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British
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South China Economic Monitor

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China's Manufacturing and Export Engine Back in Gear

Summary

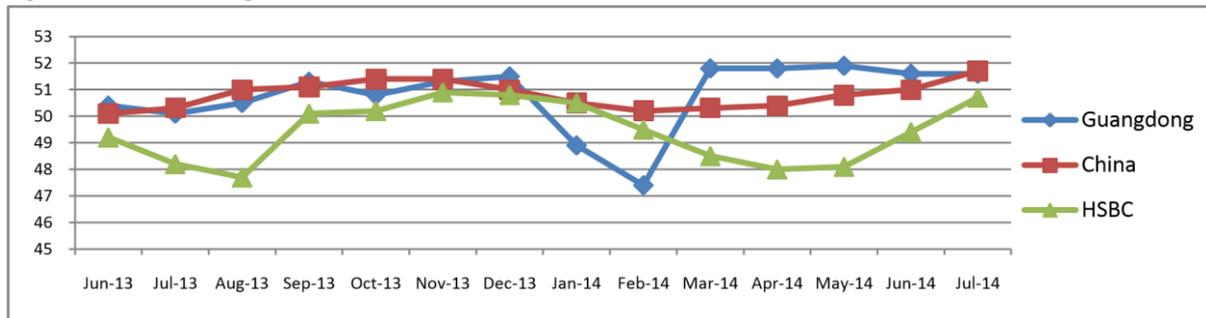
Thanks, in part, to a series of mini stimulus measures growth in Guangdong has recovered momentum after a slow start to the year. Trade figures looked very weak for the first 5 months of the year because of a crack down on over-invoicing. June figures suggest that real exports are still growing slowly.

Economic Activity Recovers

1. Through a series of mini-stimulus measures including streamlining tax refunds for exports, China's largest provincial economy, Guangdong, has successfully stabilised growth. Year on year growth for the first half of 2014 was 7.5%, 0.1% above the national average. As a result, investor confidence has improved, illustrated by week-long rally in the Shenzhen Stock Exchange in late July.
2. Growth in advanced manufacturing and hi-tech sectors has been particularly strong, with y.o.y growth of 9.5% and 10.8% respectively. These two sectors have also expanded their shares in Guangdong's manufacturing pie: hi-tech manufacturing picked up from 23.7% last June to 25.5% this year, advanced manufacturing grew from 48.0% to 48.5%. Pre-tax profits reported by manufacturing companies in Guangdong recorded 24.1% y.o.y growth.
3. However, a slight decline in the most recent Guangdong Manufacturing PMI suggests that growth may now be stabilising. Guangdong's Manufacturing PMI rebounded from 47.4 to 51.8 in March, and then hit a peak of 51.9 in May. The latest index released 1 August read 51.6, with three

of its five survey indices, i.e. output, new order and stocks of purchases all slightly falling by 0.3-0.4 but still above 50, indicating that manufacturers are slowing their expansion. Guangdong's Manufacturing PMI so far remains the only provincial PMI in China, and owing to the weight of the province's manufacturing industry as well as its export sector, Guangdong's index is viewed as a good predictor of China's manufacturing and export performance (see Fig 1).

Fig 1: Manufacturing PMI

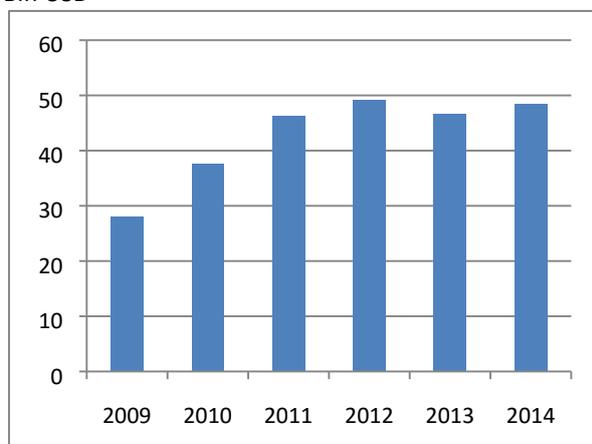


Real Exports Growing Slowly

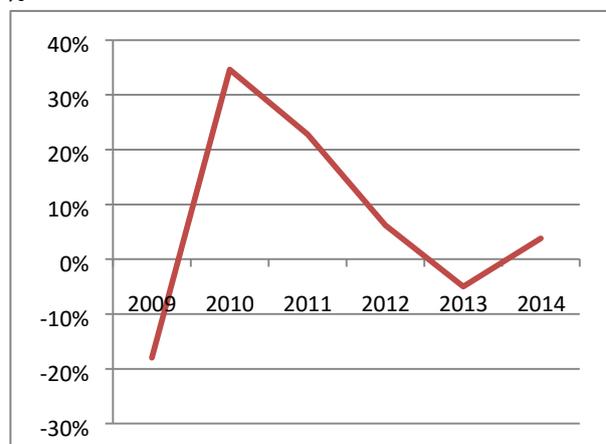
4. After declining sharply for 5 months, Guangdong's exports started to grow. June saw a mild y.o.y growth of 3.8% to 48.43 bln USD, close to record high in June 2012 (see Fig 2). However figures for the first half year still show a 16.7% decline in total foreign trade. We judge that this decline is entirely explained by the crack down on schemes to take advantage of substantial onshore-offshore interest rate differentials via 'over-invoicing' in export to Hong Kong and Taiwan in particular. The problem of 'over-invoicing' came to end last May, and so comparing June y.o.y growth figures gives us the best indication of what is happening in the real economy (Fig 2). These figures suggest that real export growth is recovering. Exports to EU and ASEAN are particularly strong. During the first half of 2014 y.o.y growth in trade between Guangdong and the EU reached 9.2%. We have also observed the Guangdong authorities taking steps to strengthen its economic and trade ties with Southeast Asia and Middle East following the 'new maritime silkroad' strategy.

Fig 2: Guangdong Exports in June in Recent Years

Export Value in Recent Junes
Bln USD

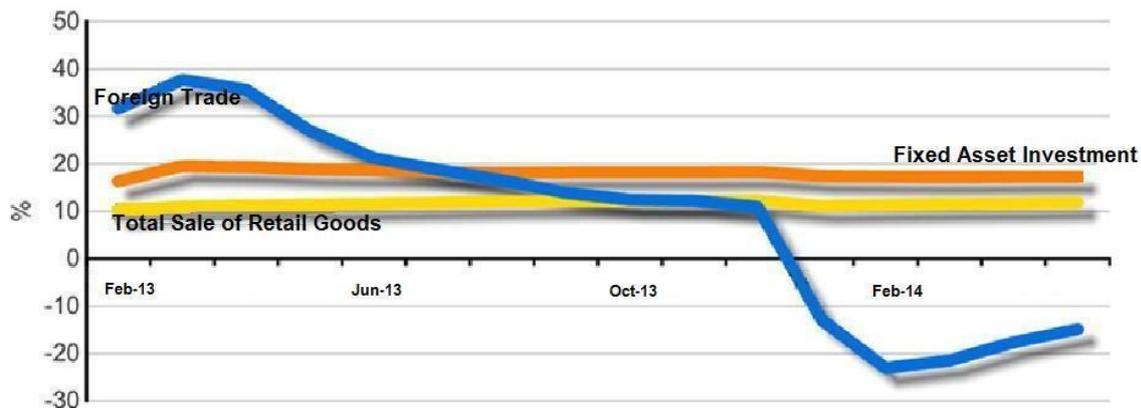


y.o.y export growth in Recent Junes
%



5. Although Guangdong is still the province which accounts for the largest proportion of China's exports, it has been trying to reduce its reliance on foreign trade, partly prompted by the global financial crisis in 2008. Guangdong's net export valued equivalent to 17% of its GDP in 2013, down from the peak at 25% in 2007; during the same period, domestic consumption of retail goods increased from 34% to 41%. This trend is consistent with the results from various surveys where foreign investors increasingly see Guangdong as a market for goods they produce here.

Fig 3: Growth Rate of Guangdong's Economic Drivers



Outlook for the Rest of the Year

6. Despite this improvement in key economic indicators, Guangdong is likely to fail to achieve its yearly target. To hit the GDP growth target of 8.5%, the province needs a 9.0% growth rate for the next 6 months. For the rest of the year we expect to see continued targeted stimulus measures, for example exemptions from administrative fees and charges to reduce burden on business, and an acceleration of investment in major infrastructure projects in less developed peripheral regions. But even with these measures, reaching the 8.5% growth target looks like mission impossible. Improvement in foreign trade figures is likely to continue thanks to improvements in the EU and US markets.

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