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British Embassy
Beijing

China Economic Focus –December 2014

Overview

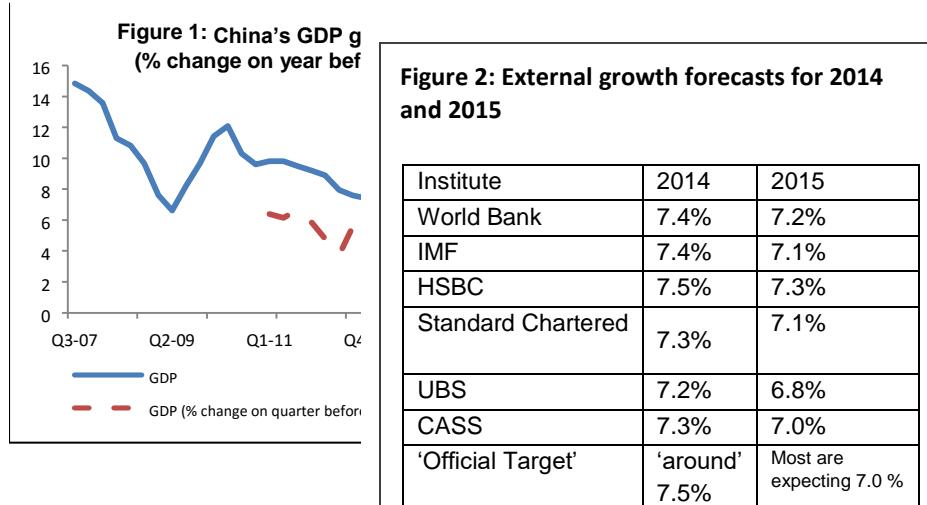
- The year ends with more of a whimper than a bang. Key indicators like fixed asset investment and industrial production are continuing their gentle decline. GDP growth in the 4th quarter is likely to be slightly lower than it was in the 3rd quarter (7.3 percent, year-on-year), with full year growth for 2014 coming in around 7.3 percent, the lower end of this year's growth target.
- The slow-down is a good thing, provided it remains gradual. The economy is undergoing a transformation, weaning itself off cheap credit and investment and building-up consumption and services as the main drivers of growth. This process will take many years. However, encouraging signs of progress are emerging: a record number of jobs were created this year, despite the slowdown in headline GDP growth.
- The main policy event this month was the Central Economic Work Conference (CEWC). The communiqué emphasised China's 'new normal' growth pattern, which means (slightly) slower and innovation-led growth, with a focus on services sector development. Premier Li also announced the establishment of new Free Trade Zones (FTZ) in Guangdong, Fujian and Tianjin, building on the Shanghai FTZ that was announced last autumn.
- Looking ahead, it is very likely that the 2015 growth target will be adjusted downwards to 7.0 (or 'around' 7.0) percent. Achieving this target won't be easy, given the property market slowdown will continue; many industrial sectors remain weighed-down by over-capacity; and the outlook for exports remains uncertain.
- Further stimulus policies are therefore likely in the first half of next year. The CEWC called for a more forceful fiscal policy, which implies a larger central government fiscal deficit. Monetary and credit conditions are also likely to loosen a little. However, absent any shocks, the authorities'

over-riding priority here is likely to keep credit growth on a declining trajectory, thereby trying to contain the significant finance risks that have arisen in recent years.

- But the main economic story in 2015 will hopefully be about reform. This would build on the significant progress made this year in fiscal, financial and administrative areas. Xi's accumulation of power, including via the anti-corruption campaign, ought to have cowed most opponents to further economic liberalisation. An early indication will be whether the deposit insurance scheme is introduced towards the start of the year, as the People's Bank of China indicated it would be on 1 December.
- 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 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. 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.**



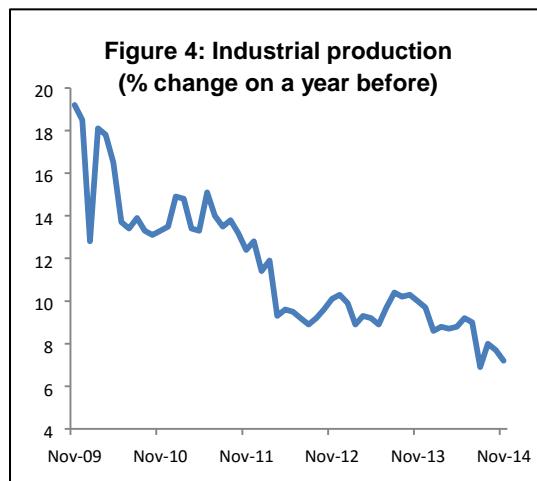
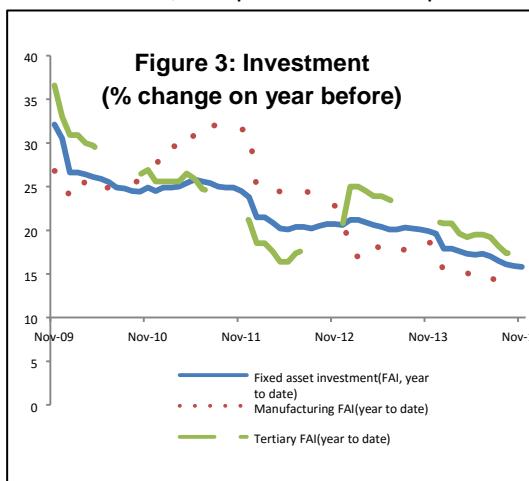
2. On December 1 PBOC announced a draft regulation on deposit insurance. This means the long-awaited deposit insurance scheme will probably be launched in early 2015. According to PBOC, with a maximum limit of RMB500,000(£50,000), the scheme is expected to cover about 99.63% of depositors in the banking sector. This is considered as a further step in interest rate liberalization and a milestone in China's financial-market reform.
3. China's top leadership had a three-day Central Economic Work Conference in early December and set economic priorities for 2015. The conference pledged to stabilize growth and accelerate

reforms. The priorities in 2015 include: maintaining stable economic growth, developing new growth drivers in the economy and encouraging innovation, transforming agriculture development model, promoting regional economic development, and improving people's livelihoods.

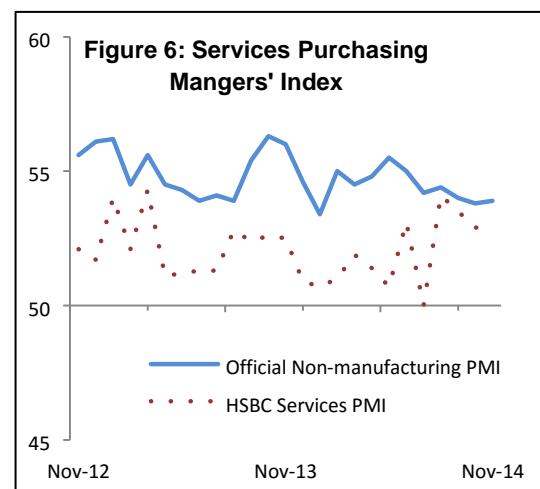
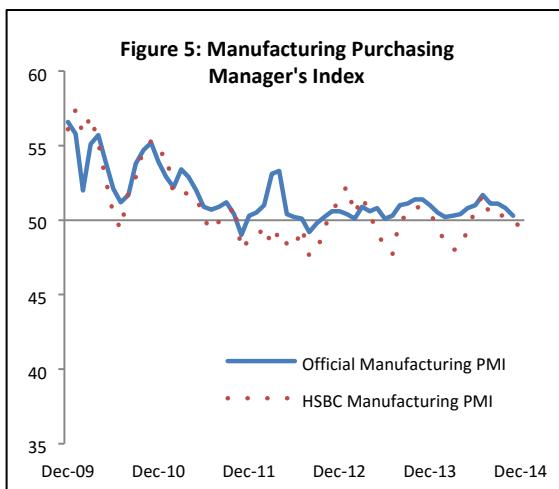
4. The State Council meeting after the Central Economic Work Conference announced further steps on Shanghai FTZ. It decided to shorten negative list and further open services and advanced manufacturing. The State Council would also approve new FTZ in Guangdong, Tianjin and Fujian.
5. Following the completion of a nationwide economic survey earlier this year, China's statistics agency (the NBS) revised the 2013 GDP up by \$308.8bn (3.4 percent of 2013 GDP). The added output is a result of revised accounting for service sector activity. Following the revision, the NBS estimates that services constitute 46.9 percent of the economy, compared with 46.1 percent previously. Manufacturing is estimated to contribute 43.7 percent of the economy.

Key economic indicators remain weak.

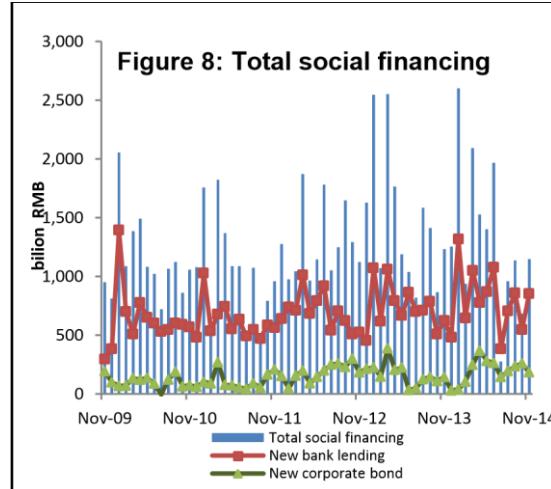
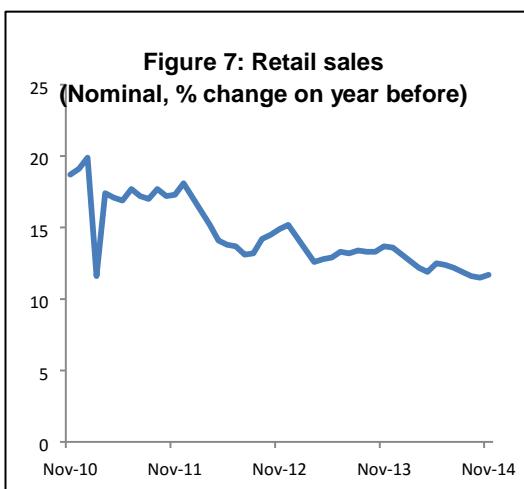
6. Headline fixed asset investment (FAI) increased by 15.8 percent from January to November (on a year earlier), slightly down from 15.9 percent from January to October. This was in line with market expectations. **See Figure 3.** On monthly basis (seasonally adjusted), FAI growth rose 1.02 percent in November, compared with 1.66 percent in October. Infrastructure investment remained strong.



7. Industrial production (IP) grew by 7.2 percent in November (on a year earlier), down from 7.7 percent in October and lower than market expectations. This was due to temporary factory closure during APEC and also weak domestic demand. On a monthly basis (seasonally adjusted), IP growth was 0.52 percent in November compared with 0.5 percent in October. **See Figure 4.** The production of cement, steel, automobiles, crude oil and electricity all decreased.
8. The official manufacturing purchasing managers' index (PMI), a forward-looking measure of business conditions, came in at 50.3 in November, further down from 50.8 in October. The HSBC manufacturing PMI, seen as a better measure of conditions facing small businesses, dropped to a seven-month low of 49.5 in the flash reading for December, compared with 50.0 in November. Official services PMI improved slightly to 53.9 in November from 53.8 in October. The HSBC services PMI also improved to 53 in November compared with 52.9 in October. **See Figure 5 and**



9. Growth of retail sales increased by 11.7 percent in November (on a year earlier), compared with 11.5 percent in October and higher than market expectations. This was due to additional APEC holidays and the Single-day online sales. On monthly basis (seasonally adjusted), retail sales grew by 0.89 percent in November. **See Figure 7.**



Total credit growth continues to decline

10. Overall year-on-year credit growth continues to decline, reaching 14.1 percent in November, down from around 18 percent growth a year ago. Total social financing (TSF), a measure of all forms of new credit, increased by RMB 1.15 trillion (£115 billion) in November, rebounding from RMB 663 billion (£66.3 billion) in October and much higher than expectations. Bank lending growth picked up, trust loans and bill acceptance continued to shrink in November as a result of tighter shadow banking rules. **See Figure 8.**

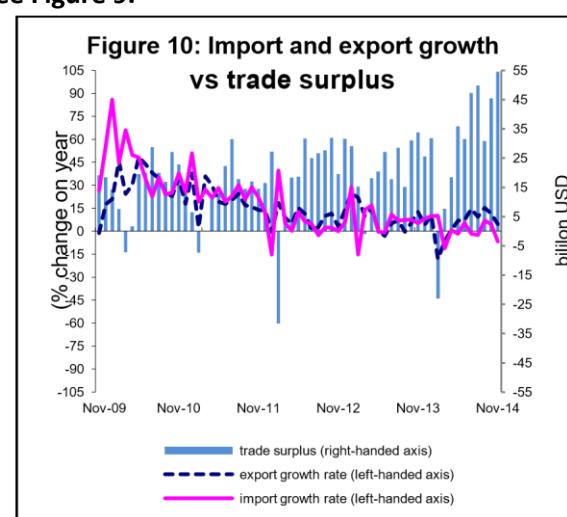
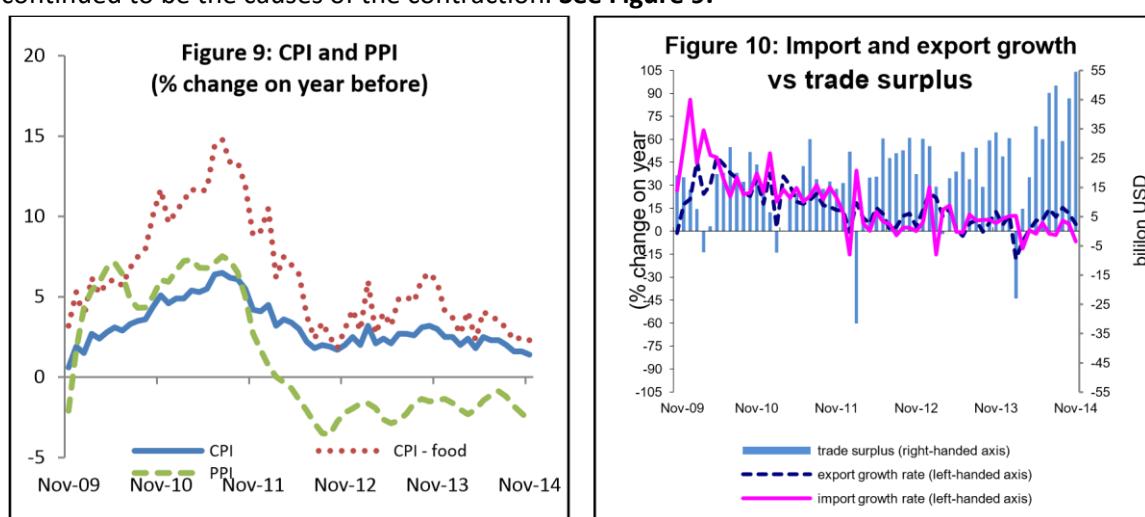
11. New bank lending increased by RMB 852.7 billion (£85.27 billion) in November, up from RMB 548 billion (£54.8 billion) in October. This was also higher market expectations. This showed PBOC's interest cut begun to have some positive effect on credit growth. Most of the pickup was seen in corporate lending.

12. Money supply (M2) grew by 12.3 percent in November (on a year earlier), compared with 12.6 percent in October.

Inflation remains low

13. The consumer prices index (CPI) rose by 1.4 percent in November (on a year earlier), compared with 1.6 percent in October. This was lower than market expectations and the lowest since January 2010. On monthly basis, CPI declined by 0.2 percent in November. Low oil prices and low vegetable and pork prices were the main causes for low CPI.

14. The Producer Prices Index (PPI), an indicator for upstream inflation pressure, declined by 2.7 percent in November (on a year earlier), further down from 2.2 percent decline in October. This was below market expectations. Weaker commodity prices and overcapacity in some sectors continued to be the causes of the contraction. **See Figure 9.**



Exports and imports growth slowed.

15. China's exports rose by 4.7 percent in November (on a year earlier), down from 11.6 percent in October and much lower than market expectations. The decrease was due to unfavorable base effect and weaker external demand. Exports to most major trade partners slowed.

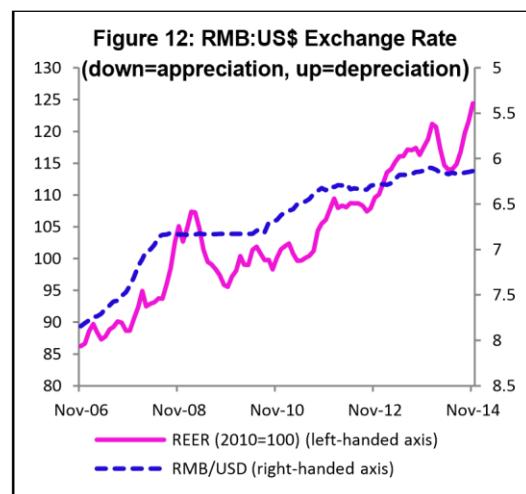
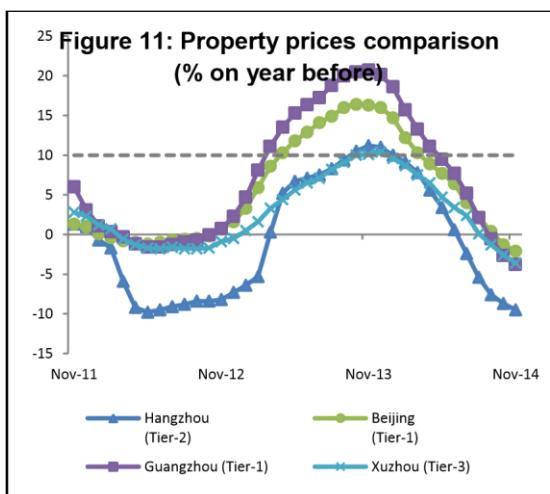
16. Imports declined by 6.7 percent in November (on a year earlier), compared with 4.6 percent rise in October and lower than market expectations. The sharp decline in imports growth was mostly the result of the lower oil prices and other commodity prices.

17. China registered a trade surplus of USD 54.5 billion in November, further increasing from 45.4 billion in October. This was the highest in record. **See Figure 10.**

18. On November 6, the State Council announced new policies to promote imports. It would encourage imports of advanced equipments and key parts, stabilizing imports of resource products, consumer goods, and promoting imports of trade in services. It would also streamline import management and promote international trade cooperation.

The property sector still weak but sales slightly improved

19. Official data show that out of 70 cities surveyed, 67 saw lower property prices in November (on a month earlier), compared with 69 in October. The contraction of property price further slowed. On year before, 68 out of the 70 cities had lower property prices in November, compared with 67 in October, which was mainly due to high base in last year. **See figure 11.**
20. Property sales increased by 13.1 percent in November compared with October and reached the highest in 2014. This was mainly due to changes of credit policies and the central bank's interest cut in November.
21. Property investment grew by 11.9 percent from January to November, down from 12.4 percent from January to October.



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

22. As of 18 December, the RMB:US\$ exchange rate has depreciated by 0.34 percent since the beginning of the year. It has appreciated by 0.54 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 2.28 percent from October to 124.43 in November. From January to November of 2014, the RMB's REER had appreciated by 4.78 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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