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British Embassy  
Beijing

## China Economic Focus – September 2014

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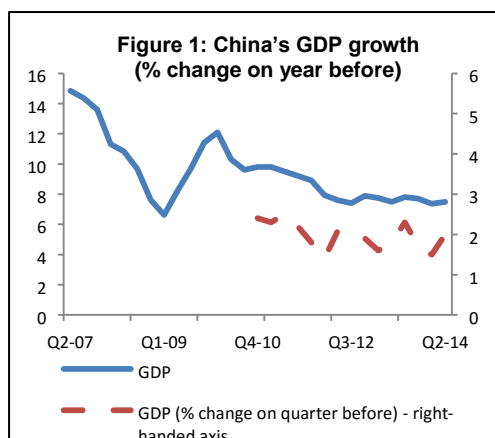
### Overview

- China's economy has resumed its slow-down, following a short-lived pick-up in activity in Q2 this year. Industrial production recorded its lowest figure since December 2009; fixed asset investment its lowest since 2002; retail sales edged down to 11.9 percent (year-on-year), one of the lowest readings on record. Absent intervention, annual growth looks likely to fall toward 7.0 percent, compared with an official target of 'around 7.5 percent'.
- So far the authorities appear calm. No new stimulus policies have been announced since the data was released. A recent liquidity injection from the PBOC, which was misinterpreted by some analysts as stimulus, was much more likely to be normal operations ahead of the National Day holidays next week.
- Three factors explain their response:
  - the labour market remains tight. According to official data, 9.7 million urban jobs were created between January–August this year, 100,000 more jobs than over the same period in 2013 (which itself was a record year for employment generation);
  - not all economic indicators are gloomy. Both exports and the purchasing managing indices, a forward-looking gauge of business conditions, are still strong. Some of the weakness of the August data is attributable to a base-effect from last year; and
  - there is little alternative. China's leaders know the economy's growth potential is in long-term decline and that reversing this would only exacerbate structural weaknesses.

- We therefore shouldn't expect a significant pick-up in growth. The down-turn in the property market, caused by over-supply in some areas, will continue. Credit conditions will continue to tighten, as the authorities step-up regulatory oversight after many years of rapid credit growth. Tighter credit will continue to plague those sectors plagued by over-capacity, as illustrated by a recent potential loan default by Sinosteel, a major State Owned Enterprise.
- However, we also shouldn't expect growth to slow further. Premier Li Keqiang and his peers won't allow the growth target to be missed completely. Doing so could destabilise expectations, causing private businesses to delay investments, with knock-on effects for employment. It would also damage the leadership's credibility as guardians of economic stability.
- So full year growth of around 7.3 percent in 2014 remains likely. Achieving this will require (at least) further targeted investments in rail and social housing, and some credit easing.
- 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.**



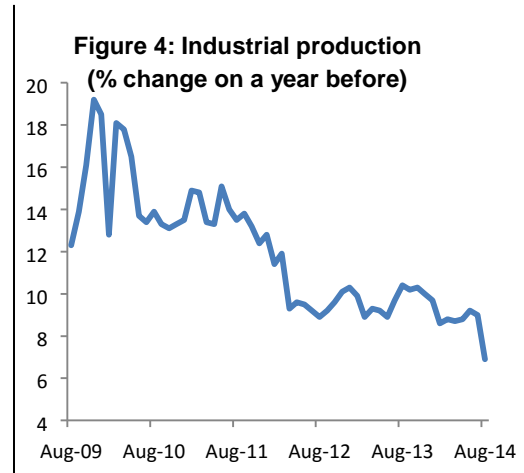
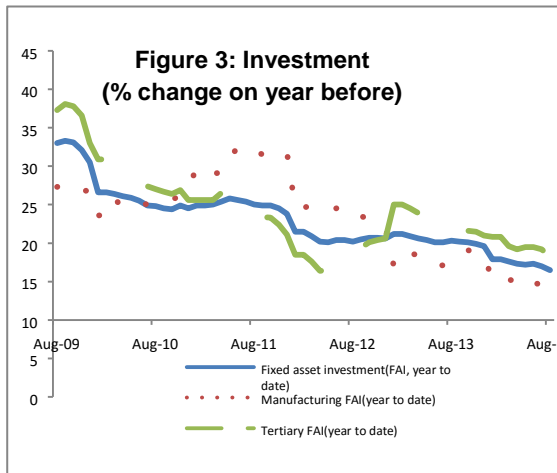
**Figure 2: External growth forecasts for 2014 and 2015**

Institute	2014	2015
World Bank	7.6%	7.5%
IMF	7.4%	7.1%
HSBC	7.5%	--
Standard Chartered	7.4%	7.0%
UBS	7.2%	6.8%
CASS	7.4%	--
'Official Target'	'around' 7.5%	--

2. On 31 August, China's National People's Congress Standing Committee approved the amendment of the budget law, which will come into effect on 1 January 2015. The revised budget law regulates local governments' debt, reduces special transfer payment, increases transparency, enhances NPC supervision and restores central bank's role as manager of Treasury department. On 3 September, the State Council Executive Meeting also decided to improve budget management and transparency.
3. On September 2 Chinese Premier Li Keqiang presided a meeting discussing the drafting of the 2016-2020 national development plan. Li said China should continue to take development as the top priority, put emphasis on reform and innovation and seek greater progresses in promoting scientific development, transforming the development pattern and resolving deep-rooted problems, so as to maintain a medium and high growth of the economy.

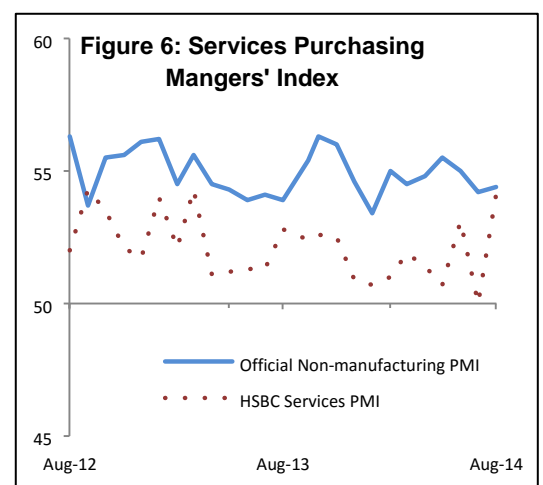
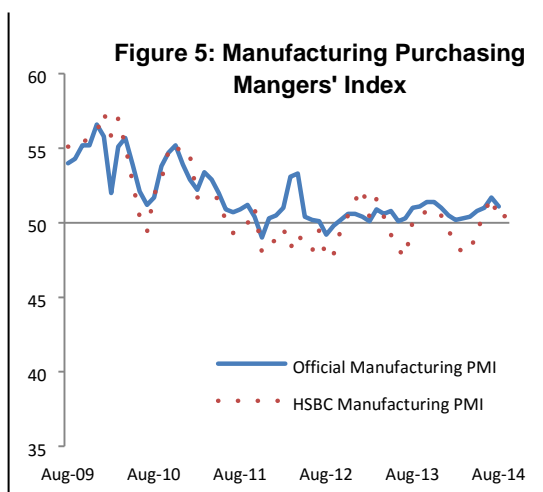
**Slowdown of key economic indicators**

- Headline fixed asset investment (FAI) came in at 16.5 percent from January to August (on a year earlier), further down from 17 percent from January to July and lower than market expectations. This is the lowest since 2002. **See Figure 3.** On monthly basis (seasonally adjusted), FAI growth rose 1.23 percent in August. Property investment, manufacturing investment and infrastructure investment all slowed.

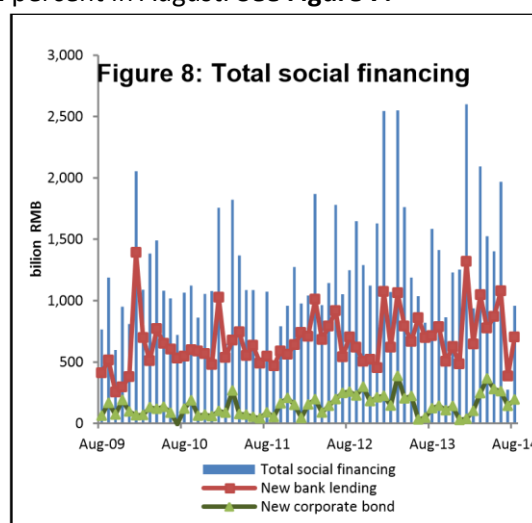
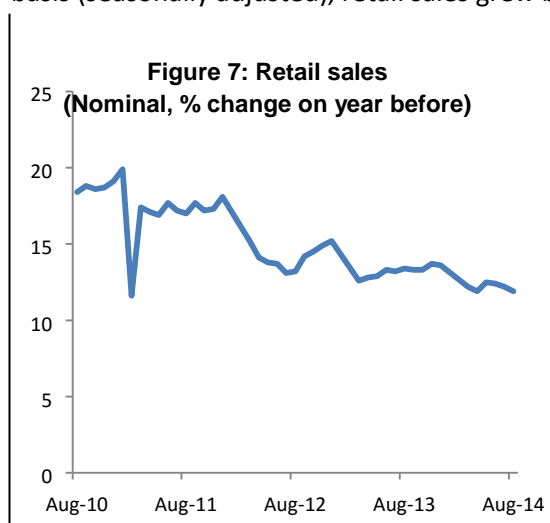


- Industrial production (IP) grew by 6.9 percent in August (on a year earlier), declining from 9 percent in July. This is much lower than market expectations and is the lowest since March 2009. On a monthly basis (seasonally adjusted), IP growth was only 0.2 percent in August, compared with 0.62 percent in July. Only growth of crude oil improved. Electricity production fell 2.2 percent, compared with 3.3 percent growth in July. **See Figure 4.**

- The official manufacturing purchasing managers' index (PMI), a forward-looking measure of business conditions, came in at 51.1 in August, lower than 51.7 in July. The HSBC manufacturing PMI, seen as a better measure of conditions facing small businesses, was 50.5 in the Flash reading for September, up from the final reading of 50.2 in August. Official services PMI improved slightly to 54.4 from 54.2 in July. The HSBC services PMI rebounded to a seventeen-month high of 54.1 in August after dropped to 50 in July. **See Figure 5 and 6.**



- Growth of retail sales increased by 11.9 percent in August (on a year earlier), compared with 12.2 percent in July. It was relatively stable but was still one of the lowest points in records. On monthly basis (seasonally adjusted), retail sales grew by 0.92 percent in August. **See Figure 7.**

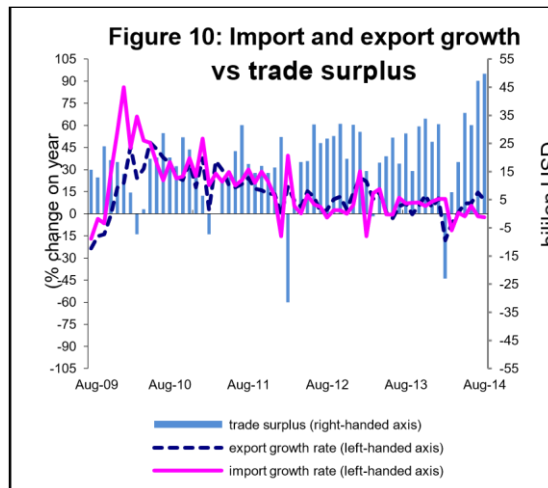
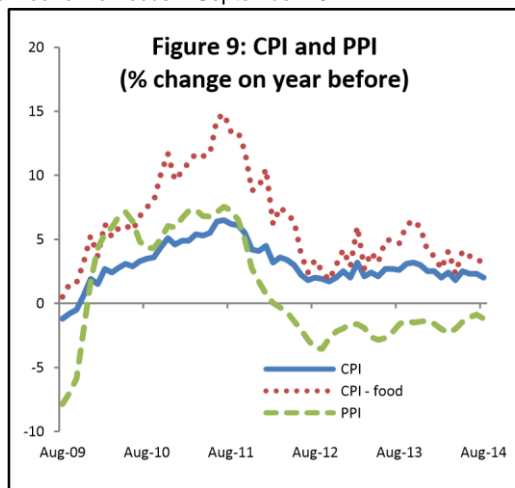


**Recovery of total social financing and bank lending**

- Total social financing (TSF), a measure of all forms of new credit, increased by RMB 957.4 billion (£95.74 billion) in August, improving from RMB 273.1 billion (£27.31 billion) in July but still lower than the same period last year. This is still due to government’s efforts on risk control. **See Figure 8.**
- New bank lending in August increased RMB 702.5 billion (£70.25 billion), rising from 385.2 billion (£38.52 billion) in July. The recovery of loan growth mainly came from cooperate loan growth, partly due to recent efforts in solving the problems of enterprises’ financing.
- Money supply (M2) grew by 12.8 percent in August (on a year earlier), compared with 13.5 percent in July (on a year earlier) and below market expectations. This is below the official target of 13 percent.

**Inflation remains low and broadly stable.**

- The consumer prices index (CPI) rose by 2.0 percent in August (on a year earlier), compared with 2.3 percent in July and lower than expectations. On monthly basis, CPI rose by 0.2 percent. Food inflation is still the main driver and some food inflation such as bananas, apples and eggs are very high. But this is offset by a slack housing market.
- The Producer Prices Index (PPI), an indicator for upstream inflation pressure, declined by 1.2 percent in August (on a year earlier), compared with the decline of 0.9 percent in July. **See Figure 9.**

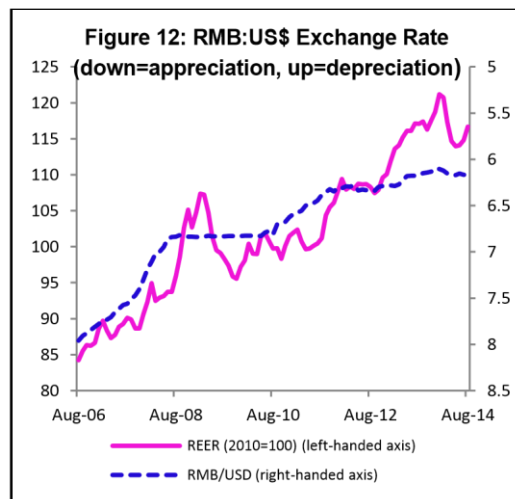
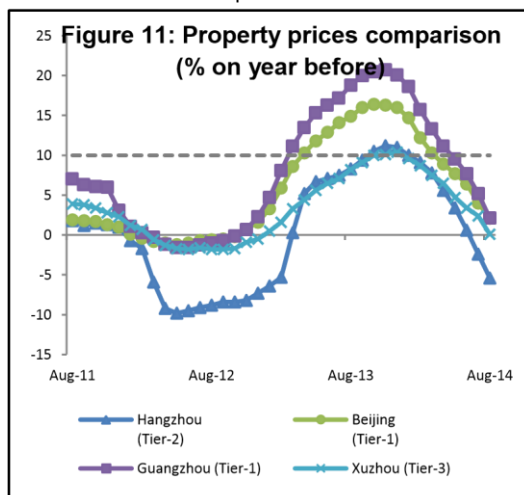


**Exports growth resilient but imports disappoint**

- 13. China’s exports rose by 9.4 percent in August (on a year earlier), dropping from 14.5 percent in July. This is largely in line with market expectations. As July figure was largely due to base effect, August growth is still resilient. The stable growth shows external demands is improving.
- 14. Imports declined by 2.4 percent (on a year earlier) in August, compared with of 1.6 percent decline in July. This is due to still weak domestic demand and further decline in import prices.
- 15. China registered a trade surplus of USD 49.8 billion in August, further increasing from USD 47.3 billion in July. It is the highest in record. **See Figure 10.**
- 16. People Daily, the official newspaper of the Communist Party, commented that China’s trade has entered a period of transformation after three decades’ high-speed increase. It is unrealistic to keep two-digit growth and it will be slightly higher or the same as GDP growth for the long run.

**The property sector weakens further**

- 17. Official data show that only 1 out of 70 cities surveyed saw higher property prices in August (on a month earlier), compared with 2 in July. All Tier 1 cities (Beijing, Shanghai, Guangzhou and Shenzhen) saw property prices decline (on a month earlier). **See figure 11.**
- 18. The impact of easing home purchase restrictions in some cities is limited. Some provinces are beginning a second round of stimulus to help the property market. There is possibility that if this round still could not help improve the market, the central government might take some stimulus again.
- 19. Property investment grew by 13.2 percent from January to August, lower than 13.7 percent from January to July.



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

20. As of 22 September, the RMB:US\$ exchange rate has depreciated by 0.82percent since the beginning of the year. It has appreciated by 0.03 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 1.62 percent from July to 116.68 in August. From January to August of 2014, the RMB’s REER had depreciated by 1.74 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:

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