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Advisory Division

—The macroeconomy—

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Summary

In January–March, China's real GDP (gross domestic product) grew 7.0%. This was the lowest level of growth since January–March 2009 (+6.6%). With employment moving stably, from here on the authorities will probably focus on stimulating the economy through traditional fiscal and monetary policies, such as cuts to interest rates and required reserve ratio or the implementation of railway or other infrastructure building projects. They are also expected to push forward with economic structural adjustment as they try to tackle the problems of regional debt and overcapacity.

1. **March economic indicators deteriorated on January–February**
   - **Growth stood at +7.0% in January–March**
   - **March indicators deteriorated on January–February**
   - **Exports are enjoying a gentle recovery on a quarterly basis**
   - **CPP and PPI continue to move bearishly**
   - **Total social financing and money supply growth slowed**

2. **As the government implements policy responses and the employment situation moves stably, the authorities are focusing on structural adjustment and stable growth**
   - **Prioritizing structural adjustment and stable growth**
   - **The announcement of an action plan for the 'One Belt One Road' initiative**

1. March economic indicators deteriorated on January–February

- **Growth stood at +7.0% in January–March**

On April 15, the National Bureau of Statistics (NBS) announced that China's real GDP (gross domestic product) in January–March had grown +7.0% on the same period last year (all figures from here on refer to 'same-period previous-year' growth unless otherwise specified). Though this was in line with the government's target of +7.0%, growth had dipped on the previous quarter's figure of +7.3% to hit its lowest level since January–March 2009 (+6.6%). Growth was up 1.3% on the previous quarter (see Fig. 1).

Though the NBS has yet to release the details of the GDP contribution rate by demand item, at a press conference on the same day, NBS spokesman Sheng Laiyun said that the domestic demand and consumption situation remained largely unchanged. He also stated that the contribution of exports to economic growth had increased, with the trade surplus expanding on the back of import and export price movements, while the contribution of gross capital formation was down 4%Pt on the first quarter of 2014. He also stated that the contribution of consumption was nearly 60% in the first quarter of 2014, with things likely to be the same this year too[1].

A glance at the growth rate by sector shows the primary and secondary industries both dipping on the previous quarter, from +4.1 to +3.2% and from +7.3% to +6.4%, respectively. The tertiary industry moved firmly at +7.9%, but this was still down slightly on the previous quarter's figure of +8.1%. The slump in the secondary industry is considered to be the main factor behind the recent slowdown (see Fig. 2).

A glance at the composition of nominal GDP shows the tertiary industry overtaking the secondary industry in 2013 (46.9% compared to 43.7%), with the tertiary industry's share of GDP rising to 48.2% in 2014. This share rose higher to hit 51.6% in the first quarter of 2015. As NBS spokesman Sheng Laiyun explained, the service industry was always likely to receive a boost from factors related to the Chinese New Year holidays (when productive activity slows and demand for food, drinks and vacations increases).

[1] The State Council of the People's Republic of China, April 15, 2015: 'Briefing by the National Bureau of Statistics on China's economic performance in Q1 2015'
http://www.gov.cn/xinwen/zb_xwb61/xwb1_wz.htm

Fig. 1: GDP and major economic indicators (quarterly)

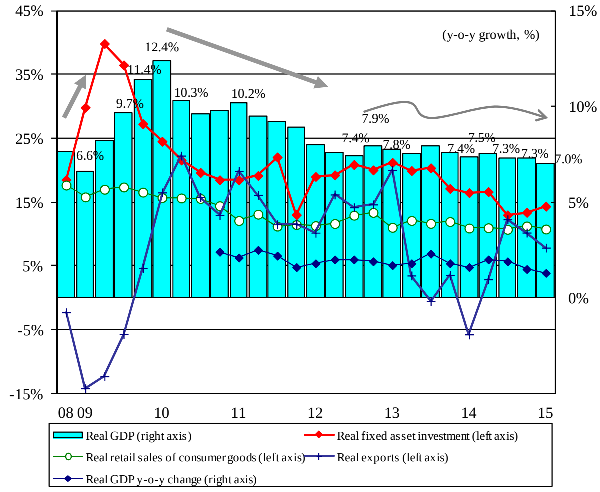
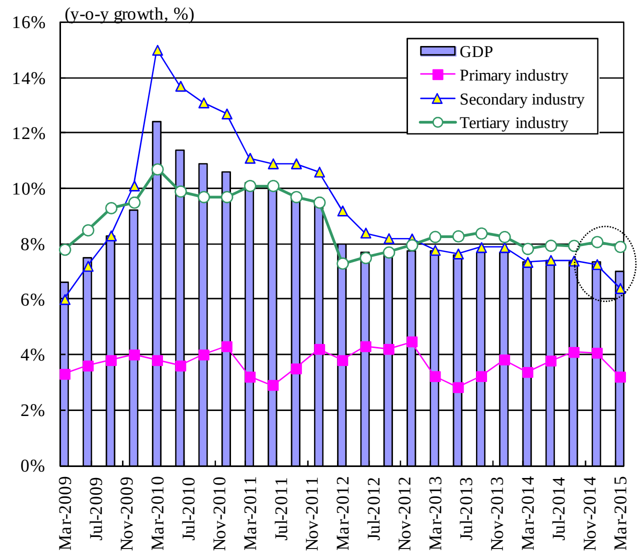


Fig. 2: GDP and major economic indicators



Note: The real RMB value of exports is indexed using the production price index (PPI); the real value of fixed asset investments is indexed using the price index of investment in fixed assets; and the real value of retail sales of consumer goods is indexed using the retail price index (RPI).

Source: National Bureau of Statistics of China, CEIC

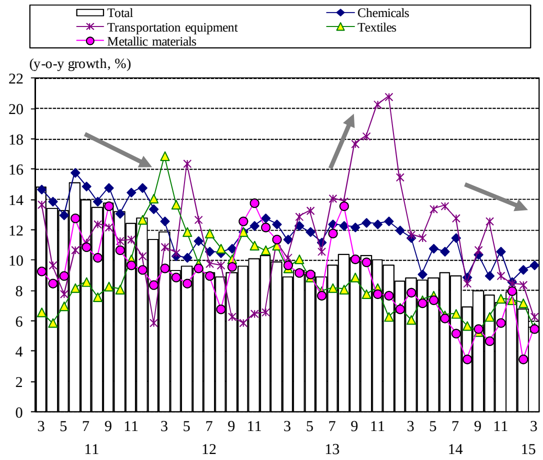
Source: National Bureau of Statistics of China, CEIC

- **<u>March indicators deteriorated on January–February</u>**

March economic indicators continuously deteriorated on January–February. At +5.6%, value-added industrial production in March was down on the figure of +6.8% recorded in January–February (+0.3% on the previous period) (see Fig. 3). At +6.4%, meanwhile, the aggregate figure for January–March was down on 2014 (+8.3%) and also below the government's target of +8.0%. As NBS spokesman Sheng Laiyun mentioned, though, the hi-tech industry grew by 11.4%, while production of robots and new-energy vehicles soared by over 50%.

Electricity consumption and rail freight transportation volumes continue to slide (see Fig. 4). The NBS puts this down to weather-related factors (the hot temperatures in March were conducive to energy saving), falling demand for raw materials, and structural changes to the transportation environment (following a diversification of the means of transportation towards roads and waterways).

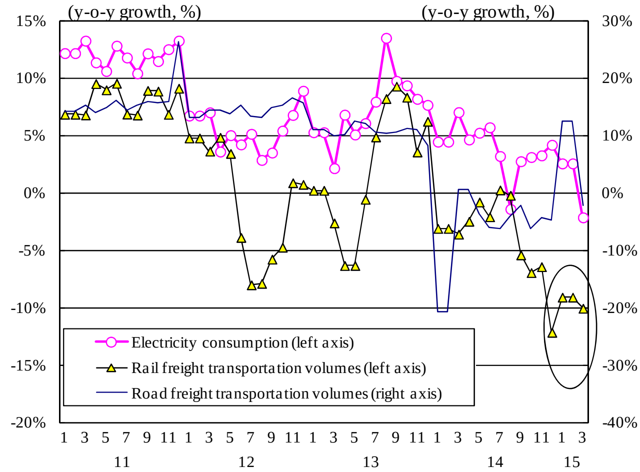
Fig. 3: Value-added industrial production



Note: The value-added industrial production amount. The figure for January shows the aggregate year-on-year change for the period January–February. Transportation equipment has meant automobiles since March 2012.

Source: CEIC

Fig. 4: Electricity consumption and rail/road freight transportation volumes

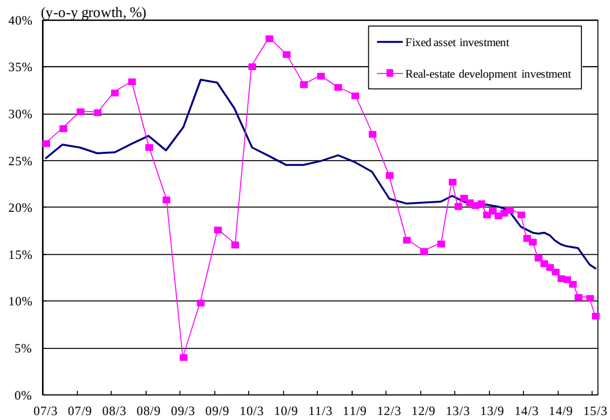


Note: The figure for January and February shows the cumulative same-period previous-year growth for the period January–February.

Source: China Electricity Council, Ministry of Railways, CEIC

Nominal fixed asset investment stood at +13.1% in March, a slight slowdown on January–February's +13.9% (month-on-month change: +1.0%). At +8.5%, real-estate development investment growth was down on January–February (+10.4%) (see Fig. 5). The cumulative figure for January–March stood at +13.5%, down on the +15.7% recorded in 2014. However, investment in railway transportation grew by 14.9% (see Fig. 6), with the standalone figure for March soaring from +14.5% in January–February to +70.7%.

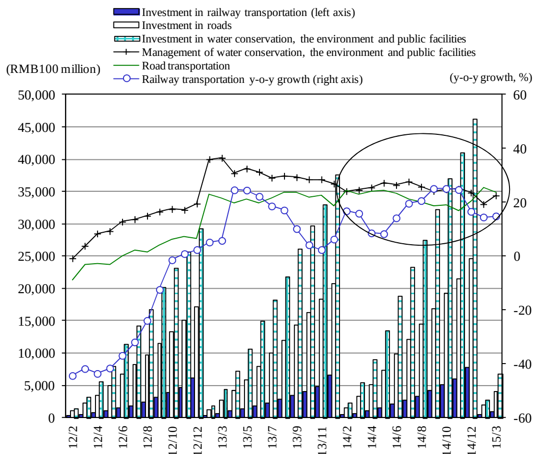
Fig. 5: Fixed asset investment



Note: The figures show a same-period previous-year comparison of the cumulative results for periods lasting from the beginning of the target year until the month in question. The figures for the end of March, June, September, and December were listed until the end of 2012; the monthly figures were listed from 2013 onwards.

Source: National Bureau of Statistics of China, CEIC

Fig. 6: Fixed asset investments in railways, roads, water conservation and the environment



Note: The figures show the cumulative results and a same-period previous-year comparison for periods lasting from the beginning of the target year until the month in question.

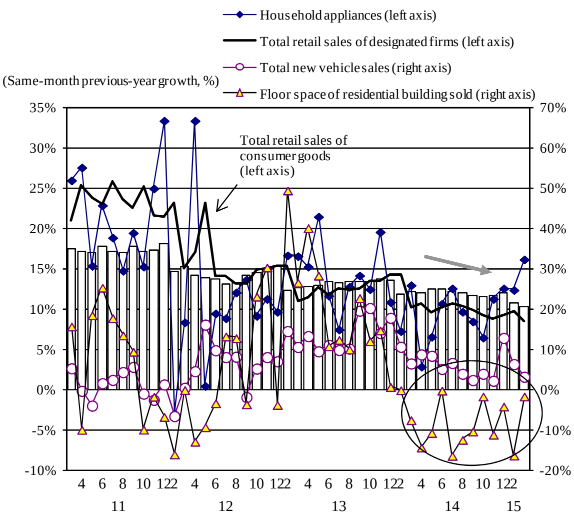
Source: National Bureau of Statistics of China, CEIC

Nominal retail sales of consumer goods grew by 10.2% in March, down on the +10.7% recorded in January–February. Even with inflationary factors removed from the equation, real growth stood at +10.2%, a deceleration on January–February's figure of +11.0% (+0.7% m-o-m) (see Fig. 7). The cumulative figure for January–March stood at +10.6%, down on the +12.0% recorded in 2014. Internet retail sales grew by 41.0% to hit RMB 760.7 billion (goods: RMB 631 billion/+41.0%; services: RMB 129.7 billion/+43.0%), with net shopping accounting for 8.9% of all retail sales of consumer goods.

The floor space of residential buildings sold fell by 1.6% (94,905 m^2) in March, though this marked an improvement on January–February (-16.3%/87,639 m^2). The slide is being arrested by measures aimed at supporting the real estate market, with the People's Bank of China (PBOC) announcing on February 28 that it was cutting the benchmark deposit and lending rates (effective from March 1), for example, while the (lowest) down payment rate for second homebuyers was also slashed from 60% to 40% on March 30[2].

2.241 million new vehicles were sold in March (+3.3%). Though this was an increase on the average number of vehicles sold in January–February (1.956 million/+4.3%), growth dropped off. At 6.154 million vehicles (+3.9%), the pace of expansion slowed in January–March compared to 2014 (23.489 million vehicles/+6.8%). A glance at the details shows sales of commercial vehicles dropping on the previous year from April 2014 onwards, though sales of passenger vehicles have continued to grow around 10% y-o-y (see Fig. 8).

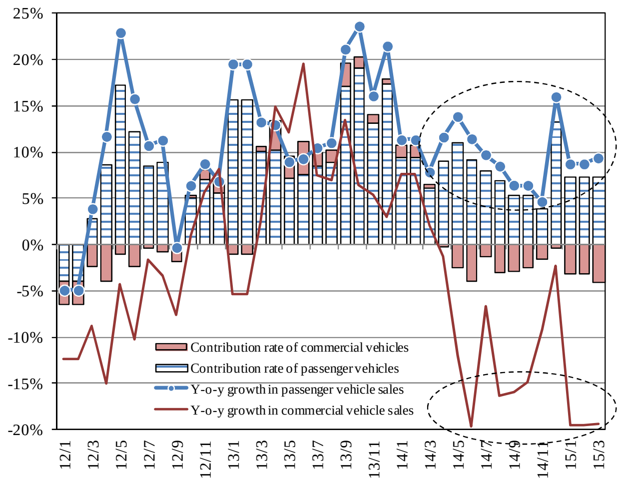
Fig. 7: Retail sales of consumer goods; retail sales by item; floor space of residential building sold



Note: Designated firms: firms with an annual turnover of RMB 5 million or over; the household appliance data also refers to sales by these desinated companies; February = the cumulative results for January–February.

Source: CEIC

Fig. 8: Number of vehicles sold (y-o-y growth and contribution rate)



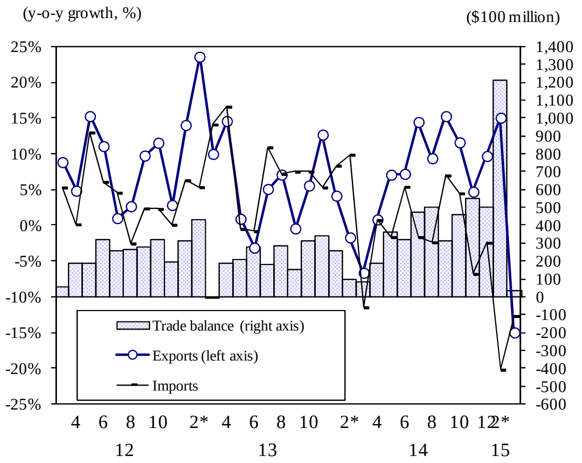
Note: The figure for January and February shows cumulative y-o-y growth for the period January–February.

Source: China Association of Automobile Manufacturers, CEIC

[2] PBOC, March 30, 2015: 'Circular of the PBOC, the Ministry of Housing and Urban-Rural Development, and the China Banking Regulatory Commission (CBRC) on personal mortgage policy issues.'
http://www.pbc.gov.cn/publish/goutongjiaoliu/524/2015/20150330163822150415674/20150330163822150415674_.html

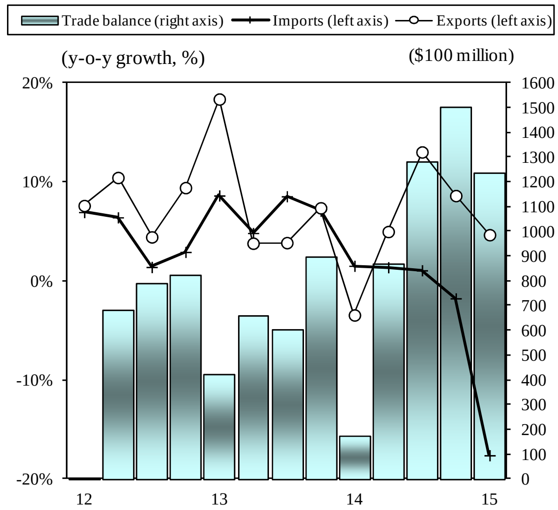
- **Exports are enjoying a gentle recovery on a quarterly basis**

Fig. 9: Imports/exports; trade balance



Note: Same-period previous-year growth and cumulative figures for January–February.
Source: China Customs Statistics

Fig. 10: Imports/exports; trade balance (quarterly)



Source: China Customs Statistics

Exports were down 15.0% in March ($144.57 billion), while imports fell by 12.7% ($141.49 billion), with the trade surplus standing at $3.08 billion (see Fig. 9, 10). The export data had deteriorated and the import data had improved compared to the figures for January–February (Exports: +15.0%, Imports: -20.2%). In January–March, exports were up 4.7% ($513.9 billion) while imports were down by 17.6% ($390.2 billion), with total trade standing at -6.3%, below the government's 2014 target for trade growth of +6.0%. The trade balance was in the black to the tune of $123.7 billion.

Ministry of Commerce spokesman Danyang Shen explained that the sharp fall of exports in March was due to factors related to the Chinese New Year holidays. He said that every year during the first quarter, the size and variability of imports and exports were difficult to predict. He put this relatively-large volatility down to the impact of incomparable factors, such as changes in the number of working days or shifts in the previous year's base figures. In 2015, exports had fallen slightly in January, risen sharply in February, then dropped again in March. Shen said that it was impossible to make an objective and correct assessment of these sharp fluctuations unless they were analyzed from a quarterly perspective. According to the Ministry of Commerce's tentative analysis, he continued, on the whole exports were moving stably within the range of forecasts, though the slump in imports was quite striking and considerably larger than expected[3].

[3] Ministry of Commerce, April 16, 2015: 'Regular Press Conference of Ministry of Commerce on April 16, 2015.'
http://english.mofcom.gov.cn/article/newsrelease/press/201504/20150400947477.shtml
Due to calendar-related factors, the number of working days fluctuates according to whether the Chinese New Year holidays fall in January or February. The holidays fell in late February this year, and thus the impact of the holidays seems to have stretched over into March.

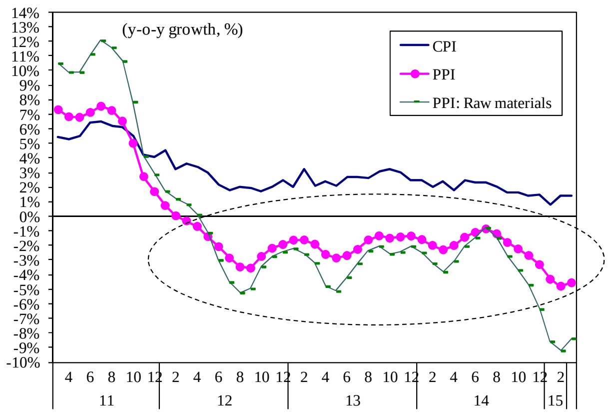
- <u>**CPP and PPI continue to move bearishly**</u>

In March, CPI (Consumer Price Index) growth stood at +1.4%, the same as in February. It was down 0.5% compared to the previous month. The PPI (Producer Price Index) fell by 4.6% in March. Though this was an improvement on February's figure of -4.8%, it was the same as the average figure for January–February (-4.6%), with the PPI now remaining in negative territories for 37 successive months since March 2012 (see Fig. 11).

The NBS put forward three reasons to explain why the CPI dipped on the previous month: (1) Demand for some fresh foods had dropped off after the Chinese New Year holidays; (2) rising temperatures and moderate rainfall had boosted the output of fresh vegetables after the Chinese New Year holidays; and (3) the prices of services such as car washing, hairdressing and housekeeping had normalized (after rising during the holidays) as migrant workers returned to the cities (from their home provinces)[4].

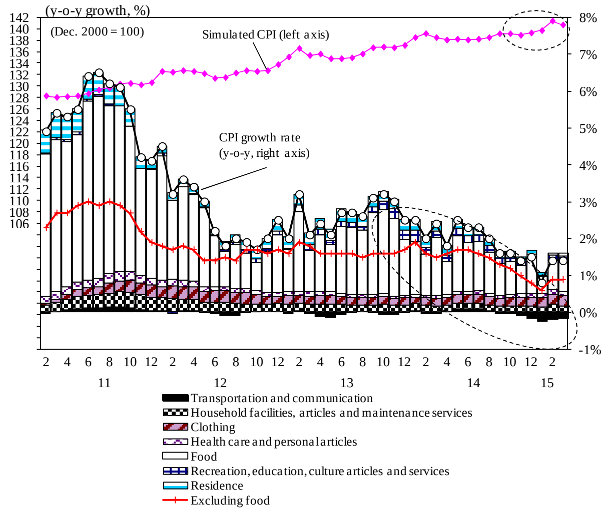
At +1.2%, the average CPI for January–March was significantly below the government's target of +3.0%. A breakdown of the CPI data shows food prices jumping 2.3% in March, up on the +1.7% average recorded in January–February (see Fig. 12). At +2.0%, the price of pork began rising again for the first time in 15 months, since December 2013 (+1.6%). Non-food prices rose 0.9% in March, slightly up on the figure for January–February (+0.8%).

Fig. 11: CPI, PPI



Source: National Bureau of Statistics of China, CEIC

Fig. 12: CPI; Growth contribution by item



Note: The contribution rate of each item is calculated by Mizuho Bank based on the y-o-y growth rate and consumption expenditure statistics for each item. The simulated CPI data is calculated by Mizuho Bank based on the m-o-m growth rate for each month, with December 2000 as the base month.

Source: National Bureau of Statistics of China, CEIC

[4] National Bureau of Statistics, April 10, 2015: 'Yu Qiumei, a senior statistician at the National Bureau of Statistics, deciphers the March 2015 CPI and PPI data.'
http://www.stats.gov.cn/tjsj/sjjd/201504/t20150410_708982.html

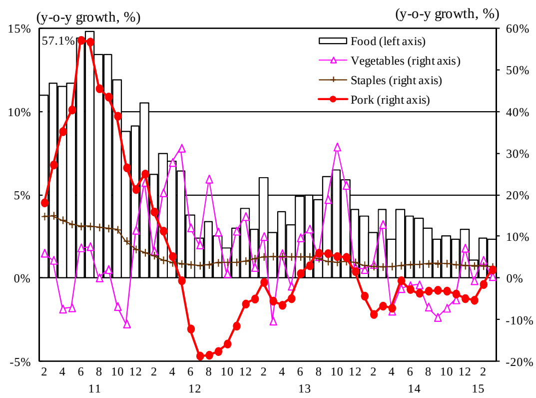
- **Total social financing and money supply growth slowed**

According to the PBOC, new bank loans increased by a net RMB 1.18 trillion in March, up on February's figure of RMB 1.12 trillion. As for the money supply, M2 increased by 11.6% in March. This was down on February's +12.5% and also below the government's target of +12% (see Fig.14). Total social financing, which includes other financing besides bank lending, rose to a net RMB 1.18 trillion in March[5], down on February's figure of RMB 1.3532 trillion. There was a larger net increase in corporate bonds and non-financial-institution equity issuance, but a slower net increase in the amount of RMB loans and entrusted loans, while the amount of foreign currency loans, trust loans, and bankers' acceptances actually saw a net decrease (see Fig. 15, 16).

Sheng Songcheng, head of the PBOC's Financial Survey and Statistics Department, said the slowdown in money-supply growth was due to: (1) a decline in the amount of funds outstanding for foreign exchange; (2) a fall in the number of fund operations in the interbank market; and (3) a fall in off-balance-sheet financing[6]. As for (3), commercial banks are facing stricter supervision, and thus trust loans, entrusted loans, and bankers' acceptances (the off-balance proportion of the total social financing) have grown at a far slower rate or actually decreased.

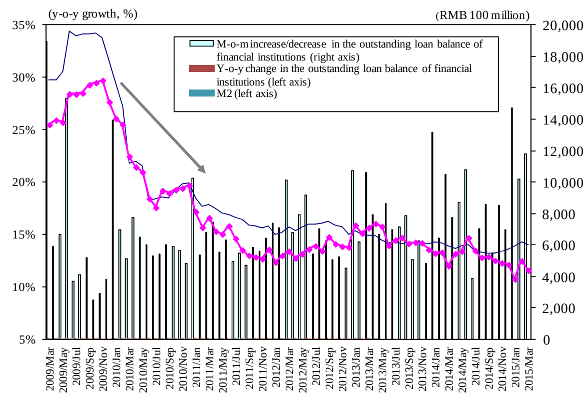
The four main factors shaping the scale of total social financing were: (1) an increase in the amount of RMB loans aimed at the real economy, with RMB loans rising sharply to account for 78.3% of the total social financing amount; (2) a drop-off in the amount of foreign-currency loans; (3) a rise in the amount of direct financing, with equity issuances rising sharply; and (4) a slowdown in off-balance-sheet financing after the stricter supervision by the authorities.

Fig. 13: Food prices



Source: National Bureau of Statistics of China, CEIC

Fig. 14: Financial institution lending; the money supply



Note: The graph shows end-of-quarter figures up until the end of 2010. The figure in the graph shows the y-o-y change in the outstanding loan balance for the most recent month.

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5 The (preliminary) total social financing data showed RMB loans increasing by a net RMB 995.5 billion.
PBOC, April 15, 2015: 'Financial Statistics, Q1 2015.'
http://www.pbc.gov.cn/publish/english/955/2015/20150421083855791843271/20150421083855791843271_.html
PBOC, April 15, 2015: 'Total Social Financing Statistics, Q1 2015.'
http://www.pbc.gov.cn/publish/goutongjiaoliu/524/2015/20150414083251616951502/20150414083251616951502_.htm

6 PBOC, April 14, 2015: 'Sheng Songcheng, head of the PBOC's of Financial Survey and Statistics Department, replies to press questions about the Q1 financial statistics.'
http://www.pbc.gov.cn/publish/goutongjiaoliu/524/2015/20150414153718117625570/20150414153718117625570_.html

Source: PBOC, CEIC

Fig. 1: Total Social Financing

People's Bank of China – Total Social Financing Statistics (RMB 100 million)

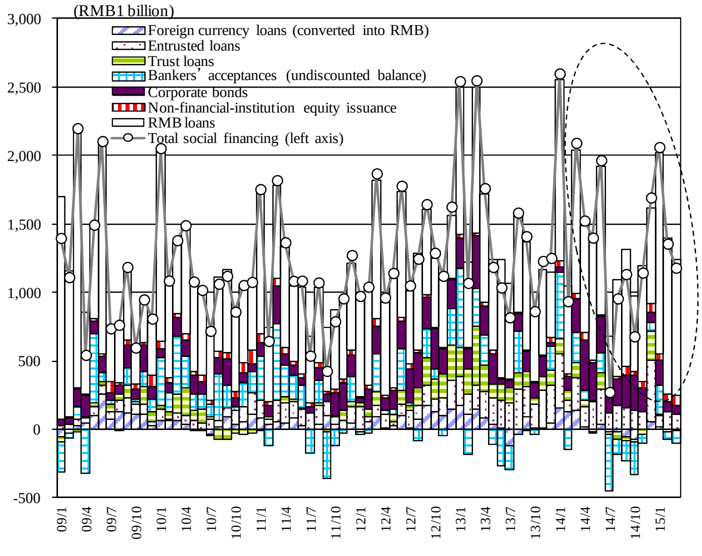
Period	Total Social Financing	Breakdown: RMB loans	Foreign currency loans (converted into RMB)	Entrusted loans	Trust loans	Bankers' acceptances (undiscounted balance)	Corporate bonds	Non-financial-institution equity issuance
2002 (total)	20,112	18,475	731	175	-	-695	367	628
2005 (total)	30,008	23,544	1,415	1,961	-	24	2,010	339
2010 (total)	140,191	79,451	4,855	8,748	3,865	23,346	11,063	5,786
2011 (total)	128,286	74,715	5,712	12,962	2,034	10,271	13,658	4,377
2012 (total)	157,631	82,038	9,163	12,838	12,845	10,499	22,551	2,508
2013 (total)	173,169	88,916	5,848	25,466	18,404	7,756	18,111	2,219
January–March 2014	56,308	30,136	4,252	7,182	2,878	5,736	3,865	975
January–June 2014	105,254	57,382	4,632	13,291	4,601	7,876	12,951	1,873
January–September 2014	128,923	76,832	3,756	17,871	3,602	1,188	18,658	3,034
2014 (total)	164,571	97,816	3,554	25,070	5,174	-1,285	24,253	4,350
March 2015	46,021	36,065	61	3,242	13	604	3,137	1,808

Total Social Financing Statistics (by fiscal year; composition ratio) (%)

2002	100.0%	91.9%	3.6%	0.9%	-	-3.5%	1.8%	3.1%
2005	100.0%	78.5%	4.7%	6.5%	-	0.1%	6.7%	1.1%
2010	100.0%	56.7%	3.5%	6.2%	2.8%	16.7%	7.9%	4.1%
2011	100.0%	58.2%	4.5%	10.1%	1.6%	8.0%	10.6%	3.4%
2012	100.0%	52.0%	5.8%	8.1%	8.1%	6.7%	14.3%	1.6%
2013	100.0%	51.3%	3.4%	14.7%	10.6%	4.5%	10.5%	1.3%
January–March 2014	100.0%	53.5%	7.6%	12.8%	5.1%	10.2%	6.9%	1.7%
January–June 2014	100.0%	54.5%	4.4%	12.6%	4.4%	7.5%	12.3%	1.8%
January–September 2014	100.0%	59.6%	2.9%	13.9%	2.8%	0.9%	14.5%	2.4%
2014	100.0%	59.4%	2.2%	15.2%	3.1%	-0.8%	14.7%	2.6%
March 2015	100.0%	78.4%	0.1%	7.0%	0.0%	1.3%	6.8%	3.9%

Note: The discrepancy between the total amount and the cumulative amount of the composition ratios is around 2% on average.
Source: PBOC, CEIC

Fig. 16: Total social financing (net increase or decrease)



Source: PBOC, CEIC

2. As the government implements policy responses and the employment situation moves stably, the authorities are focusing on structural adjustment and stable growth

- **Prioritizing structural adjustment and stable growth**

With the government intermittently implementing stimulus measures to tackle the ongoing economic downturn, the focus is on whether there will be even more policy support in the wake of the recent GDP results. For now, the authorities will probably focus on stimulating the economy through traditional fiscal and monetary policies, such as cuts to interest rates and required reserve ratio or the implementation of railway or other infrastructure building projects (with a series of projects already given the official go-ahead). They are also expected to push forward with economic structural adjustment as they try to tackle the problems of regional debt and overcapacity.

During his keynote speech at the Boao Forum for Asia on March 28, Chinese President Xi Jinping said the following: "When looking at China's economy, one should not focus on the growth rate only. As the economy continues to grow in size, around 7% growth would be quite impressive, and the momentum it generates would be larger than growth at double digits in previous years. It is fair to say that the Chinese economy is highly resilient and has much potential, which gives us enough room to leverage a host of policy tools. Having said that, China will continue to be responsive to the new trend and take initiatives to shape the new normal in our favor. We will focus on improving quality and efficiency, and give even greater priority to shifting the growth model and adjusting the structure of development[7]."

In an interview with the Financial Times, a UK newspaper, Premier Li Keqiang stated that "the Chinese economy has become so large, amounting to 10 trillion US dollars. So, it won't be easy to achieve another 7 per cent growth this year. This requires vision, perseverance and courage." He also denied the government had been intervening to devalue the RMB, saying "We don't want to see further devaluation of the Chinese currency, because we can't rely on devaluing our own currency to boost exports[8]."

The authorities seem relatively calm about the economic outlook, with the employment situation moving stably as they place more focus on improving the quality and efficiency of economic development than on maintaining the pace of growth. At the recent NBS briefing, spokesman Sheng Laiyun announced that the surveyed unemployment rate stood at 5.1%, the same as at the end of 2014[9]. However, if the employment situation worsens from here on following moves to rid the economy of overcapacity, for example, the authorities may well try to stimulate the economy through tried-and-tested methods such as pouring money into large infrastructure projects. For the time being, they are likely to continue running the economy while striking the right balance of economic policies aimed

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7 Xinhua, March 29, 2015: 'Full text of Chinese President's speech at Boao Forum for Asia.'
http://news.xinhuanet.com/english/bilingual/2015-03/30/c_134108646.htm

8 The State Council of the People's Republic of China, April 16, 2015: 'Transcript of Premier Li Keqiang's Interview with Financial Times Editor Lionel Barber.'
http://www.gov.cn/guowuyuan/2015-04/16/content_2847342.htm

9 See footnote 1.

at structural adjustment and stable growth.

- **The announcement of an action plan for the 'One Belt One Road' initiative**

March 28 saw the release of an action plan for the 'One Belt One Road' initiative connecting China with the rest of the world (the Silk Road Economic Belt and 21st-Century Maritime Silk Road). This initiative was raised at the December 2014 Central Economic Working Conference and the March National People's Congress as a priority regional policy. The main points of the action plan are outlined in Fig. 17 below.

Fig. 17: Main points of the 'One Belt One Road' action plan

1. Infrastructure	• Pursue mutual cooperation and promote green (environmentally friendly), low-carbon infrastructure construction and operation management
2. Transport infrastructure	• Link up unconnected road sections; increase sea routes and the number of voyages; and expand and build platforms and mechanisms for comprehensive civil aviation cooperation
3. Energy infrastructure	• Work in concert to ensure the security of oil and gas pipelines and other transport routes; build cross-border power supply networks; cooperate in regional power grid upgrading and transformation
4. Communications	• Jointly advance the construction of cross-border optical cables and other communications trunk line networks; improve spatial (satellite) information passageways
5. Trade	• Open free trade areas; develop cross-border e-commerce; integrate investment and trade
6. Customs cooperation	• Lower non-tariff barriers
7. Investment	• Agriculture, energy, minerals, environmental protection, biopharmacy, etc.
8. Cooperation in emerging industries	• Establish entrepreneurial and investment cooperation mechanisms
9. Financial integration	• Expand the scope and scale of bilateral currency swaps and settlements; make efforts to establish the Asian Infrastructure Investment Bank (AIIB) and BRICS New Development Bank
10. Financial regulation	• Give full play to the role of the Silk Road Fund and sovereign wealth funds (SWF); encourage commercial equity investment funds and private funds to participate in the construction of key projects of the Initiative.

Source: The State Council of the People's Republic of China, April 15, 2015: 'Vision and actions on jointly building Belt and Road'
http://www.gov.cn/xinwen/2015-03/28/content_2839723.htm

Mihoko Hosokawa, Research Executive; Advisory Division, Mizuho Bank (China), Ltd.