Why China?

Background

China is the great economic success story of the past 30 years. Since the "reform and opening-up" policy was introduced in 1978, China has changed beyond recognition. A Soviet-styled planned economy has transformed into a vibrant market-orientated economy and 600 million people have been lifted out of poverty. Between 1985 and 2010, 70% of the world population who had been lifted out of poverty were Chinese. Without China, the global poor population would have risen by 58 million.

Well known for its manufacturing capability, China is the largest global producer of toys, textiles, washing machines, cameras and computers (among hundreds of other products). It is also the world's largest consumer of iron, steel, coal and cement, and China's hunger for raw materials continues.

Driving global economic recovery

Traditionally, China provided low-cost manufacturing solutions for the global market, but exports declined sharply after the global downturn in 2008 and China's manufacturing industry responded by quickly moving up the value chain.

The Chinese economy has grown at just under 10% a year for 32 years, overtaking Japan in 2010 to become the world's 2nd largest economy. According to the OECD's International Comparison Programme (ICP), China is projected to overtake the US in 2016 in Purchasing Power Parity (PPP) terms.

While many of the world's major economies are still struggling to recover from economic contraction, China's economy grew by 9.2% in 2011 (down from 10.3% in 2010), and this economic slowdown continued in 2012 to around 8.2%, partly due to suppressed demand in China's largest export markets (Europe, USA) but also to tightening of monetary policy in late 2011. The Chinese government has subsequently since been loosening monetary policy and has launched a major investment programme.

The Chinese Government is now pressing hard to improve infrastructure and social welfare as well as targeting resources to develop China's vast rural and interior regions, unleashing domestic consumption among the wider population. Industrial structures are shifting inland with dozens of new cities emerging and coastal areas developing into sophisticated urban clusters.

McKinsey reckon that China's economic transformation is happening at 100 times the scale of the first country to urbanise – the UK – and at 10 times the speed. By 2030, they predict that there will be 221 cities in China with a population of more than 1 million, compared with 35 such cities in Europe today, and HSBC reckon there are currently around 80 Chinese cities with a population of over 5 million with no system of mass transportation.

By 2025, China will build TEN New York-sized cities. Forty billion square metres of floor space will be built in five million buildings. 50,000 of these buildings could be skyscrapers – the equivalent of ten New York Cities.

Source: Mckinsey, “Preparing for China’s urban billion”

Economic Focus

Gross Domestic Product (GDP) grew by about 10% a year from the start of market reforms in 1978 to the 2008 financial crisis. The headline figure has now (May 2015), fallen to just over 7% as the government rebalances the economy to make growth less reliant on investment.

The World Bank predicts growth of 7.2% in 2015 and 7.1% in 2016 following growth of 7.7% in 2013. Slowing growth has resulted in significant changes to China’s growth strategy.

Nearly 40 Chinese companies have entered the Global Fortune 500 list, and China’s middle class is expected to reach 600 million by 2020. Import demand is expected to rise by USD $3.4 trillion between 2010 and 2020.

Source: UKTI March 2015

The FCO recently published China’s economic annual data for 2014. The headline figure was growth of 7.4%, consistent with the authorities’ target of ‘around 7.5%’. 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 (2014) was nearly USD $1 trillion, around 30% of the entire UK economy and nearly double China’s incremental GDP growth in 2009, when headline growth was more than 10%.

Source: British Embassy Beijing: “China Economic Focus” January 2015

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.

Source: British Embassy Beijing: “China Economic Focus” January 2015

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. 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 on improving efficiency, selling assets and identifying more sustainable new sources of revenue.

Source: British Embassy Beijing: "China Economic Focus" January 2015

The economy The Chinese economy grew by 7.4% in 2014, consistent with the official target of "around 7.5%". Economic growth in 2014 Q4 was 7.3%, the same as in 2014 Q3 and higher than market consensus. On a quarterly basis (seasonally adjusted), growth further slowed to 1.5% in Q4 from 1.9% in Q3.

In 2014 growth in most provinces did not meet local targets. As a consequence, most provinces have lowered their targets for 2015. Shanghai is the only province/municipality so far that has not set a GDP growth target for 2015.

The data showed some positive structural changes. The tertiary (services) sector contributed 48.2% to GDP in 2014, up from 46.9% in 2013. Consumption contribution to GDP was 51.2%, compared with 49.2% in 2013, while investment contributed 48.5% to GDP.

In January 2015, China's Ministry of Commerce released the draft 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), (See the Free Trade Zone section later in this guide for more detail). It will be the most significant change in China's regime for foreign investment.

Source: British Embassy Beijing: "China Economic Focus" January 2015

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

Industrial production (IP) grew by 7.9% in December 2014 (on a year earlier), up from 7.2% in November, a bit higher than market expectations. On a monthly basis (seasonally adjusted), IP growth was 0.75% in December, compared with 0.54% in November. IP growth for whole year 2014 was 8.3%, compared with 9.7% in 2013.

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 was 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 the previous month.

Official services PMI improved to 54.1 in December 2014 from 53.9 in November. The HSBC services PMI also improved to 53.4 in December from 53 in November.

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

Source: British Embassy Beijing: "China Economic Focus" January 2015

Credit growth In 2014, China's overall credit growth slowed to 14.7% year-on-year, down from 18.5% 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.

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.

Money supply (M2) grew by 12.2% in December (on a year earlier), compared with 12.3% 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.

Source: British Embassy Beijing: "China Economic Focus" January 2015

Inflation The consumer prices index (CPI) rose by 1.5% in December 2014 (on a year earlier), compared with 1.4% in November. This was in line with market expectations. On a monthly basis, CPI rose by 0.3% in December, compared with a 0.2% decline in November. Food inflation was the main contributor of the increase. The full year CPI in 2014 rose by 2%, well below the official target of 3.5%.

The Producer Prices Index (PPI), an indicator for upstream inflation pressure, declined by 3.3% in December 2014 (on a year earlier), further down from 2.7% decline in November. This was below market expectations. Falling of oil prices and overcapacity were the main causes of the contraction. The full-year PPI in 2014 declined by 2.2%, compared with a 2% decline in 2013.

Source: British Embassy Beijing: "China Economic Focus" January 2015

Exports and imports growth China's exports rose by 9.7% in December 2014 (on a year earlier), up from 4.7% 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.

Imports declined by 2.4%in December 2014 (on a year earlier), compared with 6.7% decline in November and much higher than market expectations. Weak demand and low commodity prices still put pressure on imports.

China registered a trade surplus of USD $49.6 billion in December 2014, down from the highest record of USD $54.5 billion in November.

China's full year trade growth in 2014 was 3.4%, well below the official target of 7.5%. This was the third consecutive year that trade growth failed to meet the target. This was attributed to three factors: slow recovery of the world economy; the weakening of China's comparative advantages in low cost and declining of manufacturing investment in China from advanced economies; and the rapid falling of commodity prices.

Source: British Embassy Beijing: "China Economic Focus" January 2015

Labour market Income growth remained strong. Rural incomes grew by 9.2% in Q4, lower than 9.7% in Q3. Growth of urban income slowed to 6.8% in Q4, compared with 6.9% in Q3. In 2014 income growth was 8.0%, urban income grew by 6.8% and rural income grew by 9.2%.

The labour market remained buoyant. The quarterly job/job seeker ratio was 1.15% in Q4, compared with 1.09% in Q3. 13.22 million new urban jobs were created in 2014, a record year despite the growth slow-down.

Source: British Embassy Beijing: "China Economic Focus" January 2015

Property sector Official data show that out of 70 cities surveyed, 66 saw lower property prices in December 2014 (on a month earlier), compared with 67 in November. The contraction of property prices 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 a year before, 68 out of the 70 cities had lower property prices in December 2014, the same as in November.

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

Source: British Embassy Beijing: "China Economic Focus" January 2015

RMB:$ exchange rate The RMB depreciated by 0.36% against the US$ in 2014, compared with

3.1% appreciation in 2013. The RMB's real effective exchange rate (REER) appreciated by 6.2% in 2014, compared with 7.9% appreciation in 2013.

Source: British Embassy Beijing: "China Economic Focus" January 2015

Trade with the UK

For many years the USA has been our largest trading import partner by value, but since 2013 it has shared this top position with China.

Exports to China from the UK in February 2015 were £0.9 billion, a 7.6% increase from February 2014. Imports to the UK from China totalled £2.9 billion in February 2015, 9.7% down from the previous month, but 23% up from February 2014.

Source: HM Revenue & Customs Overseas Trade Statistics, April 2015

UK Exports to the top 5 Non-EU countries, February 2

Partner Country	February 2015 Exports (£ millions)	Change from January 2015 (%)	Change from February 2014 (%)
USA	3,197	-6.3	8.3
Switzerland	974	-47.8	-71.6
China	890	7.6	-23.0
United Arab Emirates	681	38.4	56.1
Qatar	400	137.4	56.2
Others	5,829	3.1	-5.2
Total Exports	**11,971**	**-3.6**	**-16.8**

Source: HM Revenue & Customs Overseas Trade Statistics
Note: 2014 & 2015 data are provisional

UK Imports from top 5 Non-EU countries, February 201

Partner Country	February 2015 Total (£ millions)	Change from January 2015 (%)	Change from February 2014 (%)
China	2,918	-9.7	23.0
USA	2,869	1.9	22.7
Norway	1,088	10.8	-27.4
Switzerland	974	33.8	47.8
Canada	822	-24.5	12.3
Others	7,307	-4.6	10.4
Total Imports	**15,979**	**-3.2**	**12.4**

Source: HM Revenue & Customs Overseas Trade Statistics
Note: 2014 & 2015 data are provisional

Source
\- *www.uktradeinfo.com/Statistics/NonEUOverseasTrade/Pages/NonEuOTS.aspx*

UK's exports to China are growing 3 times as fast as our imports from China. Top UK exports to China include:

- road vehicles
- medicinal and pharmaceutical products

- power generating machinery / equipment
- metalliferous ores and scrap metal
- general industrial machinery, equipment and parts

Source: UKTI March 2015

Seizing opportunities

While the rise of China is easy to acknowledge, businesses constantly need to catch up with the speed and depth of change and development in China's large and complex market space. Whether selling, trading, investing or franchising, China offers opportunities in abundance to UK companies, large or small. It is therefore worth contacting the CBBC to assess the very latest updates and opportunities available across China. See: www.cbbc.org for more information.

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