

## Chapter 2

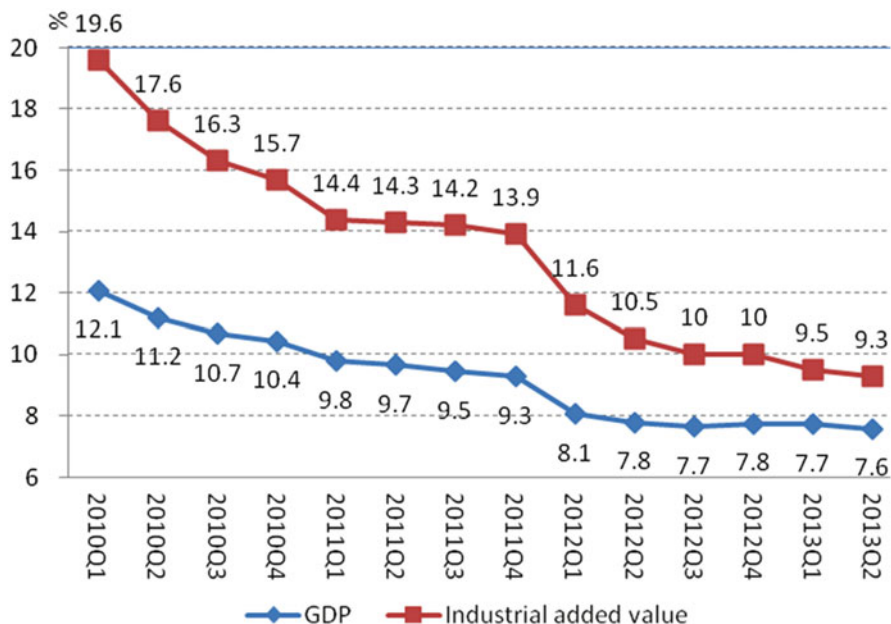
# A Review of China's Economy in the First Half of 2013

In the first half of 2013, China's industrial production grew slowly, economic growth rate continued to decline, and the growth rate of government revenue fell sharply because of the sluggish external market demand as well as domestic excess production capacity; the expansion of consumption demand could not continue due to the slowdown in the growth rate of real income of urban and rural residents; therefore, the investment in fixed assets was still the main driving force of economic growth. Looking forward to the second half of 2013, the euro-zone economy continued to shrink, and Chinese exports to Europe will be restrained; on the other hand, the steady economic growth of the USA and the developing countries will be conducive to China's exports. However, the slow growth of domestic real economy, government revenue, resident real income and private investment demand have become the important obstacles to growth of China's economy. Overall, China's economic growth in 2013 may achieve 7.5 %, the target set by the central government, and the price level may be stable. To achieve China's economic targets and to ensure that China's economy will maintain the growth rate within a reasonable range, the macroeconomic policy authority of China should still take precautions according to the dynamic of the economic development, carry out timely and appropriate anticipatory adjustments and fine-tuning, and make policies more targeted, flexible, and anticipatory. Meanwhile, to ensure that China's economy will grow sustainably, China needs to launch a new round of reform of social and economic systems, to develop and improve the socialist market economy, to promote equal competition, to optimize resource allocation, to correct price distortions, to adjust the economic structure, to improve the government's public management, to reduce the burden of enterprises, to improve supply efficiency, to release the economic growth potential, to foster domestic demand. All these works will in favor of the social and economic development and transformation, the smooth transition from the middle-income economies to a higher stage of development.

## 2.1 Economic Growth Slowed Down, Structural Imbalance Persisted

The growth rate of China's industrial production and gross domestic product (GDP) continued to decline (Fig. 2.1) because of the weak external market demand and domestic excess production capacity. The growth rate of cumulative industrial added value fell from 19.6 % in the first quarter of 2010 to 9.3 % in the second quarter of 2013, and GDP growth rate also fell from 12.1 to 7.6 %, both reached their nadirs within nearly 3 years.

Based on the expenditure accounting approach, the cumulative contribution rate of investment to GDP growth increased from 30.3 % in the first quarter to 53.9 % in the first half year of 2013 meanwhile, the cumulative contribution rate of final consumption to GDP growth decreased from 55.5 % to 45.2 %, an decrease of 5.2 percentage points over the previous year; the cumulative contribution rate of net outflow of goods and services to GDP was 0.9 %. Therefore, China's economy continued to slow down, meanwhile, the structural imbalance persisted; investment was still the main driving force of economic growth in the first half of 2013.



**Fig. 2.1** The changes in the growth rate of GDP and industrial added value (on year-on-year basis) from 2010 to 2013 (Data Source: CEIC Data)

## 2.2 Manufacturing Investment Growth Fell Sharply, Transportation Investment Grew Fast

In the first half of 2013, urban cumulative fixed asset investment increased by 20.1 %, a decrease of 0.3 percentage points over the previous year. In terms of industries, the cumulative growth rate of investment in the manufacturing sectors was 17.1 %, a decrease of 7.4 percentage points over the previous year, the lowest growth rate within a decade; the cumulative growth rate of investment in real estate was 22.9 %, an increase of 0.8 percentage points over the previous year; the cumulative growth rate of investment in transportation, storage and postal services was 21.5 %, an increase of 23.5 percentage points over the previous year (Fig. 2.2). A sharp drop in the cumulative growth rate of manufacturing investment has reflected the slowdown in the real economy, as well as excess production capacity in the first half of 2013.

In the first half of 2013, in terms of the sources of budgets, the growth rate of investment from the central budget was 9.7 %, an increase of 13.8 percentage points over the previous year; the growth rate of investment from budget of the local governments was 20.7 %, a decrease of 1.4 percentage points over the previous year.

In terms of the types of investors, the cumulative growth rate of investment from state-owned and state holding enterprises was 17.5 %, an increase of 3.7 percentage points over the previous year; the cumulative growth rate of investment from Hong

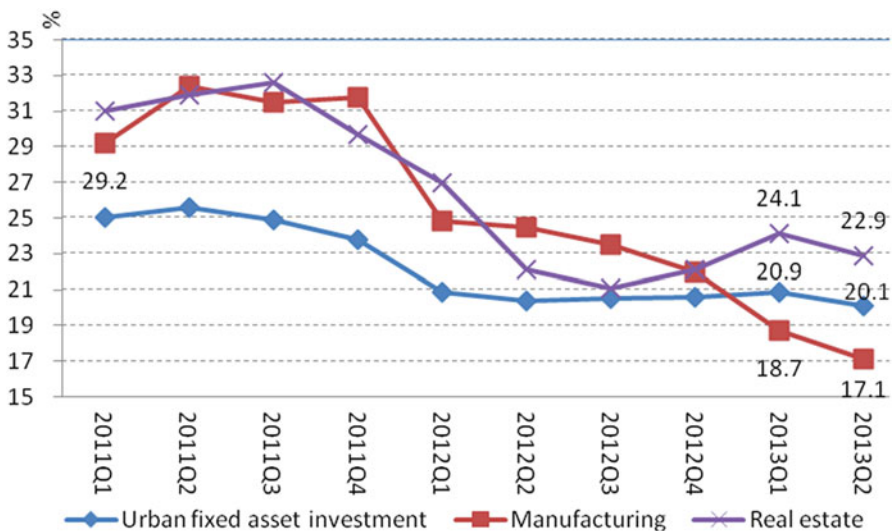


Fig. 2.2 On year-on-year basis, the cumulative growth rate of urban fixed asset investment and its industry component (Data Source: CEIC Data)

Kong, Macao and Taiwan's enterprises was 7.5 %, a decrease of 3.7 percentage points over the previous year; the cumulative growth rate of investment from foreign enterprises was 3.9 %, a decrease of 10 percentage points over the previous year. In terms of finance sources, the growth rate of investment from domestic loans was 13 %, an increase of 7.2 percentage points over the previous year; the growth rate of investment from self-raised fund was 18.6 %, a decrease of 4.3 percentage points over the previous year; the growth rate of foreign investment was -8.4 %, a decrease of 2.9 percentage points over the previous year. It can be said that the external market demand shocks and domestic excess production capacity have led to a significant decline in the growth rate of investment in non-state-owned enterprises in the first half of 2013; A substantial increase in the growth rate of investment by state-owned and state holding enterprises, domestic loans and transportation (and real estate) sector is an important factor in the steady growth of fixed asset investment in the first half of 2013.

### 2.3 The Growth of Imports and Exports Was Weak, the Trade Surplus Continued to Expand

In the first half of 2013, the weak demand from major countries, the continued appreciation of the RMB and the increase in wages have led to the weak growth of China's imports and exports. The total exports in dollars increased by 10.4 %, only up 1.3 percentage points over the previous year; the total imports grew by 6.7 %, the same as the previous year (Fig. 2.3). The cumulative trade surplus reached 107.95

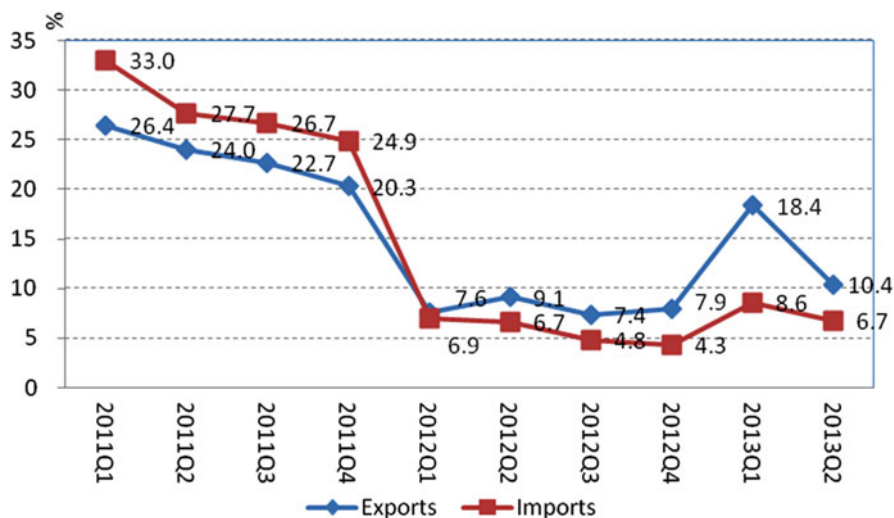


Fig. 2.3 The cumulative year-on-year growth of nominal export and import (Data Source: CEIC Data)

billion dollars, an increase of 57.4 % over the previous year. Total utilized foreign direct investment increased by 4.8 %, an increase of 7.8 percentage points over the previous year; new foreign exchange reserves stood at 185.1 billion dollars.

In terms of trade composition, in the first half of 2013, general trade exports increased by 10 %, a drop of 0.1 percentage points over the previous year; general trade imports increased by 3 %, a drop of 4.8 percentage points over the previous year; trade deficit of general trade cumulatively totaled 23.3 billion dollars. The growth rate of processing trade exports declined 0.9 %, a decrease of 7.3 percentage points over the previous year; and that of imports in processing trade grew by 4.6 %, an increase of 3.9 percentage points over the previous year; trade surplus of processing trade reduced to 172.9 billion dollars.

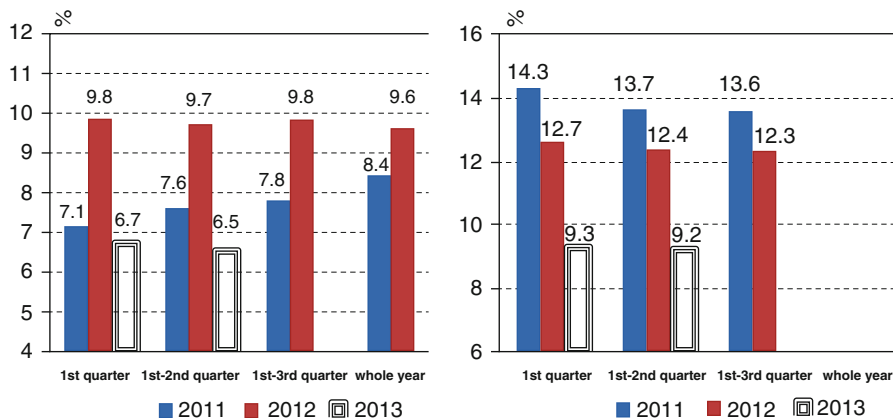
In terms of imports and exports by regions, in the first half of 2013, the growth rate of China's exports dropped by 2.1 % to Europe, by 1.7 % to the U.S., and by 20.1 % to Asia. The share of China's exports to Europe in total exports was 17.8 % in the first half of 2013, a decrease of 2.3 percentage points over the previous year; the share of exports to the U.S. was 16.0 %, a decrease of 1.3 percentage points; the share of China's exports to Asia was 52.7 %, an increase of 4.3 percentage points over the previous year.

From the import side, in the first half of 2013, the growth rate of China's imports increased by 7.3 % from Europe, by 15.1 % from the U.S., and by 7.3 % from Asia; the share of imports in three regions was roughly stable.

## **2.4 The Growth Rate of Real Income Declined, the Growth of Domestic Consumption Slowed Down**

In the first half of 2013, the per capita disposable income of urban residents was only 13,649 Yuan, due to the slowdown of the wage income; the real growth rate was 6.5 %, lower than the growth rate of GDP in the same period; a decrease of 1.1 percentage points compared with the same period of 2011, a decrease of 3.2 percentage points compared with the same period of 2012. As the price of agricultural products declined, the per capita cash income of rural residents was 4817 Yuan in the first half of 2013, the real growth rate was 9.2 %; a decrease of 4.5 percentage points compared with the same period of 2011, a decrease of 3.2 percentage points compared with the same period of 2012 (Fig. 2.4). The growth rate of real income of urban and rural residents dropped sharply, and then consumption demand could not expand.

The total retail sales of consumption goods only increased by 12.7 % in the first half of 2013, a decrease of 1.7 percentage points over the previous year, the lowest growth rate since 2008. Among the total retail sales, urban area accounted for 85 %, and rural area for 15 %. Total retail sales in urban areas rose by 12.5 %, a decrease of 1.8 percentage points over the previous year; and it increased by 14.3 % in rural areas, a decrease of 0.2 percentage points. According to the household survey data,



**Fig. 2.4** The cumulative year-on-year real growth rate of urban per capita disposable income and rural per capita cash income (Note: The National Bureau of Statistics does not publish the year-on-year real growth rate of the per capita cash income of rural residents at the end of the year. Data Source: CEIC Data)

the cumulative per capita consumption of urban residents grew by 7.2 % in the first half of 2013, a decrease of 4.2 percentage points compared with the same period in 2011, a decrease of 4.8 percentage points compared with the same period in 2012. The cumulative per capita cash expenditure of rural residents rose by 12.8 %, a decrease of 10.3 percentage points compared with the same period in 2011, a decrease of 3.8 percentage points compared with the same period in 2012.

## 2.5 CPI Changed Smoothly, PPI Continued to Fall

In June 2013 (Fig. 2.5), the consumer price index (CPI) rose by 2.7 % over the same period of previous year, of which 70.4 % was contributed by the carryover effect, 29.6 % by current price factors. The CPI excluding food and energy rose by 1.7 %, the non-food CPI rose by 1.6 %. The CPI changed mildly in the first half of 2013. On the other hand, the industrial producer price index (PPI) continued to decline.

In June 2013, the PPI fell to 2.7 %, and would fall further. Decline in PPI likely resulted from the decline in commodity prices<sup>1</sup>; and it reflected the excess production capacity of some industries, such as iron and steel, coal, glass, aluminum, photovoltaic, cement.

<sup>1</sup> The Dow Jones-UBS Commodity index showed that commodity prices decreased by about 46 % compared with the peak in 2008.

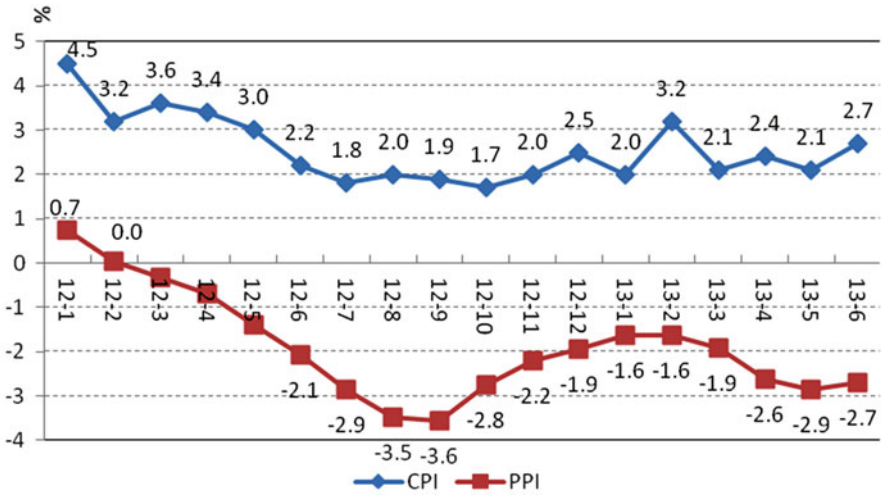


Fig. 2.5 The monthly year-on-year growth rate of the consumer price index (CPI) and the industrial producer price index (PPI) (Data Source: CEIC Data)

## 2.6 The Monetary Policy Was Tightening Gradually and the Fiscal Policy Was Fine-Tuning Actively

The monetary policy basically maintained a steady tightening situation in the first half of 2013. Broad money supply (M2) grew by 15.7 % in the first quarter and 14 % in the second quarter, a decrease of 2.46 and 4.47 percentage points over the previous year respectively. At the end of June, currency in circulation (M0) increased by 9.7 %, a decrease of 1.1 percentage points over the previous year. The balance of RMB loans increased by 14.2 % in the first half of 2013, a decrease of 1.8 percentage points over the previous year; new loans reached 5.1 trillion Yuan, 221.8 billion Yuan more than the same period of last year. Among the new loans, the real estate accounted for about 25.6 %, an increase of nearly 14 percentage points over the previous year. At the same time, the “total amount of social financing” grew rapidly in the first half of 2013, the year-on-year growth rate reaching 30.5 % until June of 2013. New loans accounted for 50 % of total amount of social financing, a decrease of 19.9 percentage points over the previous year (Fig. 2.6).

In the first half of 2013, the manufacturing investment and economic growth decreased, while the monetary and credit expanded. This showed that the slowdown in real economy had directly inhibited the willingness to invest in the real economy, and then the effect of monetary policy was restrained. On the other hand, this showed that the most new loans had gone into the real estate industry, which



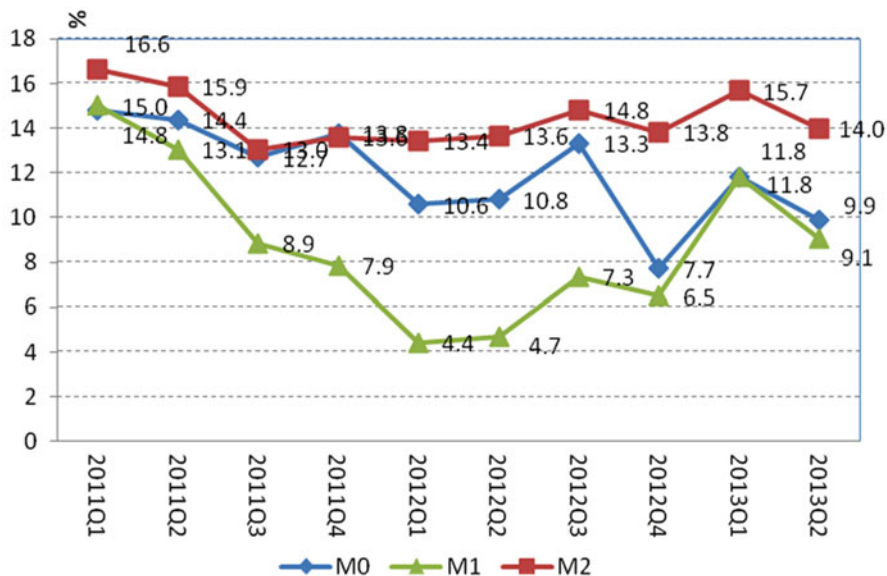


Fig. 2.6 The year-on-year growth rate of the money supply (Data Source: CEIC Data)

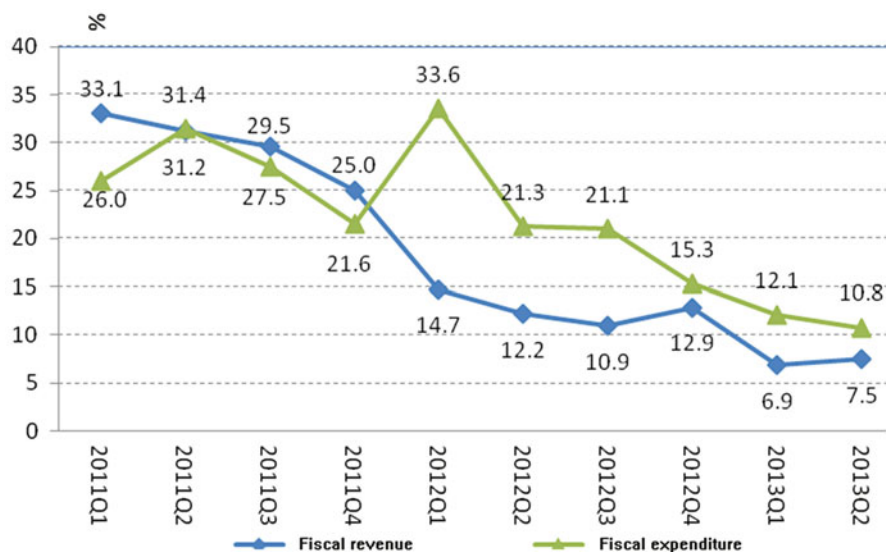
restricted by new government's regulation, rather than into the real economy. The most important one is that the driving effects of investment on economic growth were weak under the current pattern of economic growth, and the financial system had less effect on the economic growth.

On fiscal policy, in the first half of 2013, government revenue increased by 7.5 %, a decrease of 4.7 percentage points over the previous year (Fig. 2.7). The tax revenue only grew by 7.9 % in the first half of 2013, a decrease of 1.9 percentage points over the previous year due to the slowdown in the industrial production; government non-tax revenue increased by 5.3 %, a decrease of 24.2 percentage points over the previous year. In terms of the composition of government revenue, tax revenue accounted for 86.4 %, an increase of 0.3 percentage points over the previous year; non-tax revenue accounted for 13.6 %.

In tax revenue, the cumulative growth rate of corporate income tax was 14.2 %, a decrease of 3.1 percentage points over the previous year, accounting for 25.3 % of the total tax revenue; the cumulative growth rate of the value added tax was 6.6 %, a decrease of 1.45 percentage points, accounting for 24.2 % of the total tax revenue; the cumulative growth rate of the sales tax was 12.9 %, an increase of 3.2 percentage points over the previous year, accounting for 14.9 % of the total tax revenue. In addition, the decline in the growth rate of the general trade imports also led to the negative growth of the consumption tax and value added tax of the imported goods.

The growth rate of government expenditure decreased greatly due to the decline in the growth of government revenue (Fig. 2.7). The cumulative growth rate of government expenditure was 10.8 % until June, a decrease of 10.5 percentage points over the previous year, the lowest growth rate in recent years.



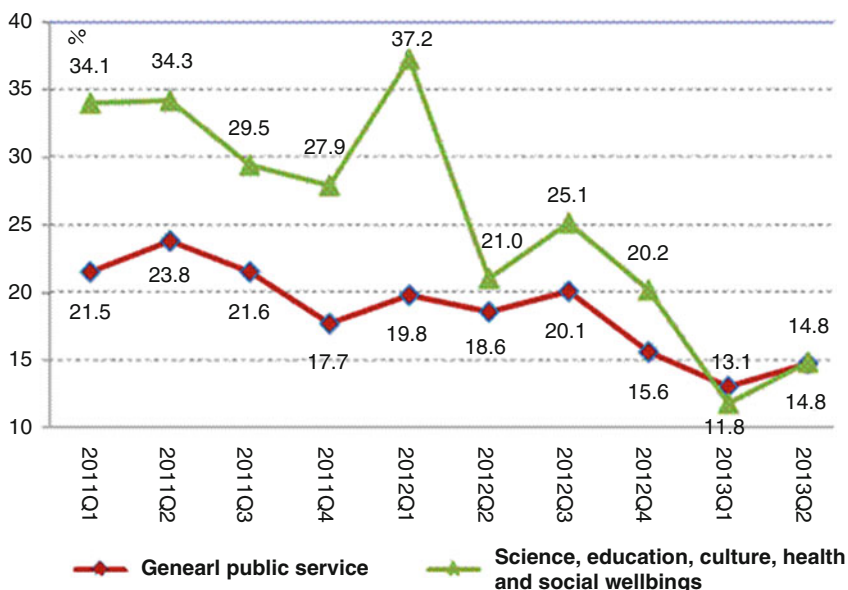


**Fig. 2.7** The year-on-year nominal growth of fiscal revenue and expenditure (Data Source: CEIC Data)

In terms of the composition of government expenditure, the cumulative growth of the general public service expenditure was 14.8 %, a decrease of 3.8 percentage points over the previous year, accounting for 10.4 % of the total government expenditure; the cumulative growth of expenditures related to people's wellbeing, such as education, science and technology, culture, sports and media, health care, social security and employment, was 14.8 %, a decrease of 6.2 percentage points (Fig. 2.8), accounting for 38.5 % of the total government expenditure. From the beginning of the year, the fiscal policy authority has introduced many fine-tuning measures<sup>2</sup> to improve government fiscal situation. However, reducing the growth rate of the expenditure in the areas related to people's wellbeing due to budget constraint is obviously not conducive to promoting the adjustment of economic structure, as well as the transformation of pattern of economic development, under the fact that the real economy is slowing down, and the relationship between investment and economic growth is increasingly weak.

In conclusion, in the first half of 2013, industrial production grew slowly, economic growth rate continued to decline, and the growth rate of government revenue fell sharply due to the weak external market demand as well as domestic excess production capacity. Although the price level remained stable, the expansion of

<sup>2</sup>As introduced in July to reduce the government general public service expenditure 5 %, some fine-tuning measures have been implemented across the country since August 1, such as "replacing the business tax with a value-added tax", stopping the construction of luxurious government office buildings and halls, tax relief for small businesses, optimizing administrative measures for export enterprises and safeguarding railway capital construction and so forth.



**Fig. 2.8** The year-on-year growth rate of government expenditure of people's livelihood in a narrow sense (Data Source: CEIC Data)

consumption demand was inhibited due to the slowdown in the growth rate of real income of urban and rural residents. A substantial increase in the growth rate of investment by state-owned enterprises, domestic loans and transportation industry, to some extent, offset the decline in the growth rate of investment in the private manufacturing sector; therefore, the growth of investment in fixed asset could keep steady. Investment was still the main driving force of economic growth, and the problem of economic structural imbalance remained unsolved. In the second half of 2013, although the recovery of the world economy will help to ease the pressure on a continuing fall in the growth of China's exports, the Chinese economy in 2013 is expected to achieve 7.5 %, a target set by the central government. However, the economic structural imbalance would worsen. Especially, under the background of the decline in the growth of government revenue, the growth rate of expenditure for people's wellbeing in the fiscal expenditure will decline more sharply than the growth rate of expenditure in the general public services of government, and the growth rate of real income of urban and rural residents will decrease. The above negative effects will hinder transformation of pattern of economic development, the adjustment of the economic structural imbalance, and the effort to increase real per capita income of residents to be in step with economic growth of the country.



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