



British Embassy
Beijing

China Economic Focus – October 2014

Overview

- China's economic slowdown continues. Growth in 2014 Q3 registered 7.3 percent (year-on-year), below 7.5 percent in Q2 and the lowest quarterly growth figure since 2009. On a sequential basis, growth slowed to 1.9 percent, down from 2.0 percent in Q2.
- It's clear why growth is slowing. Fixed investment growth has decelerated from 21 percent in January 2013 to 16 percent in September 2014. Property investment, a subset, has slowed further, down to 12.5 percent in September 2014 from 23 percent growth in January 2013.
- Industrial production, which expanded in August at the slowest pace since the global financial crisis, recovered to 8 percent growth. Inflation dropped markedly in September to 1.6 percent, compared with 2.0 percent in August. The producer price index remains below zero.
- Latest data also reveal the continuation of a number of trends that point towards a steady, structural deceleration rather than anything more dramatic. Retail sales, incomes and the services sector all showed robust growth, which is positive for internal economic rebalancing.
- Crucially, the labour market, always the main focus of the authorities' attention, remains robust, with official data showing this year's target for urban job creation had already been met at the end of September. Growth in median income continued to outpace nominal GDP growth, meaning that the average household is enjoying an increasing share of dividends from growth.
- As a result, the authorities are unlikely to introduce large-scale stimulus measures soon. Premier Li Keqiang and other senior figures said that growth during the three quarters of 2014 remained 'in a reasonable range' and described the situation as a 'new normal'.
- Monetary policy is likely to remain relatively tight, including as a result of a regulatory clamp-down on shadow-banking and other more exotic forms of financial intermediation. Credit continues to grow faster than headline GDP, meaning that China's debt-to-GDP ratio continues to rise, but pace of expansion has been slowing steadily for the past 18 months.
- The Communist Party's fourth plenum in October focused on rule of law. While this is less-clearly relevant to the economy than, say, last year's 3rd Plenum, many economists see creating a transparent and predictable legal system as one of China's greatest challenges to sustainable growth.
- 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 7.3 percent in 2014 Q3. Provincial GDP growth all slowed.

1. The Chinese economy expanded by 7.3 percent in 2014 Q3, lower than 7.5 percent in Q2 (both year-on-year). This was the lowest since 2009 but slightly higher than market consensus (7.2 percent). On a quarterly basis (seasonally adjusted), growth slightly slowed from 2.0 percent in Q2 to 1.9 percent in Q3. **See Figure 1. See Figure 2** for latest external growth forecasts.



Figure 2: External growth forecasts for 2014 and 2015

Institute	2014	2015
World Bank	7.4%	7.2%
IMF	7.4%	7.1%
HSBC	7.5%	--
Standard Chartered	7.4%	7.0%
UBS	7.2%	6.8%
CASS	7.3%	7%
'Official Target'	'around' 7.5%	--

2. The primary sector (agriculture) grew by 4.2 percent in Q3, up from from 3.9 percent in Q2, the secondary sector (manufacturing) remained the same 7.4 percent as in Q2, and the tertiary sector (services) slowed slightly to 7.9 percent in Q3 compared with 8.0 percent in Q2.

3. Growth in Q3 in most provinces also slowed year-on-year. But growth was relatively stable compared with Q2. **See Figure 3.**

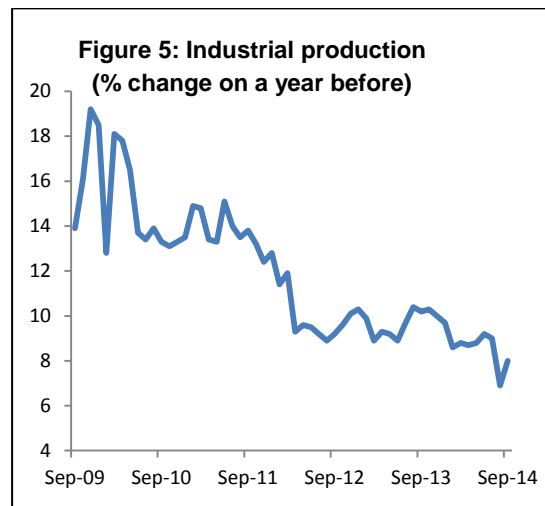
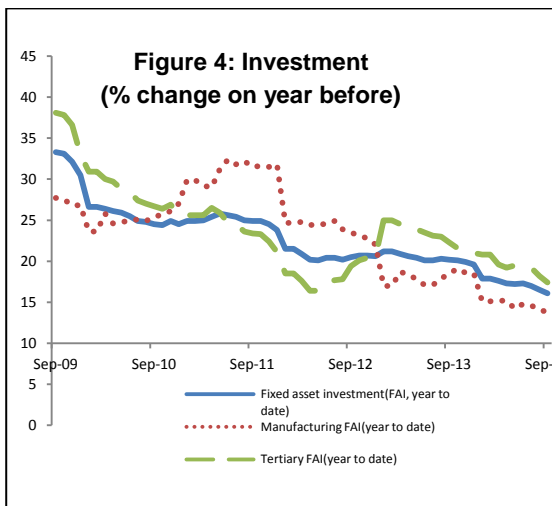
Figure 3: Local GDP growth in 2014 Q2 and Q3, with 2013 figures in (), percent growth

Provinces/ Municipalities	Q2 2014	Q3 2014
Beijing	7.2 (7.7)	7.3 (7.7)
Tianjin	10.3 (12.5)	10.0 (12.6)
Hebei	5.8 (8.7)	6.2 (8.5)
Shanxi	6.1 (9.0)	5.6 (9.0)
Guangdong	7.5 (8.5)	7.6 (8.5)
Sichuan	8.5 (10.1)	8.5 (10)
Chongqing	10.9 (12.4)	10.8 (12.4)
Yunnan	8.4 (12.4)	8.0 (12.1)

4. The 18th Central Committee of the Communist Party of China concluded its fourth plenary session in Beijing on October 23. It discussed advancing a rule of law in order to “form a system serving the socialist rule of law with Chinese characteristics.” The rule of law would benefit a market economy through implementing a stronger, more transparent and less political legal system.

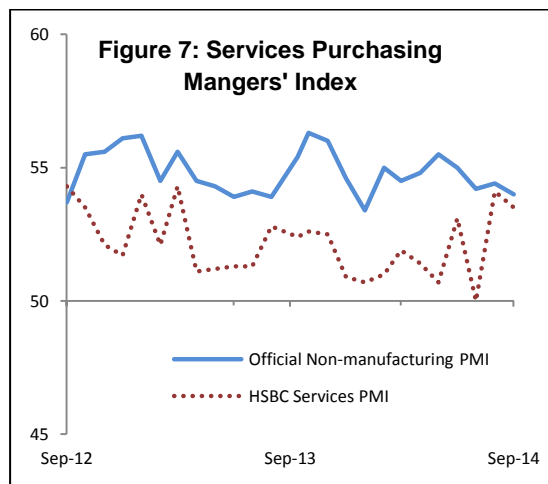
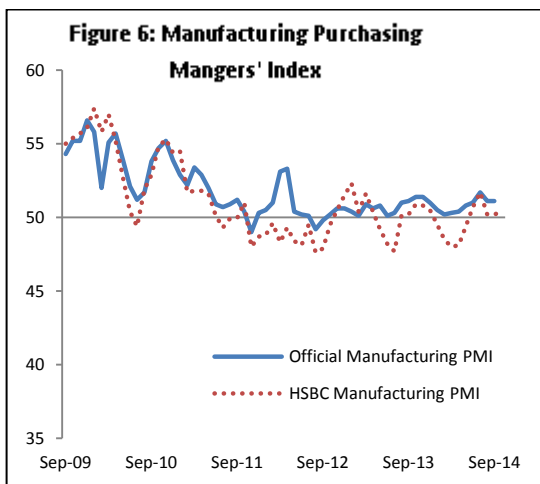
Key economic indicators were not bad.

5. Headline fixed asset investment (FAI) increased by 16.1 percent between January to September (on a year earlier), down from 16.5 percent from January to August and weaker than market expectations. **See Figure 4.** On monthly basis (seasonally adjusted), FAI growth rose 0.77 percent in September. Manufacturing investment slowed to the lowest in records.

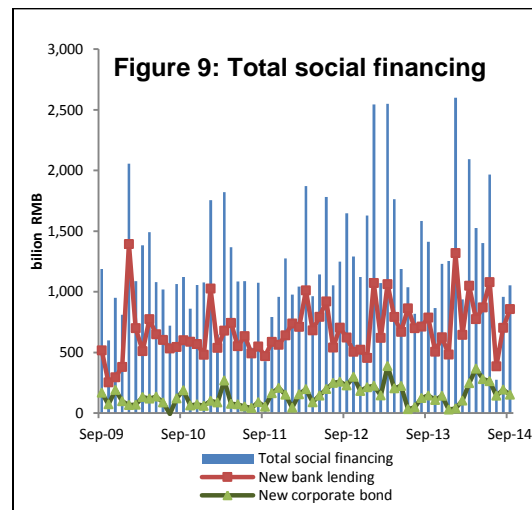
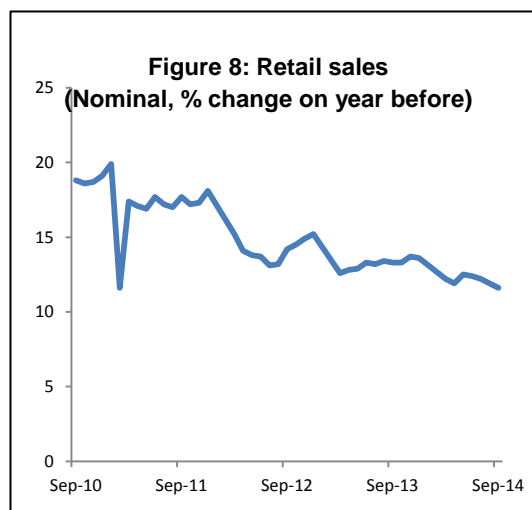


- 6. Industrial production (IP) grew by 8.0 percent in September (on a year earlier), improving from 6.9 percent in August and higher than market expectations. On a monthly basis (seasonally adjusted), IP growth rose to 0.91 percent in September from 0.2 percent in August. Electricity production increased by 4.1 percent, compared with 2.2 percent decline in August. **See Figure 5.**

- 7. The official manufacturing purchasing managers’ index (PMI), a forward-looking measure of business conditions, came in at 51.1 in September, the same as August. The HSBC manufacturing PMI, seen as a better measure of conditions facing small businesses, was 50.4 in the flash reading for October, up from 50.2 in the final reading for September. Official services PMI went down to 54 in September from 54.4 in August. The HSBC services PMI fell to 53.5 in September from a seventeen-month high of 54.1 in August. **See Figure 6 and 7.**



- 8. Growth of retail sales increased by 11.6 percent in September (on a year earlier), slightly down from 11.9 percent in August. On monthly basis (seasonally adjusted), retail sales grew by 0.85 percent in September. **See Figure 8.**

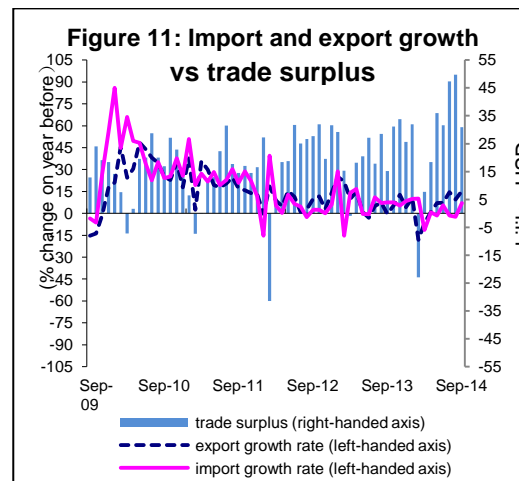
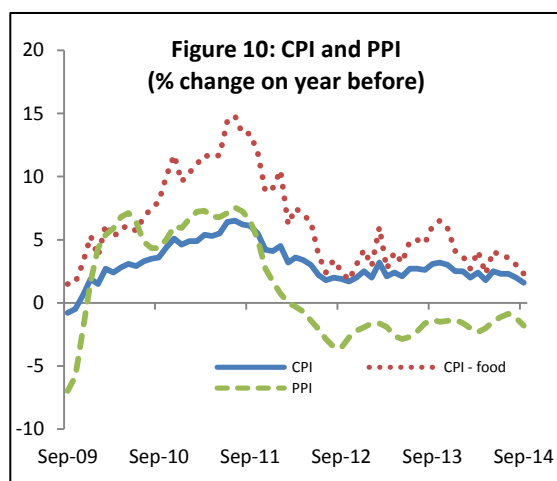


Total social financing and bank lending stable

9. Total social financing (TSF), a measure of all forms of new credit, increased by RMB 1.05 trillion (£105 billion) in September, improving marginally from RMB 957.4 billion (£95.74 billion) in August. The increase is mainly due to loan growth, while trust loans and bankers' acceptance notes continued to decline in response to tighter regulations on the shadow banking system. **See Figure 9.**
10. New bank lending increased by RMB 857 billion (£85.7 billion) in September, improving from RMB 702.5 billion (£70.25 billion) in August. By breakdown short term lending rebounded.
11. Money supply (M2) grew by 12.9 percent in September (on a year earlier), compared with 12.8 percent in August. This is in line with expectations.

Inflation remains low with rising risk of deflation.

12. The consumer prices index (CPI) rose by 1.6 percent in September (on a year earlier), compared with 2.0 percent in August. This was slightly below market expectations and was the lowest since January 2010. On monthly basis, CPI rose by 0.5 percent. Food inflation slowed but was still the main driver.
13. The Producer Prices Index (PPI), an indicator for upstream inflation pressure, declined by 1.8 percent in September (on a year earlier), compared with the decline of 1.2 percent in August. **See Figure 10.**



Labour market remains stable

- 14. Income growth remained stable. Growth of rural income continued to outpace headline GDP growth. It grew by 9.7 percent in Q3, slightly lower than 9.8 percent in Q2. Growth of urban income slowed to 6.9 percent in Q3, compared with 7.1 percent in Q2.
- 15. The labour market has met full year target. New urban employment totalled 10.82 million people in Q3, slightly higher than that in the same time last year, and exceeding 2014 target of 10 million.

Exports growth strong and imports rebound

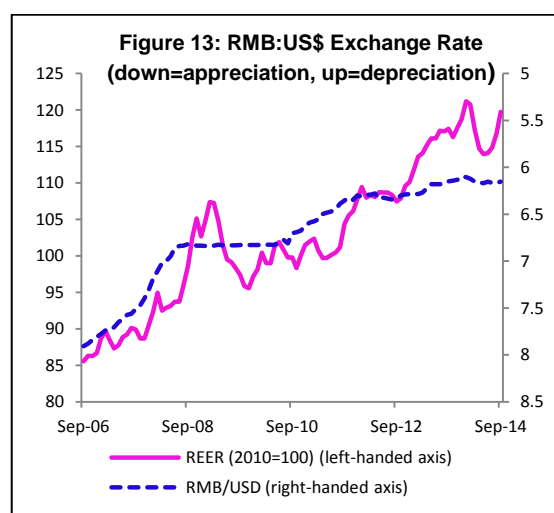
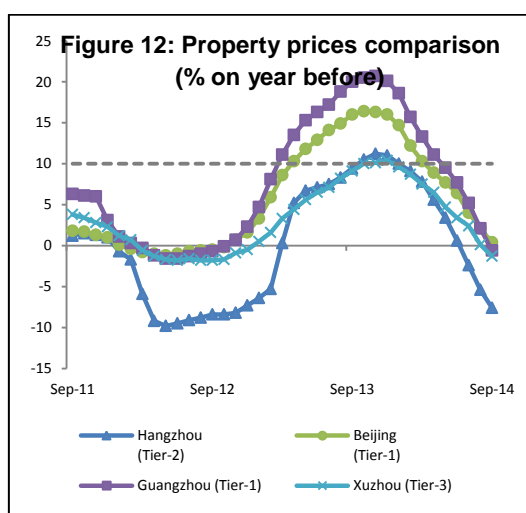
- 16. China’s exports rose by 15.3 percent in September (on a year earlier), up from 9.4 percent in August and higher than market consensus. This is due to last year’s low base and improving external demands.
- 17. Imports rebound to 7.0 percent (on a year earlier) in September, compared with of 2.4 percent decline in August and much higher than market expectations. Processing imports increase played a big role in the rebounding.
- 18. China registered a trade surplus of USD 30.9 billion in September, down from USD 49.8 billion in August due to the big increase in import. **See Figure 11.**
- 19. The spokesman of China Customs attributed trade growth in Q3 to the government’s measures of boosting trade and companies’ improving confidence, recovery of external demands, and reform of the customs. Although he was optimistic toward trade outlook, the spokesman also pointed out three difficulties: the competitiveness of Chinese exports products was weakened, investment from developed countries in manufacturing fell sharply, and commodity price continued to fall.
- 20. China’s foreign exchange reserves totalled USD 3.89 trillion as of end September 2014, compared with USD 3.99 trillion as of end June 2014.

The property sector weakens further

21. Official data show that out of 70 cities surveyed, none saw higher property prices in September (on a month earlier), compared with 1 in August. But the contraction of property price slowed slightly compared with August. Only 10 out of the 70 cities had higher property prices in September on year before. **See figure 12.**

22. On September 30, PBoC and CBRC (China’s banking regulator) jointly released an announcement to support the sluggish property market. The criteria for ‘first-time home buyer’ were relaxed. ‘First-time home buyer’ can enjoy favourable policies, including relatively low down payment (minimum 30%) and discounted interest rates. The policy easing is expected to help property sales.

23. Property investment grew by 12.5 percent from January to September, further down from 13.2 percent from January to August.



RMB:\$ exchange rate still down on the year but no longer depreciating

24. As of 24 October, the RMB:US\$ exchange rate has depreciated by 0.79 percent since the beginning of the year. It has appreciated by 0.34 percent over the past month. **See Figure 13.** According to the Bank of International Settlements, the RMB’s real effective exchange rate (REER) appreciated by 2.54 percent from August to 119.75 in September. From January to September of 2014, the RMB’s REER had appreciated by 0.84 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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