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British Embassy
Beijing

China Economic Focus –January 2015

Overview

- Annual data for 2014 were recently published. The headline figure was growth of 7.4 percent, consistent with the authorities' target of 'around 7.5 percent'.
- Predictably the media focused on the fact that growth was the slowest for 24 years. This is true but misses the point. Incremental GDP growth last year was nearly \$1 trillion, around 30 percent of the entire UK economy and nearly double China's incremental GDP growth in 2009, when headline growth was more than 10 percent. More interesting trends include:
- Rebalancing. Consumption contributed more to 2014 growth than investment. The services sector is growing faster than manufacturing, keeping the labour market tight. Income growth remains high, supporting household consumption. These changes are driven primarily by powerful structural forces, including demography;
- Regionalisation. Richer Provinces are rapidly converging with advanced economies in terms of income levels and economic structure. Poorer Provinces remain highly dependent on investment-driven growth. The north-eastern provinces face especially daunting challenges: maintaining steady growth and pivoting away from heavy industry, their traditional comparative advantage but also major source of Northeast China's chronic air pollution; and
- Reform. The main priority for China's leadership in 2014 was the anti-corruption campaign. That said, significant progress was achieved on implementing economic reforms, in particular financial, fiscal and administrative reform.

- Growth will continue to slow in 2015 thanks to slowing credit growth combined with an ongoing property market correction. That said, the authorities have emphasised that reform cannot come at the expense of stability. This likely means that targeted investment stimulus will continue to be used to ensure a gradual rather than precipitous deceleration in growth.
- Rebalancing, regionalisation and reform will all continue. The pace of reform is the most interesting variable. We judge a mild acceleration in reform is likely, on the back of:
 - a better external environment, with stronger US growth and lower oil prices; and
 - tighter budget constraints at the local-level, focusing mind on improving efficiency, selling assets and identifying more sustainable new sources of revenue.
- Please get in touch if you have any questions or comments. Further examples of our recent reporting can be found at: <https://www.gov.uk/government/collections/fco-political-and-economic-updates#china>.

The economy is on a gentle downwards trajectory.

1. The Chinese economy grew by 7.4 percent in 2014, consistent with the official target of “around 7.5 percent”. Economic growth in 2014 Q4 was 7.3 percent, the same as in 2014 Q3 and higher than market consensus. On a quarterly basis (seasonally adjusted), growth further slowed to 1.5 percent in Q4 from 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%	7.1%
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%	Most are expecting 'around' 7.0 %

2. In 2014 growth in most provinces did not meet local targets. As a consequence, most provinces lowered their targets for 2015. **See Figure 3.**

3.

Shanghai was the only province/municipality so far that did not set a GDP growth target for 2015.

3. The data showed some positive structural changes. The tertiary (services) sector contributed 48.2 percent to GDP in 2014, up from 46.9 percent in 2013.

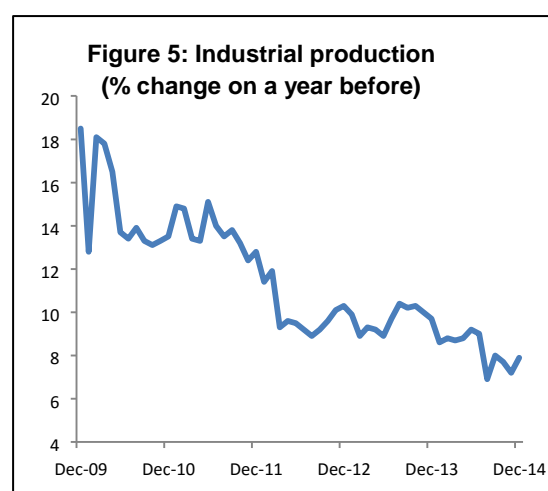
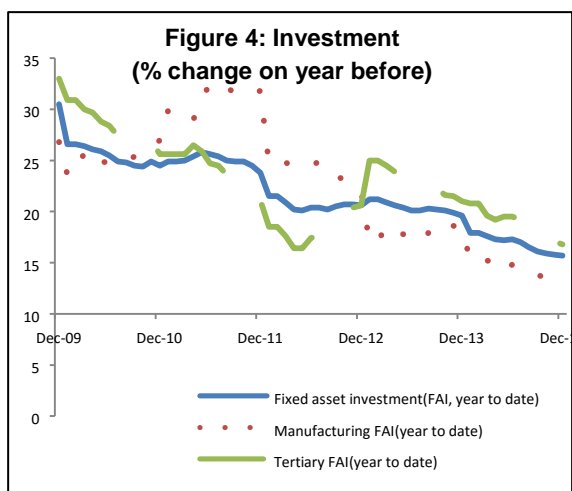
Consumption

contribution to GDP was 51.2 percent, compared with 49.2 percent in 2013, while investment contributed 48.5 percent to GDP.

4. In January 2015, China's Ministry of Commerce released the draft of Foreign Investment Law for comment. The law will give "pre-establishment national treatment" to potential foreign investors and adopt the "negative list" approach that is used in the China (Shanghai) Pilot Free Trade Zone (FTZ). It would be the most significant change in China's regime for foreign investment.

Key economic indicators remain stable.

5. Headline fixed asset investment (FAI) increased by 15.7 percent in 2014 (on a year earlier), compared with 15.8 percent from January to November and 19.6 percent in 2013. This was in line with market expectations. **See Figure 4.** On monthly basis (seasonally adjusted), FAI growth rose 1.21 percent in December, compared with 1.02 percent in November. Infrastructure investment further increased.



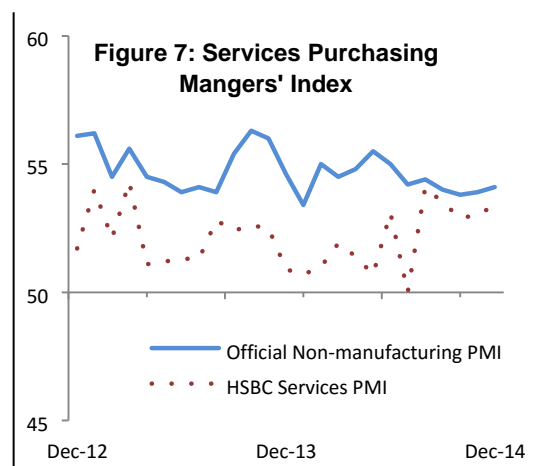
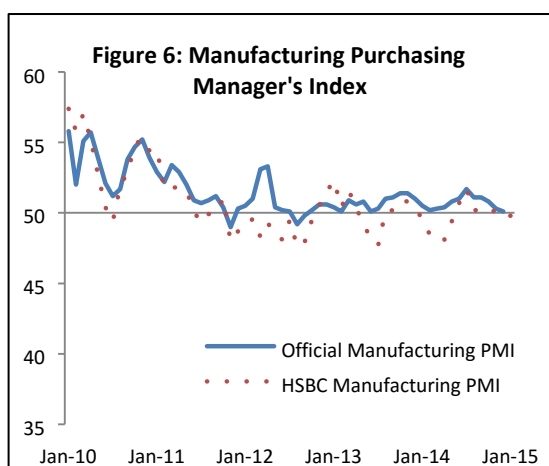
6. Industrial production (IP) grew by 7.9 percent in December (on a year earlier), up from 7.2 percent in November, a bit higher than market expectations. On a monthly basis (seasonally adjusted), IP

Figure 3: Local GDP growth in 2014

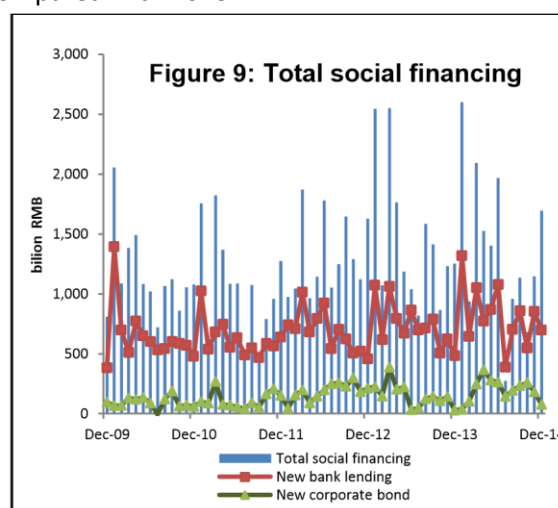
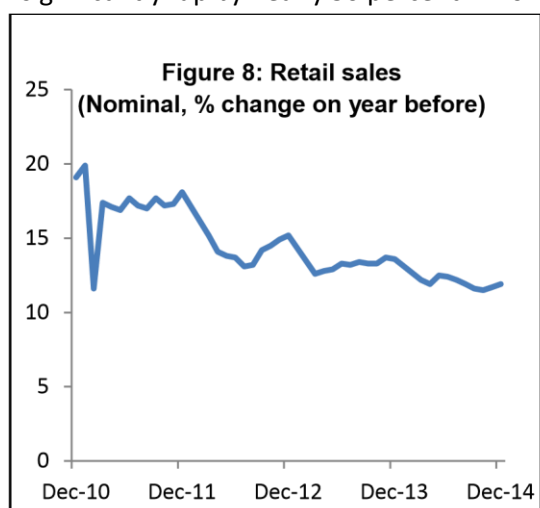
Provinces/ Municipalities	2014 target (%)	2014 growth (%)	2015 target (%)
Beijing	7.5	7.3	7
Tianjin	11	10	9
Hebei	8	6.5	7
Shanghai	7.5	7	No target
Guangdong	8.5	7.8	7.5
Xinjiang	11	10	9
Ningxia	10	8	8
Zhejiang	8	7.6	7.5
Chongqing	11	10.9	10
Hunan	10	9.5	8.5
Guangxi	10	8.5	8

growth was 0.75 percent in December, compared with 0.54 percent in November. **See Figure 5.** IP growth for whole year 2014 was 8.3 percent, compared with 9.7 percent in 2013.

7. The purchasing managers' index (PMI), a forward-looking measure of business conditions, moderated in December. The official manufacturing PMI slowed further to 50.1 in December from 50.3 in November. This is the lowest in 2014. The HSBC manufacturing PMI, seen as a better measure of conditions facing small businesses, was 49.8 in the flash reading for January 2015, compared with 49.6 in December.
8. Official services PMI improved to 54.1 in December from 53.9 in November. The HSBC services PMI also improved to 53.4 in December from 53 in November. **See Figure 6 and 7.**



9. Growth of retail sales increased by 11.9 percent in December (on a year earlier), compared with 11.7 percent in November. This was higher than market expectations. On monthly basis (seasonally adjusted), retail sales grew by 1.01 percent in December. **See Figure 8.** Retail sales growth for 2014 was 12 percent, compared with 13.1 percent in 2013. Online retail sales increased significantly: up by nearly 50 percent in 2014 compared with 2013.

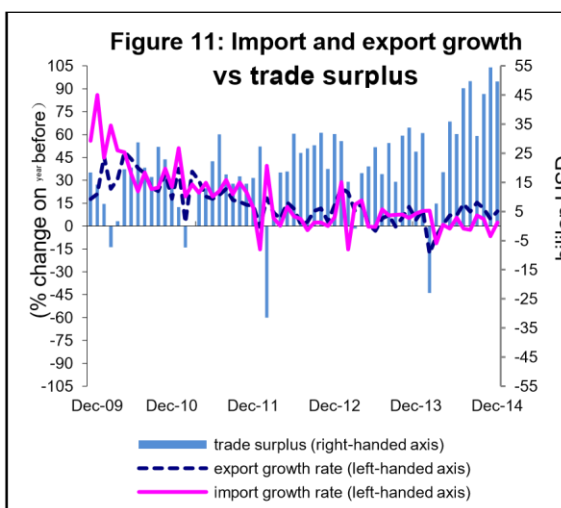
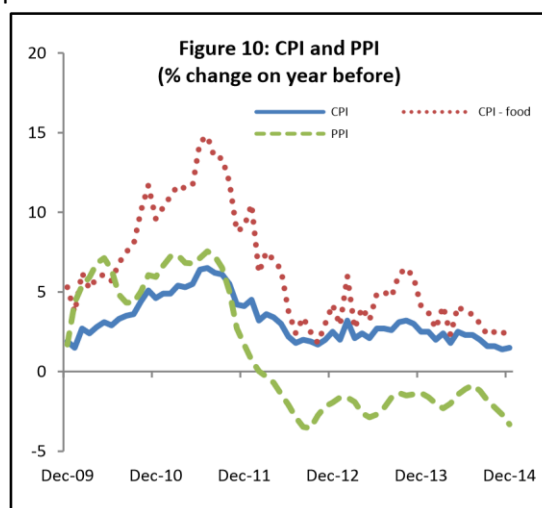


Credit growth remains high but is gradually falling.

10. In 2014, China's overall credit growth slowed to 14.7 percent year-on-year, down from 18.5 percent in 2013. Total social financing (TSF), a measure of all forms of new credit, increased by RMB 1.69 trillion (£169 billion) in December, compared with RMB 1.15 trillion (£115 billion) in November and higher than market expectations. **See figure 9.**
11. New bank lending increased by RMB 697 billion (£69.7 billion) in December, compared with RMB 852.7 billion (£85.27 billion) in November. This was lower than market expectations. Mid-to-long term loans increased, partly due to central government's approval of many infrastructure projects after November and local government needs to raise fund for these projects.
12. Money supply (M2) grew by 12.2 percent in December (on a year earlier), compared with 12.3 percent in November. China's foreign exchange reserves totalled USD 3.84 trillion as of end December 2014, compared with USD 3.89 trillion as of end September 2014.

Inflation remains low

13. The consumer prices index (CPI) rose by 1.5 percent in December (on a year earlier), compared with 1.4 percent in November. This was in line with market expectations. On monthly basis, CPI rose by 0.3 percent in December, compared with 0.2 percent decline in November. Food inflation was the main contributor of the increase. The full year CPI in 2014 rose by 2 percent, well below the official target of 3.5 percent.
14. The Producer Prices Index (PPI), an indicator for upstream inflation pressure, declined by 3.3 percent in December (on a year earlier), further down from 2.7 percent decline in November. This was below market expectations. Falling of oil prices and overcapacity were the main causes of the contraction. **See Figure 10.** The full year PPI in 2014 declined by 2.2 percent, compared with 2 percent decline in 2013.



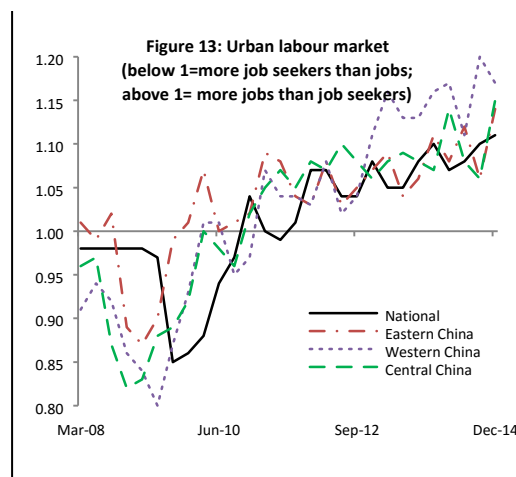
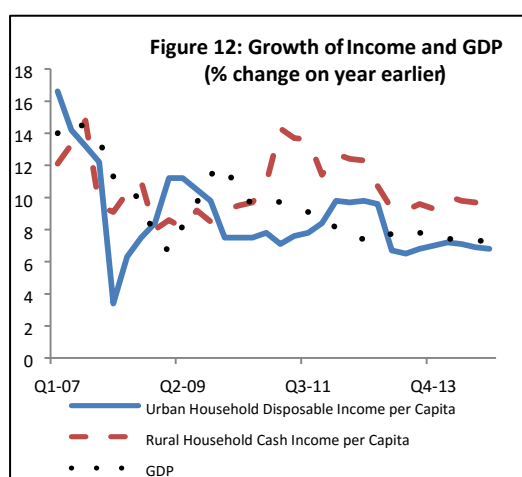
Exports and imports growth rebound.

15. China's exports rose by 9.7 percent in December (on a year earlier), up from 4.7 percent in November and beating market expectations. The improvement was mainly due to improvement in exports of mechanical and electrical products and hi-tech products. Exports to Hong Kong and EU improved a lot.

16. Imports declined by 2.4 percent in December (on a year earlier), compared with 6.7 percent decline in November and much higher than market expectations. Weak demand and low commodity prices still put pressure on imports.
17. China registered a trade surplus of USD 49.6 billion in December, down from the highest record of USD 54.5 billion in November. **See Figure 11.**
18. China's full year trade growth in 2014 was 3.4 percent, well below official target of 7.5 percent. This was the third consecutive year that trade growth failed to meet target. China Customs spokesman said even 3.4 percent growth was not achieved easily and attributed this to three factors: slow recovery of world economy, weakening of China's comparative advantages in low cost and declining of manufacturing investment in China from advanced economies, and rapid falling of commodity prices.

Labour market remains stable

19. Income growth remained strong. Rural incomes grew by 9.2 percent in Q4, lower than 9.7 percent in Q3. Growth of urban income slowed to 6.8 percent in Q4, compared with 6.9 percent in Q3. **See Figure 12.** In 2014 income growth was 8.0 percent, with urban income grew by 6.8 percent and rural income grew by 9.2 percent.
20. The labour market remained buoyant. The quarterly job/job seeker ratio was 1.15 in Q4, compared with 1.09 percent in Q3. **See Figure 13.** 13.22 million new urban jobs were created in 2014, a record year despite the growth slow-down.

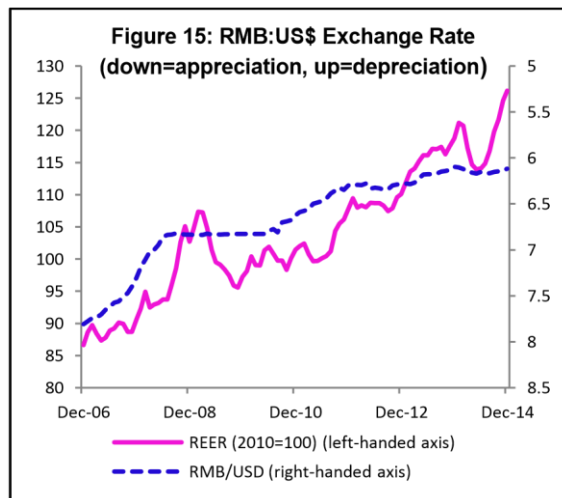
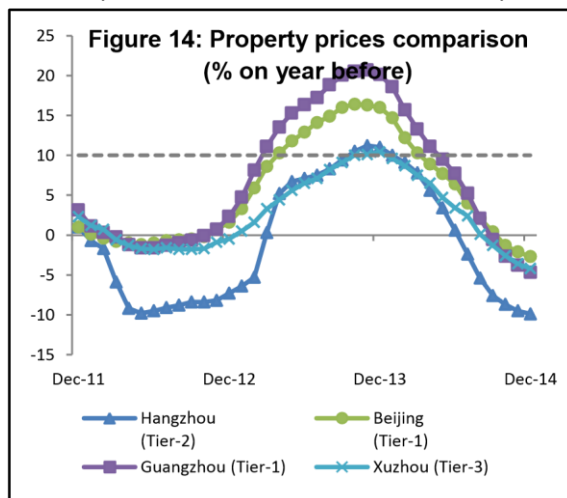


The property sector still weak but sales slightly improved

21. Official data show that out of 70 cities surveyed, 66 saw lower property prices in December (on a month earlier), compared with 67 in November. The contraction of property price further slowed. Property prices in first tier cities(Beijing, Shanghai, Guangzhou, Shenzhen) rose, but prices in

second and third-tier cities were still declining. On year before, 68 out of the 70 cities had lower property prices in December, the same as in November. **See figure 14.**

22. Property sales increased by about 9 percent in December compared with November. Property sales in first-tier cities in December all increased above 15 percent. Property investment grew by 10.5 percent in 2014, down from 19.8 percent in 2013.



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

23. The RMB depreciated by 0.36 percent against the US\$ in 2014, compared with 3.1 percent appreciation in 2013. The RMB's real effective exchange rate (REER) appreciated by 6.2 percent in 2014, compared with 7.9 percent appreciation in 2013. **See Figure 15.**

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