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British Embassy
Beijing

China Economic Focus –November 2014

Overview

- The last month has seen further gradual weakening in the economic data accompanied by a flurry of policy action from the Chinese authorities, most of which was consistent with the stated goal of structural economic rebalancing.

- Investment, industrial production, and retail sales all slowed gradually compared with the previous month. The purchasing managers indices (PMI) fell to a six-month low. Credit declined sharply. Exports and imports both moderated. Most analysts currently expect around 7.3 percent growth for 2014, moderating to around 7.0 percent growth in 2015.

- The proximate cause of the slow-down is a decline in fixed asset investment. Property investment is falling particularly fast, as the market undergoes a correction. This is driven by slowing credit growth: although credit continues to expand faster than nominal GDP (meaning the debt-to-GDP ratio continues to climb), the pace of credit growth is slowing.

- So far, the authorities appear to be comfortable with the pace of adjustment. Speaking to APEC leaders, President Xi described China's 'new normal' growth model: a moderation from 'superfast' to 'relatively-fast' growth; a focus on service sector development; and a transition from investment driven growth to innovation driven growth.

- A number of new policies were introduced or announced over the past month, including:

- trade agreements with South Korea and Australia and the establishment of various funds to support infrastructure investment along China's borders;
- the opening of the Shanghai-Hong Kong connect, allowing limited equity investment flows in either direction. The scheme has worked well operationally though investment flows, particularly from Shanghai to Hong Kong, have been low; and
- an asymmetric cut in interest rates, which reduced the lending rate by 40 basis points and the deposit rate by 25 basis points and was accompanied by a partial liberalisation of deposit rates.

➢ The latter move is particularly interesting. By cutting the lending rate more than the deposit rate and partially liberalisation the deposit rate the PBOC has managed to both satisfy calls for monetary stimulus and push forward an important structural reform.

➢ 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-andeconomic-updates#china.

The economy grew by 7.3 percent in 2014 Q3.

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**.**

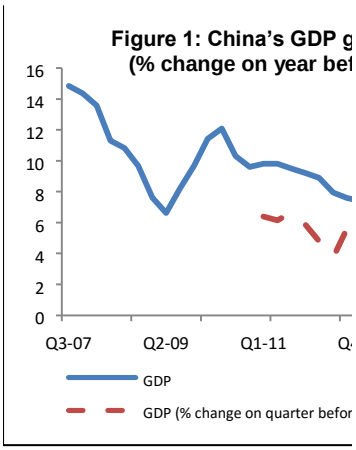


Figure 2: External growth forecasts for 2014 and 2015

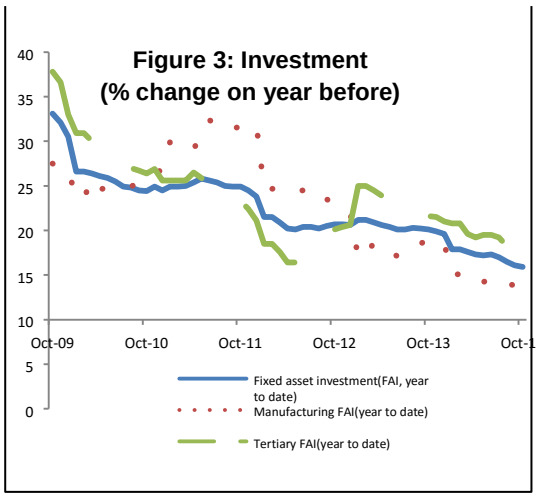
Institute	2014	2015
World Bank	7.4%	7.2%
IMF	7.4%	7.1%
HSBC	7.5%	--
Standard Chartered	7.4%	7.0%
UBS	7.2%	6.8%
CASS	7.3%	7.0%
'Official Target'	'around' 7.5%	Most are expecting 7.0 %

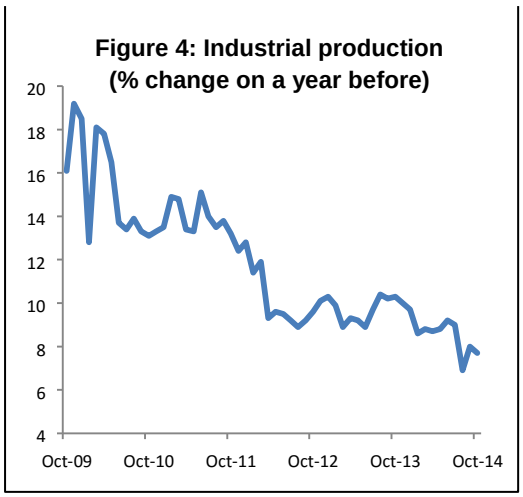
2. A number of new policies were introduced or announced over the past month, including:
   a. trade agreements with South Korea and Australia and the establishment of various funds to support infrastructure investment along China's borders;
   b. the opening of the Shanghai-Hong Kong stock connect, allowing limited equity investment flows in either direction. The scheme has worked well operationally though investment flows, particularly from China to Hong Kong, have been low; and

c. an asymmetric cut in interest rates, which reduced the lending rate by 40 basis points and the deposit rate by 25 basis points and was accompanied by a partial liberalisation of deposit rates.

Key economic indicators remain weak.

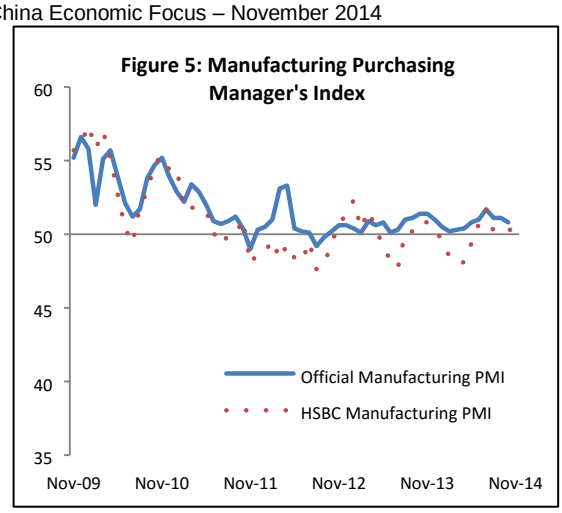
3. Headline fixed asset investment (FAI) increased by 15.9 percent between January to October (on a year earlier), down from 16.1 percent from January to September. This was in line with market expectations. **See Figure 3.** On monthly basis (seasonally adjusted), FAI growth rose 1.64 percent in October, compared with a growth of 0.76 percent in September. Infrastructure investment slightly improved.

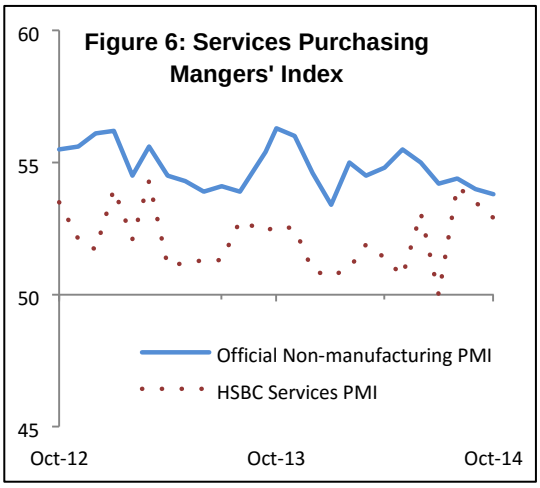




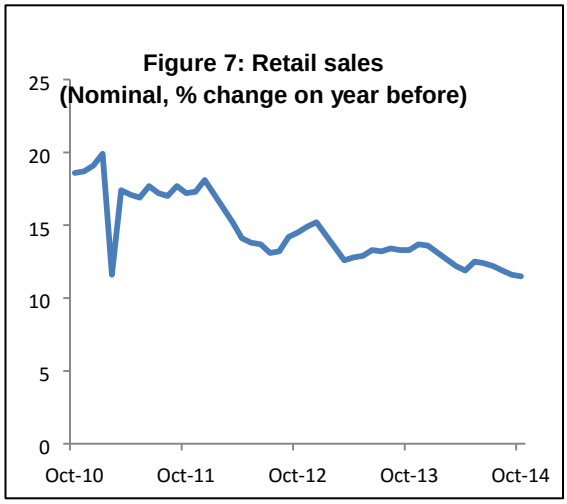
4. Industrial production (IP) grew by 7.7 percent in October (on a year earlier), down from 8.0 percent in September and lower than market expectations. On a monthly basis (seasonally adjusted), IP growth slowed to 0.52 percent in October from 0.9 percent in September. **See Figure 4.** The production of cement, steel, and automobiles increased, while crude oil and electricity production decreased.

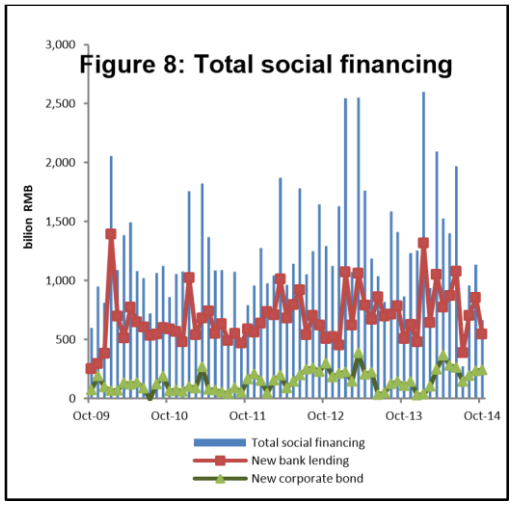
5. The official manufacturing purchasing managers' index (PMI), a forward-looking measure of business conditions, came in at 50.8 in October, down from 51.1 in September. The HSBC manufacturing PMI, seen as a better measure of conditions facing small businesses, went down to a six-month low of 50.0 in the flash reading for November, compared with the October final reading of 50.4. Official services PMI went down to 53.8 in October from 54 in September. The HSBC services PMI moderated to 52.9 in October from 53.5 in September. **See Figure 5 and 6.**





6. Growth of retail sales increased by 11.5 percent in October (on a year earlier), compared with 11.6 percent in September. This is in line with market expectations. On monthly basis (seasonally adjusted), retail sales grew by 0.98 percent in October. **See Figure 7.**





Total social financing and bank lending decrease sharply

7. Total social financing (TSF), a measure of all forms of new credit, increased by RMB 663 billion (£66.3 billion) in October, declining sharply from RMB 1.05 trillion (£105 billion) in September and lower than expectations. By breakdown, all categories contracted except RMB loans. This reflects the government was still tightening credit. **See Figure 8.**

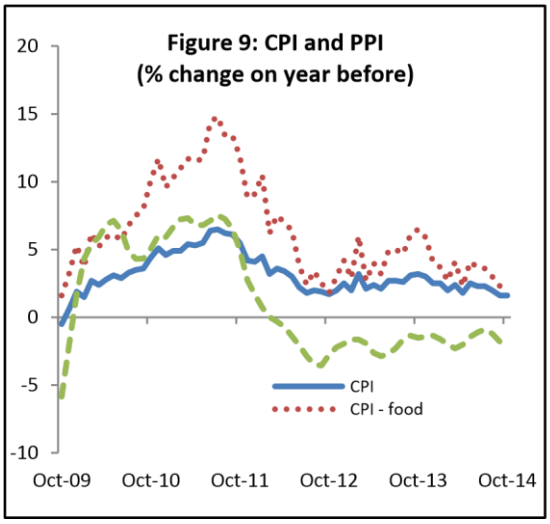
8. New bank lending increased by RMB 548 billion (£54.8 billion) in October, down from RMB 857 billion (£85.7 billion) in September. This is lower than market consensus. There are likely to be two main causes of weak loan growth: industrial firms reluctant to borrow as they grapple with over-capacity and rising debt costs and banks reluctant to lend as they deal with their rising nonperforming loans.

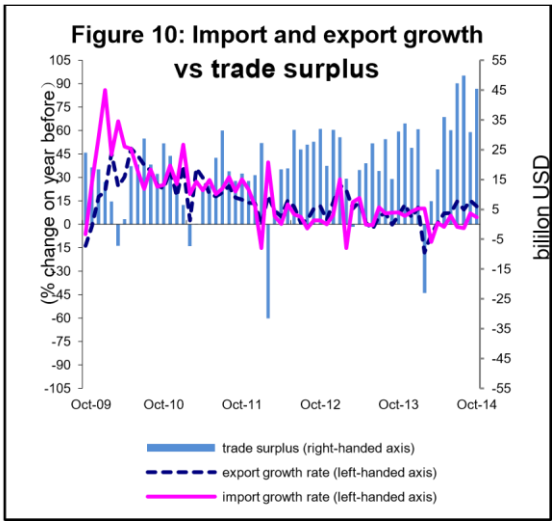
9. Money supply (M2) grew by 12.6 percent in October (on a year earlier), compared with 12.9 percent in September.

Inflation remains stable

10. The consumer prices index (CPI) rose by 1.6 percent in October (on a year earlier), the same as September. This was in line with market expectations. On monthly basis, CPI rose by 0 percent compared with 0. 5 percent rise in September. Food inflation increased on a year earlier but sequential growth eased.

11. The Producer Prices Index (PPI), an indicator for upstream inflation pressure, declined by 2.2 percent in October (on a year earlier), further down from 1.8 percent decline in September. This is below market expectations. The decline can be attributed to the fall of oil prices and overcapacity in some sectors. **See Figure 9.**





Exports and import growth slowed.

12. China's exports rose by 11.6 percent in October (on a year earlier), down from 15.3 percent in September and slightly higher than market consensus. The decrease was partly due to a less favorable base compared with previous month. Exports to Hong Kong, Japan and EU declined. Export of mechanical and electronic products increased.

13. Imports rose by 4.6 percent in October(on a year earlier) , down from 7.0 percent in September and lower than market expectations. This is mainly due to weak domestic demands and lower commodity prices.

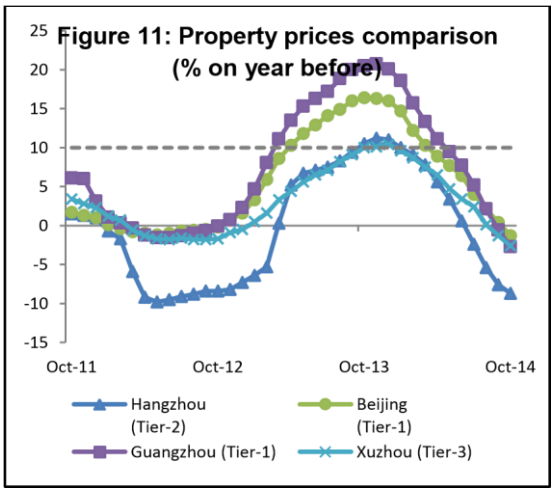
14. China registered a trade surplus of USD 45.4 billion in October, down from USD 30.9 billion in September. This is close to the highest record of USD 49.9 billion in August. **See Figure 10.**

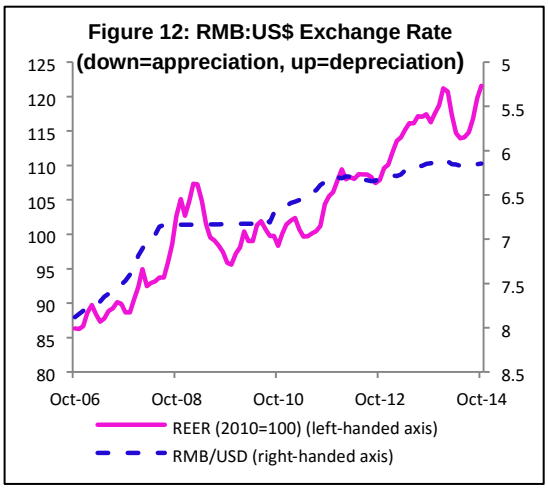
15. The Canton Fair, China's largest annual trade fair, also seen to be a reliable leading indicator of China's export, saw lower orders and visits in Autumn session in October compared with the Spring session in April, with turnover falling by 6.1 percent. This might indicate a weaker outlook for exports in the coming months.

The property sector weakens further

16. Official data show that out of 70 cities surveyed, none saw higher property prices in October (on a month earlier), the same as in September. But the contraction of property price further slowed. On year before, 3 out of the 70 cities had higher property prices in October, compared with 10 in September. **See figure 11.**

17. Property investment grew by 12.4 percent from January to October, down from 12.5 percent from January to September.





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

18. As of 25 November, the RMB:US$ exchange rate has depreciated by 0. 66 percent since the beginning of the year. It has appreciated by 0.16 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 1.5 percent from September to 121.57 in October. From January to October of 2014, the RMB's REER had appreciated by 2.37 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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