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British Embassy  
Beijing

## China Economic Focus – August 2014

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### Overview

- Following growth of 7.5 percent in 2014 Q2, the latest economic data show a relatively weak start for the Chinese economy to 2014 Q3, with investment, industrial production and retail sales all slowing slightly compared with the previous month.
- The property sector, in particular property investment, continues to be the main drag on growth. Credit conditions also continue to tighten gradually, with annual credit growth around 15 percent, compared with 20 percent last year.
- Some indicators are more positive: exports to all major markets picked up significantly, with China recording its largest trade surplus (in absolute terms) on record. The purchasing managers' indices remain robust (on the whole) and consumer confidence indicators are improving.
- With inflation remaining low and stable and the labour market tight, policy makers have been focusing on reform. Major plans concerning State Owned Enterprises and urban/rural issues were unveiled at the end of July. This past week President Xi chaired the 4th meeting of the Central Reform Leading Group (focussing on SOE reform) and delivered a long speech at the 110 year anniversary of Deng Xiaoping's birth that focused on reform.
- Another major preoccupation for policy makers has been the anti-corruption drive, with the announcement last month of formal investigations into former Chinese Communist Party (CCP) Standing Committee member Zhou Yongkang, the most senior official to have ever been investigated by the CCP.

- Looking ahead, the economy is likely to continue to soften slightly in the coming months, dragged down by the property sector and lower credit growth. It seems unlikely that full year growth will reach 7.5 percent without further stimulus. This year’s growth target is ‘around 7.5 percent’.
- The authorities are unlikely to tolerate growth falling below 7.5 percent: while at the start of the year they emphasised the flexibility of the target, this changed when growth in Q1 came in below expectations. On this basis, we should expect the introduction of further ‘mini stimulus’ in the coming months, likely to be again based around targeted credit-easing and accelerated public investments.
- 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.

**The economy grew by 7.5 percent in 2014 Q2. Policy recently focusing on long-term reform.**

1. The Chinese economy expanded by 7.5 percent in 2014 Q2, a little higher than the 7.4 percent growth recorded in 2014 Q1. **See Figure 1.** A table showing current external forecasts for full year 2014 growth is provided opposite. **See Figure 2.**



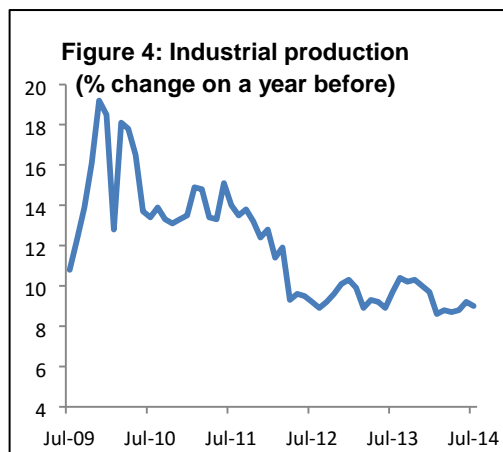
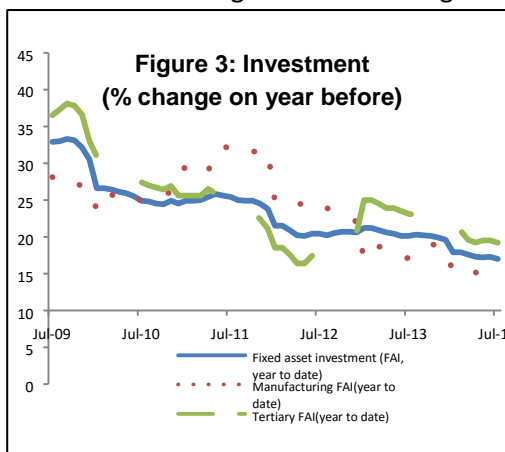
**Figure 2: External growth forecasts for 2014 and 2015**

Institute	2014	2015
World Bank	7.6%	7.5%
IMF	7.4%	7.1%
HSBC	7.5%	--
Standard Chartered	7.4%	--
UBS	7.3%	6.8%
CASS	7.4%	--
'Official Target'	'around' 7.5%	--

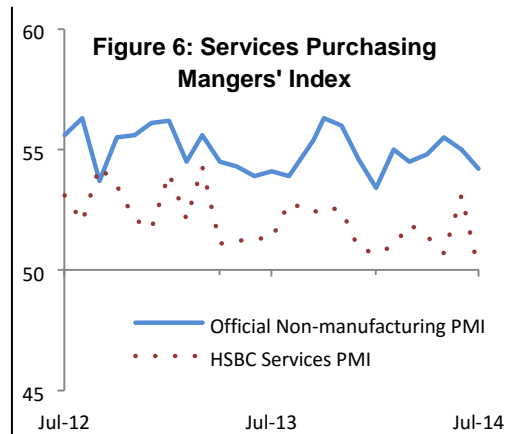
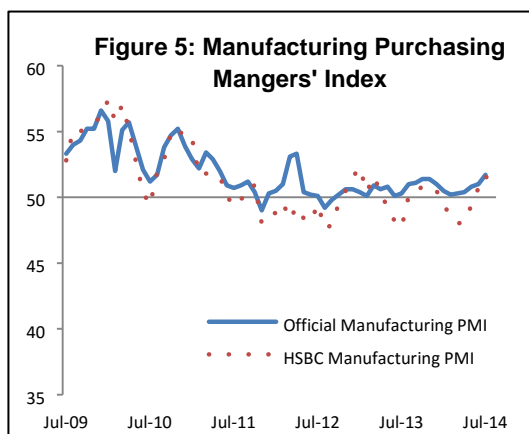
2. A Politburo conference on July 29 set the tone for economic development in the second half of 2014, focusing on continuing macro-economic policies, prioritizing reform and increasing fiscal and financial support. On July 15 the government announced four pilot reforms of SOEs, including developing state-owned capital investment companies and mixed-ownership. On July 30 the government announced a policy on household registration reform, a major breakthrough in speeding up urbanization by equalizing rural and urban status.
3. The biggest focus in July has been anti-corruption. The government announced formal investigations into former CCP Standing Committee member Zhou Yongkang on July 29, signifying the high-point of China’s anti-corruption campaign and consolidating Xi’s power. On the same day CCP also announced to have the Fourth Plenum in October with the rule of law as the main agenda.

**Gradual slowdown of key economic indicators**

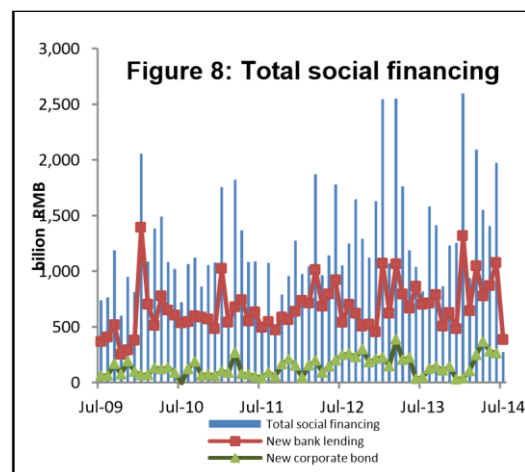
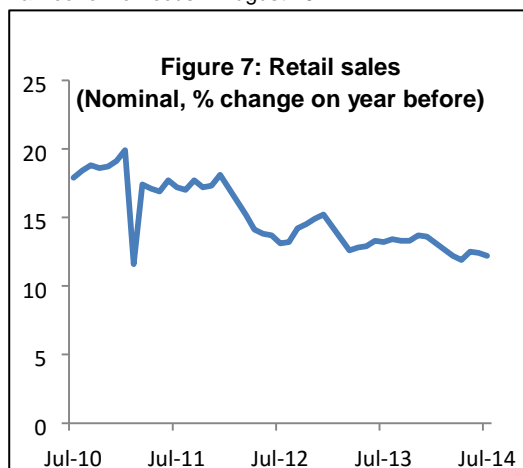
- Headline fixed asset investment (FAI) came in at 17 percent for from January to July (on a year earlier), lower than 17.3 percent in the first six months and lower than market expectations. **See Figure 3.** On monthly basis (seasonally adjusted), FAI growth rose 1.27 percent in July. Property investment was again the main drag.



- Industrial production (IP) grew by 9 percent in July (on a year earlier), compared with 9.2 percent in June. This is slightly lower than market expectations of 9.2 percent. On a monthly basis (seasonally adjusted), IP growth was 0.68 percent in July, compared with 0.77 percent in June. Only growth of cement improved, while growth of production of steel, crude oil, electricity and automobiles all slowed. **See Figure 4.**
- The official manufacturing purchasing managers' index (PMI), a forward-looking measure of business conditions, continued to improve for the fifth month to 51.7 in July, compared with 51 in June. It is the highest since April 2012. The HSBC manufacturing PMI, seen as a better measure of conditions facing small businesses, announced an August 'flash' (i.e. preliminary) estimate of 50.3, down from 51.7 in July. The final August reading will be published at the end of the month. Official services PMI weakened slightly to 54.2 from 55 in June. The HSBC services PMI dropped to 50 from 53.1 in June, the lowest since November 2005. **See Figure 5 and 6.**



- Growth of retail sales increased by 12.2 percent in July (on a year earlier), compared with 12.4 percent in June. On monthly basis (seasonally adjusted), retail sales grew by 0.86 percent in July. Sales of most products slowed, with jewellery sales contraction deepened to -11.7 percent from -0.2 percent in June. **See Figure 7.**

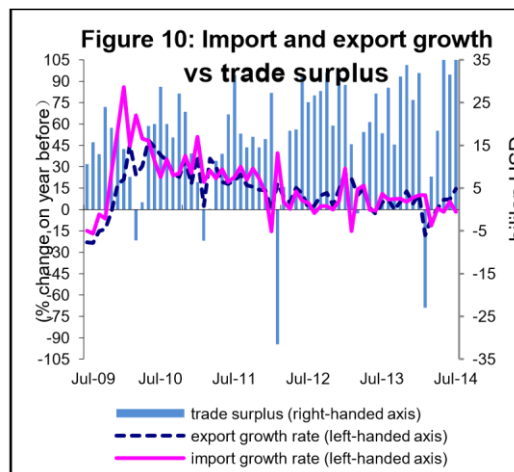
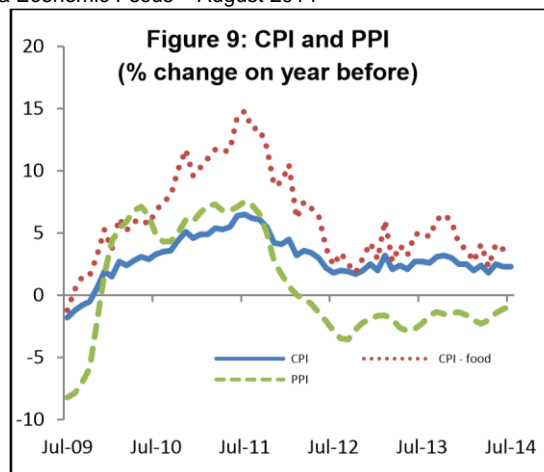


### ***Sharp decline of total social financing and bank lending***

8. Total social financing (TSF), a measure of all forms of new credit, increased by RMB 273.1 billion (£27.31 billion) in July, down from RMB 1.97 trillion (£197 billion) in June, well below expectations. PBOC attributed this decline to high base in June, seasonal volatility, and increasing efforts on risk control. **See Figure 8.**
9. New bank lending in July increased RMB 385.2 billion (£38.52 billion), falling from RMB 1.08 trillion (£108 billion) in June, a decrease of 64 percent. This was attributable to an unusually sharp rise in the issuance of wealth-management products aggravating seasonal falls in lending as banks curtail new lending to ensure they met stringent loan-to-deposit requirements, which are assessed quarterly.
10. Money supply (M2) grew by 13.5 percent in July (on a year earlier), lower than 14.7 percent in June and below expectations. PBOC commented that July monetary data were still within a reasonable range and the direction of monetary policy remained unchanged. It said for the first half of August, loans increased by around 30 billion to 50 billion every day, and expected credit and TSF would increase stably in the future.

### ***Inflation remains low and broadly stable.***

11. The consumer prices index (CPI) rose by 2.3 percent in July (on a year earlier), the same as in June. On monthly basis, CPI rose by 0.1 percent. Food inflation is still the main driver but is contained. Prices rising due to summer holidays also contributed a little to CPI rise.
12. The Producer Prices Index (PPI), an indicator for upstream inflation pressure, declined by 0.9 percent in July (on a year earlier), compared with the decline of 1.1 percent in June. This is the contraction for the fourth month. **See Figure 9.**

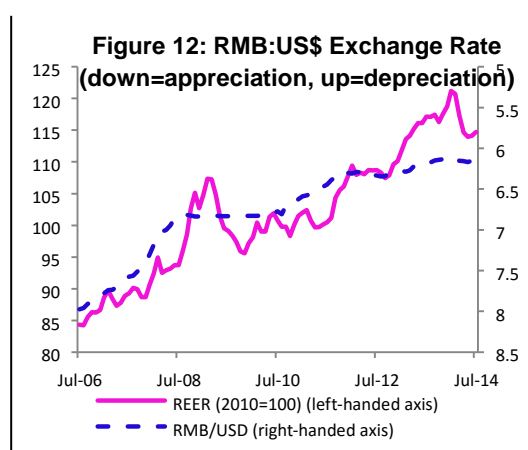
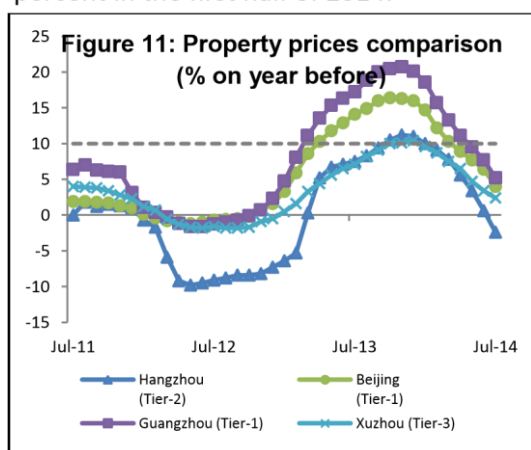


**Strong exports growth but disappointing imports**

- 13. China’s exports rose by 14.5 percent in July (on a year earlier), rebounding from 7.2 percent in June. This was the highest in 15 months and beat market expectations of 7.0 percent. The strong growth was due to the effects of stimulus in previous months, improving demands from developed and emerging market, and increasing exports from private companies.
- 14. Imports declined by 1.6 percent (on a year earlier) in July, compared with an increase of 5.5 percent in June. The sharp decline was largely due to a high base for comparison in 2013. While increasing downward pressure of the economy, difficulties in trade financing and low commodity prices were also the causes.
- 15. China registered a trade surplus of USD 47.3 billion in July, increasing greatly from USD 31.56 billion in June. It is the highest on record. **See Figure 10.**

**The property sector weakens further**

- 16. Official data show that only 2 out of 70 cities surveyed saw higher property prices in July (on a month earlier), compared with 8 in June. All Tier 1 cities (Beijing, Shanghai, Guangzhou and Shenzhen) saw property prices decline (on a month earlier). **See figure 11.**
- 17. 29 of the 46 cities that had previously introduced home purchase restrictions have now relaxed these measures, hoping to stimulate the local housing market. It is too early to tell whether this will have a significant impact, given the significant over-supply of housing that affects some cities in China.
- 18. Property investment grew by 13.7 percent from January to July, further declining from 14.1



### ***The pace of RMB depreciation slows***

19. As of 18 August, the RMB:US\$ exchange rate has depreciated by 0.89 percent since the beginning of the year. It has depreciated by 0.02 percent over the past month. **See Figure 12.** According to the Bank of International Settlements, the RMB's real effective exchange rate (REER) appreciated by 0.57 percent from June to 114.74 in July. From January to July of 2014, the RMB's REER had depreciated by 3.38 percent.
20. From July 1, China's State Administration of Foreign Exchange (SAFE) allowed banks to set their RMB exchange rate in their over-the-counter deals with clients on the basis of market demand. This is a further step in the liberalization of RMB exchange rates.

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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