25 basis-points cut to interest rates. This was the third interest rate cut introduced since last November and follows reductions to banks' required reserve ratio and accelerated spending on certain priority areas like transport infrastructure. However, the overall quantum of stimulus remains small, suggesting the authorities are comfortable with current economic situation.

- Visiting various countries in Latin America, Premier Li re-iterated his confidence that this years' growth target of 'around 7.0 percent' will be met. This view is shared by the International Monetary Fund (IMF) who just completed their annual Article IV consultation visit to Beijing. For 2015, the IMF forecast growth of 6.8 percent, inflation of 1.5 percent (the same level as it is now) and continued stability in the labour market.

- The biggest reform measure introduced this month was the further liberalisation of interest rates on deposits. The ceiling for the deposit rate was raised to 1.5 times of the benchmark rate, up from 1.3 times previously. This represents further progress towards full interest rate liberalisation, which is important for both incomes growth, the most important variable for household consumption, and capital allocation.

- The IMF now judge that the RMB is 'no longer under-valued'. This follows more than 10 percent appreciation against the dollar and more than 30 percent appreciation in real-effective exchange rate terms since 2010. It will be decided later this year whether the RMB should be included in the IMF's special drawing rights (SDR) basket of currencies.

- If previous years' experience is a guide, we should expect economic activity to pick-up slightly over the summer months, supported in part by stimulus measures introduced in recent months. A sustained rebound, however, is highly unlikely, and overall growth rates will most probably continue to moderate in the coming years.

Please get in touch if you have any questions or comments. Our details are:

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The Chinese economy continued to slow.

1. Last month, we reported that Chinese economy expanded by 7.0 percent in 2015 Q1 (on a year earlier), compared with 7.3 percent in 2014 Q4. On a quarterly basis (seasonally adjusted), growth slightly slowed to 1.3 percent in 2015 Q1, compared with 1.5 percent in 2014 Q4. **See Figure 1**. **See Figure 2** for latest external growth forecasts**.**

Figure 1: China's GDP Growth(% change on year before)

Figure 2: External growth forecasts for 2014 and 2015

Institute	2014	2015
World Bank	7.4%	7.1%
IMF	7.4%	6.8%
HSBC	7.5%	7.3%
Standard Chartered	7.3%	7.1%
UBS	7.2%	6.8%
CASS	7.3%	7.0%
'Official Target'	'around' 7.5%	'around' 7.0 %
Actual growth	7.4%	--

2. The only major policy action announced this month was the 25 basis points cut to interest rates announced by the People's Bank of China on Sunday 10 May. This was accompanied by further liberalisation of the deposit interest rate, a classic illustration of the authorities' tendency to push forward on reform and stimulus simultaneously.

Latest data for investment and industrial production

3. Fixed asset investment grew by 12 percent year-on-year during the first four months of the year, compared with 13.5 percent year-on-year growth over the first three months of the year. **See figure 3**.

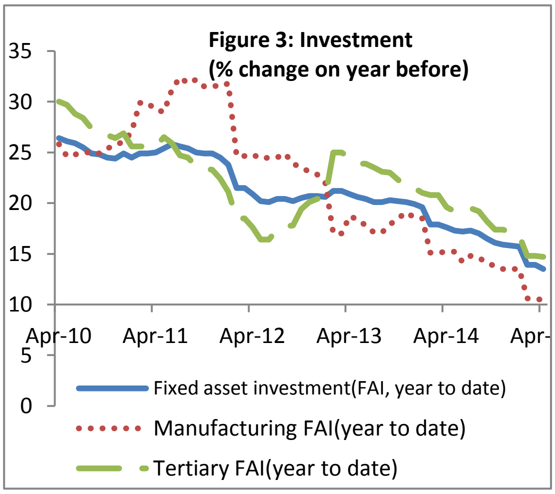


Figure 3: Investment (% change on year before)

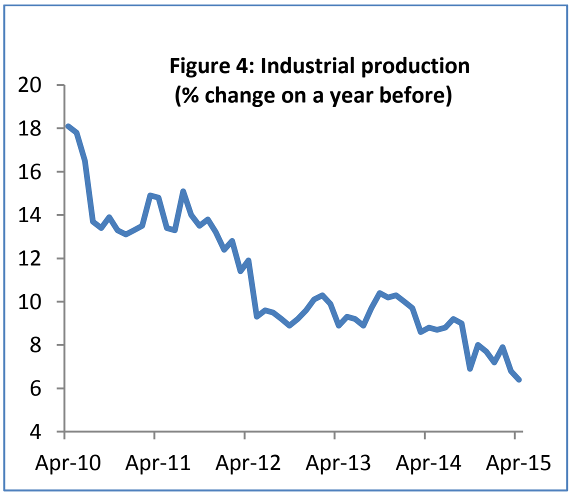
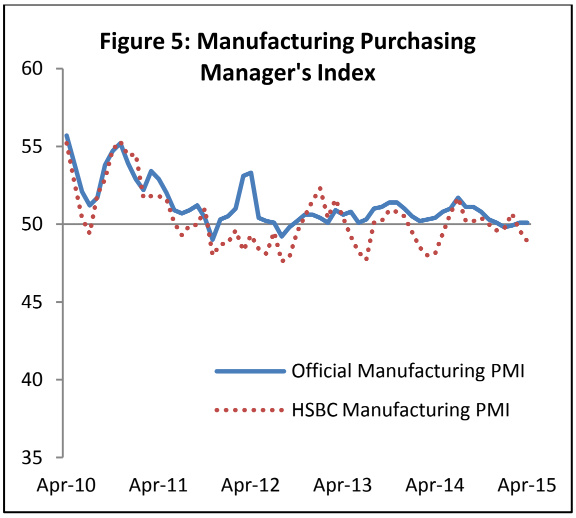


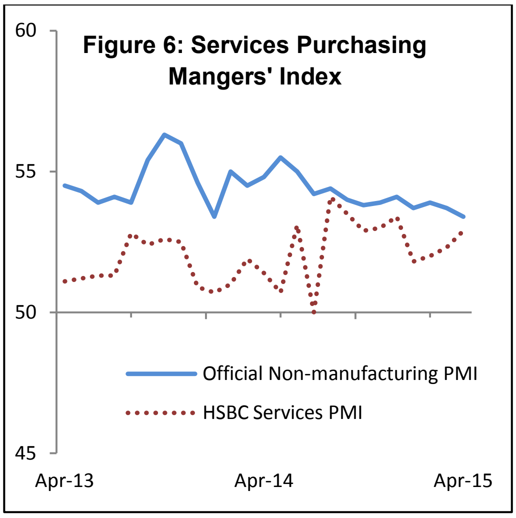
Figure 4: Industrial production (% change on a year before)

4. Industrial production (IP) grew by 6.2 percent in April (on a year earlier), slightly lower than 6.4 percent in March. On a monthly basis (seasonally adjusted), IP growth was 0.57 percent in April, compared with 0.26 percent in March. **See Figure 4.**

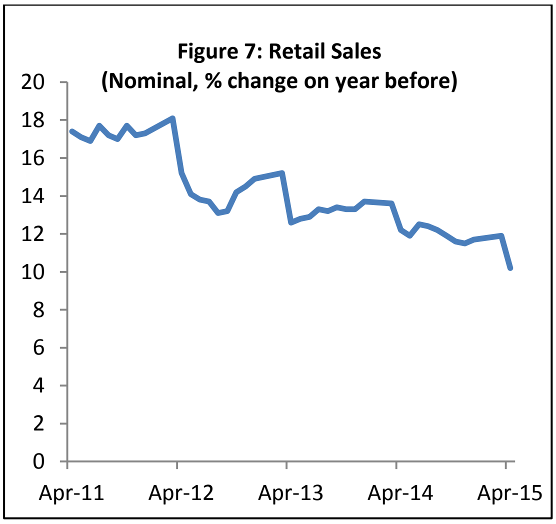
5. The purchasing managers' index (PMI), a forward-looking measure of business conditions, showed slight improvement in March. The official manufacturing PMI remained at 50.1 in April, the same as in March. The HSBC manufacturing PMI, seen as a better measure of conditions facing small businesses, fell to a one year low of 48.9 in April, compared with 49.6 in March.

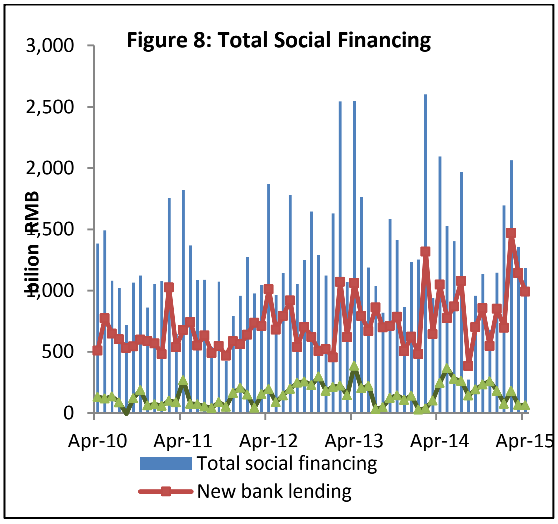
6. Official services PMI was 53.4 in April, compared with 53.7 in March. The HSBC services PMI rose to 52.9 in April, compared with was 52.3 in March. **See Figure 5 and 6.**





7. Growth of retail sales decreased by 9.9 percent in April (on a year earlier), down from 10.2 percent in March (on a year earlier). **See Figure 7.**





Credit growth slower than expected

8. Total social financing (TSF), a measure of all forms of new credit, increased by RMB 1.05 trillion (£105 billion) in April, compared with RMB 1.18 trillion (£118 billion) in March. This was lower than market expectations. **See figure 8.**

9. New bank lending increased by RMB 0.708 trillion (£70.8 billion) in April, compared with RMB 1.18 trillion (£118 billion) in March. This was slightly below market expectations.

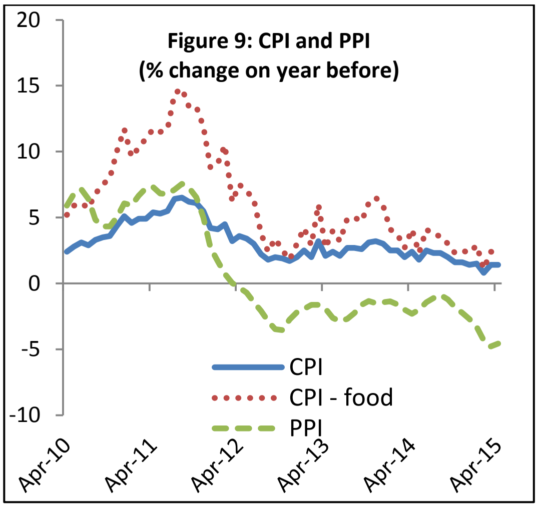
10. The PBOC (Central Bank) decided to further cut the reserve requirement ratio(the amount of cash banks are required to hold bank from lending) by 100bps from April 20, after the RRR cut of 50bps in February. This will inject about RMB 1.2 trillion to the banking system and help lower firms' funding cost.

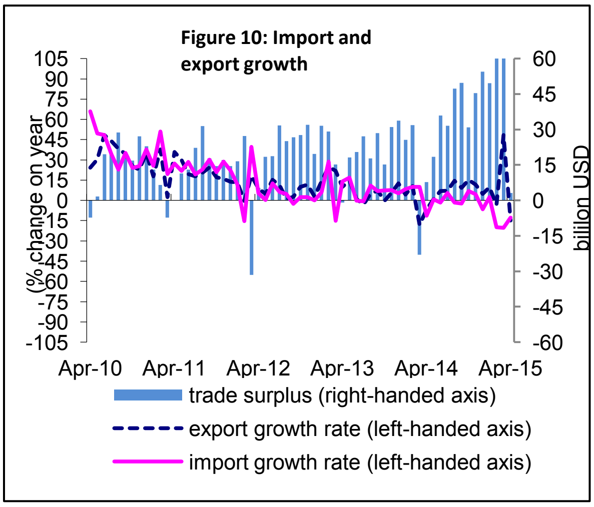
11. Money supply (M2) rose 10.1% in April (on a year earlier), compared with 11.6 percent in March. Bank's RMB position for foreign exchange purchases dropped by RMB 2.307 trillion in March, which means decline in RMB deposits from currency exchange for the private sector.

Inflation remains low and stable.

12. The consumer prices index (CPI) rose by 1.5 percent in April (on a year earlier), slightly lower than 1.4 percent in March. On monthly basis, CPI declined by 0.2 percent in April. The decline was mainly due to the consecutive weak performance in consumption as well as seasonal effects as some food prices noticeably declined after the cold winter season amid the increase of supply.

13. The Producer Prices Index (PPI), an indicator for upstream inflation pressure, declined by 4.6 percent in April (on a year earlier), the same as March. PPI has continued to dive in the past several months, pointing to weak demand in most industries amid overcapacity and deflationary pressure. **See Figure 9.**





Trade data continues to be weak.

14. China's exports declined by 6.4 percent in April (on a year earlier), compared with 15 percent decline in March. The consecutive decline of exports in the past two months probably reflects fluctuations in the global economic recovery as well as negative effects from the consecutive appreciation of the RMB against non-US currencies. The more severe industrial deflation should have also contributed to the deterioration in the export performance in the first quarter.

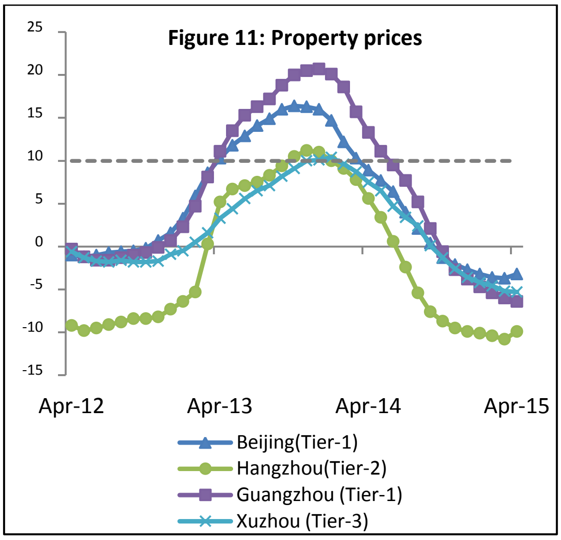
15. Imports plummeted 16.2 percent in April (on a year earlier), compared with 12.7 percent decline in March. The significant decline reflects weak domestic demand as well as severe deflation in most commodity prices.

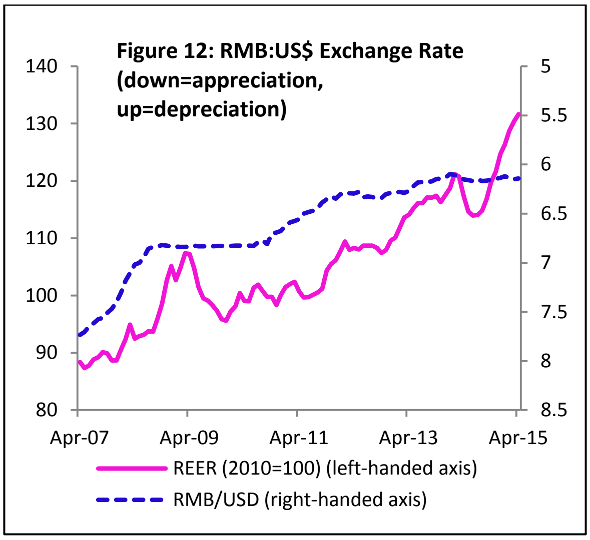
16. China registered a trade surplus of USD 34.1 billion in April, compared with USD 3.1 billion in March. **See Figure 10.**

Property market maintains a deceleration trend

17. Official data show that out of 70 cities surveyed, 48 saw lower property prices in April (on a month earlier), compared with 50 in March. **See figure 11.** Commodity housing sales (in terms of GFA sold) experienced a narrower decline of 4.8% in 4M15 after dropping 9.2% in 1Q15, supported by a noticeable increase in upgrading demand in key cities amid the authorities' consecutive loosening policies.

18. The latest round of monetary loosening may boost housing demand in a few core cities, but its actual effects on property investment and land market activities may be much weaker than expected. We expect property investment to maintain a deceleration trend and continue to pose downside risk to China's economy in the future.





IMF judge that the RMB is 'no longer under-valued'.

19. The RMB:US$ exchange rate has appreciated by 0.28 percent over the past month and has remained broadly flat since the start of the year. **See Figure 12.** According to the Bank of International Settlements, the RMB's real effective exchange rate (REER) depreciated by 0.93 percent compared with March. Compared with January 2010, the RMB:US$ exchange rate has appreciated by 10.44 percent, while the REER has appreciated by 32.98 percent.

20. At a recent Press Conference the IMF stated that "while undervaluation of the Renminbi was a major factor causing the large imbalances in the past, our assessment now is that the substantial real effective appreciation over the past year has brought the exchange rate to a level that is no longer undervalued".

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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