

Chapter 2

A Review of China's Economy in 2014

2.1 Economic Growth Continued to Fall, but the Proportion of the Tertiary Industry Continued to Improve

In 2014, China's real GDP grew by 7.4 %, a decrease of 0.3 percentage points from the previous year and the lowest since 2000 (Fig. 2.1). *The main reason for this economic slowdown was the continued deceleration of the secondary industry.* The industrial growth rate was 8.3 %, a decrease of 1.4 percentage points from the previous year. The main factors behind the continued slowdown of the secondary industry were excess production capacity and excessive investment in the real estate industry. Because of the long-term accumulation of excess capacity, adjusting the industrial structure and de-stocking the real estate industry took some time, and in 2015, these two industries are still expected to exert a downward pressure on economic growth.

In 2014, the nominal investment in fixed assets (excluding farmers' investment) grew by 15.7 %, a decrease of 3.9 percentage points from the previous year. The contribution of annual capital formation to GDP growth reduced to 38.3 %, a decrease of 16.1 percentage points from the previous year (Fig. 2.2).¹ *The continued economic slowdown is bound to hinder urban and rural residents' income growth.* In 2014, the per capita disposable income of urban residents grew by 6.8 %, a decrease of 0.2 percentage points from the previous year; the per capita net income of rural residents grew by 9.2 %, a decrease of 0.1 percentage points from the previous year. The residents' consumption structure gradually changed with their increasing income level, showing a fall in material consumption growth but a rise in

¹ The statistical bureau has not yet announced this data. However, based on a routine conference of the Commerce Department on January 21, 2015, Shen Danyang, the press spokesperson, said that in 2014, the contribution of foreign trade to economic growth was about 10.5 %. On this basis, we estimated that the rate of contribution of gross capital formation on economic growth sharply declined to 38.3 %, the lowest recorded since 2000. See http://finance.ifeng.com/a/20150122/13449424_0.shtml

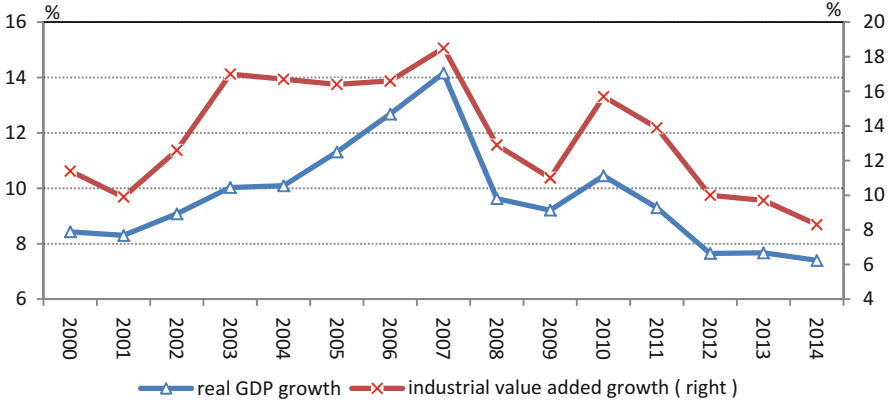


Fig. 2.1 Growth rate changes in China's GDP and industrial added value (Data source: CEIC)

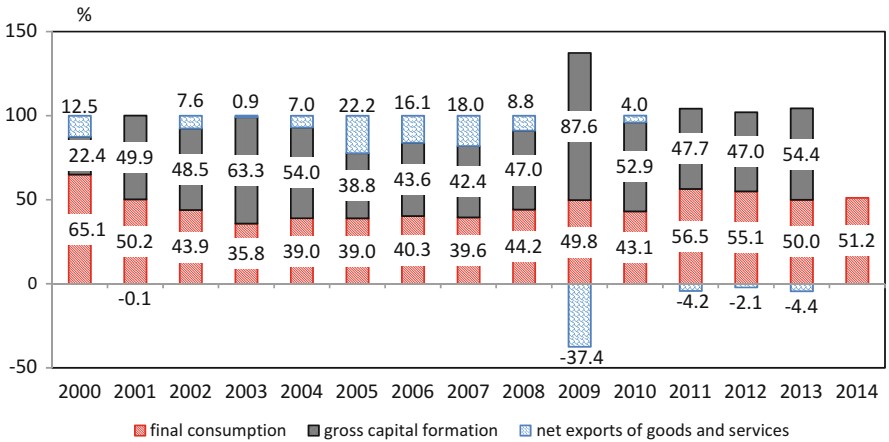


Fig. 2.2 Changes in contribution rate of GDP growth based on the expenditure accounting approach (Data source: CEIC)

proportion of service consumption. Following the government's anti-corruption move and restrictions on the "three public expenditures," the growth rate of the government's public service spending in general apparently slowed down. The total retail sales of consumption goods grew nominally, by 12.0 %, a decrease of 1.1 percentage points from the previous year.² The contribution of final consumption to

²The present total volume of retail sales contains only the domestic "material consumption amount" and "food and beverage service income" and does not include the overall residents' consumption project, especially service consumption, which grew rapidly in recent years. In tourism, for example, since 2008, the number of domestic tourists grew by 13.8 % on average per year, reaching 3.26 billion persons in 2013. The number of outbound tourists grew by 16.5 % on average per year, reaching 98.19 million people in 2013. Tourism revenue reached around 3.25 trillion

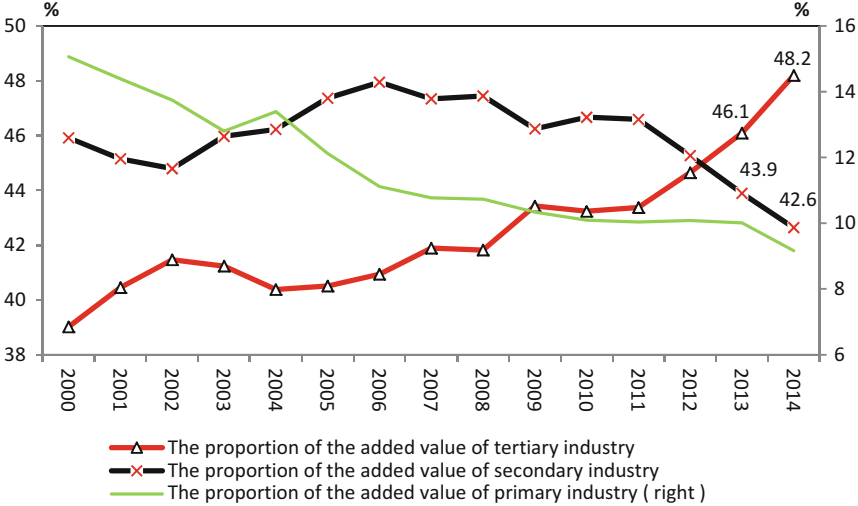


Fig. 2.3 Changes in proportion of added value of three industries in GDP (Data source: CEIC)

economic growth was 51.2 %, a slight increase of 1.2 percentage points from the previous year. Slow recovery of the external market continues to inhibit China’s export growth: the total exports in USD grew by 6.1 %, a decrease of 1.7 percentage points from the previous year. Influenced by the decline in staple commodity prices and the slowing down of domestic demand, China’s imports grew by only 0.4 %, a sharp decrease of 6.9 percentage points from the previous year. The contribution rate of net goods and services exports to economic growth sharply increased from –4.4 to 10.5 %.

From the point of industrial structure, the tertiary industry’s share in GDP increased by 2.1 percentage points in 2014, reaching 48.2 %, 5.6 percentage points higher than the share of the secondary industry (Fig. 2.3). The tertiary industry’s share continued to rise, ensuring stability of the employment situation for the whole year to a certain extent. Although the economic growth of China continued to decline, 13.22 million new jobs were generated for urban residents, exceeding the target of 10 million new jobs set in early 2014.³

USD in 2014, an increase of 11 % over the previous year. The number of domestic tourists was 3.6 billion persons, an increase by 10 % over the previous year. The number of outbound tourists hit the 100-million-person mark for the first time, reaching 109 million persons. The number of inbound tourists was 128 million persons, a decrease of 1 % from the previous year.

³The change in China’s population age structure eased the pressure on employment to a certain extent. By the end of 2012, persons aged 15–59 years (including those below 60 years), the working-age population, totaled 937 million people; this was 3.45 million persons less than the previous year. By the end of 2013, the working-age population further reduced to 920 million persons; this again dropped to 916 million people by the end of 2014, a decrease of 3.71 million persons from the end of the previous year.

2.2 Fixed Asset Investment Growth Fell Sharply, but the Investment Structure Started to Improve

In 2014, the manufacturing industry has continued its fall since 2010. Meanwhile, the years of fever in the real estate market started to cool. The beginning of the second quarter saw a drop in real estate sales growth and rise in real estate inventory. A substantial part of the urban real estate market showed a “decreasing housing price and decreasing sales volume” trend, directly inhibiting the growth of investment in the real estate industry.⁴ The manufacturing and real estate investment growth showed a sharp fall, leading to a corresponding sharp decline in growth of the total social fixed asset investment (Fig. 2.4). The full-year growth in manufacturing investment in 2014 was only 13.1 %, a decrease of 5.5 percentage points from the previous year; this accounted for 33.3 % of the total investment, a decrease of 0.6 percentage points from the previous year. Real estate investment grew by 11.1 %, a sharp decrease of 9.1 percentage points from the previous year; this accounted for 24.6 % of the total investment, a decrease of 1 percentage point from the previous year. In order to stabilize investment, infrastructure construction investment continued to maintain rapid growth; its annual growth reached 19.8 %, a fall by just 1.5 percentage points from the previous year. This accounted for 22.3 % of the total investment, an increase of 0.8 percentage points over the previous year.



Fig. 2.4 Changes in growth rate of investment in fixed assets by industry (Data source: CEIC)

⁴In 2014, by area, the national sales of commercial housing fell by 7.6 % from the previous year; the national commercial housing sales fell by 6.3 % from the previous year; and the month-to-month drop in number of newly built commercial houses sharply increased from 4 in March to 69 in September in the country's 70 large- and medium-sized cities and was 66 by the end of the year.

⁵This included transportation, warehousing and postal services, water conservancy, environment and public facilities management, electricity, heating power, gas and water production, and the supply industry.

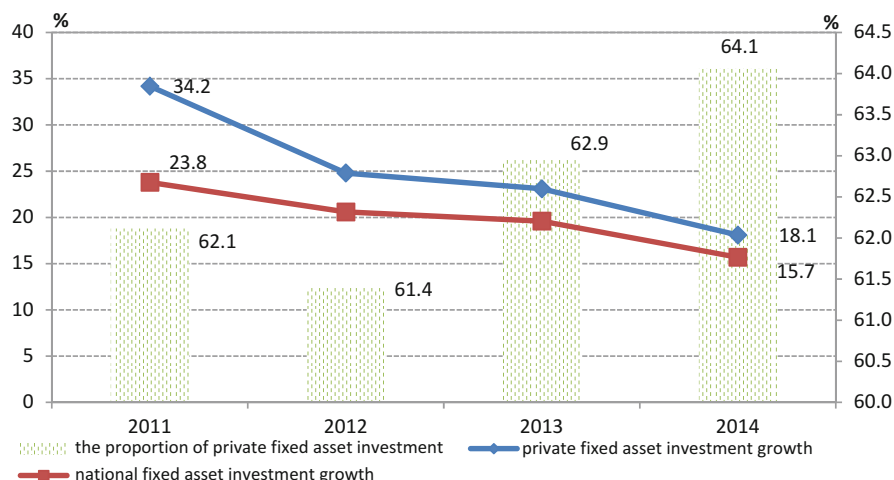


Fig. 2.5 Changes in growth rate and proportion of investment in private fixed assets (Data source: CEIC)

In terms of investment source, to begin with, in 2014, investment in domestic enterprises grew by 16.3 %, a decrease of 4.2 percentage points from the previous year. Among this, the state-owned and state-holding enterprises investment grew by 13.0 %, a decrease of 2.6 percentage points from the previous year, and private investment grew by 18.1 %, a decrease of 5 percentage points from the previous year. Although private investment growth still showed a decline, since 2012, the private fixed investment growth was always faster than the total fixed asset investment growth (see Fig. 2.5). In 2014, the proportion of private investment in the total fixed assets investment increased to 64.1 %, an increase of 1.2 % over the previous year. Private investment is the main source of growth of investment in fixed assets for stable economic growth. As the market environment changed, the economic restructure and the structure of private investment gradually started to adjust: the proportion of investment in the primary and tertiary industry increased, and the structure of investment in the secondary industry also started to adjust. Among this, investment in mining grew by 2.3 %, a decrease of 9 % from the previous year, and 18.1 % lower than in 2012; investment in manufacturing grew by 16.8 %, a fall by 4.6 % from the previous year and 10.4 % lower than in 2012.

Second, in 2014, investment from enterprises located in Hong Kong, Macao, and Taiwan grew by 8.7 %, an increase of 1.7 percentage points over the previous year; this accounted for 2.4 % of the total investment in fixed assets, an increase of 0.1 percentage points over the previous year. Finally, investment from foreign enterprises fell by 0.3 %, a decrease of 4.8 percentage points from the previous year.

In terms of project source, investment from central government projects grew by 10.8 %, a decrease of 1.6 percentage points from the previous year. Affected by the decline in local debt scale and land-transferring fee growth, the local projects investment rose only by 15.9 %, a decrease of 4.2 percentage points from the previous year.

In terms of capital source, in 2014, the source of investment funds mainly comprised domestic loans and self-raised enterprise funds. Among this, investment from the national budget funds grew by 14.1 %, a decrease of 2.9 percentage points from the previous year; this accounted for 5 % of the total investment, the same as the previous year. Investment from domestic loans grew by 8.6 %, a decrease of 5.8 percentage points from the previous year⁶; this accounted for 12 % of the total investment, the same as the previous year. Investment from self-raised funds grew by 16.4 %, a decrease of 6.4 percentage points from the previous year; this accounted for 70 % of the total investment, an increase of 3 % over the previous year and 9 % higher than that of 2010. Out of all self-raised funds, company investments from their own capital accounted for 27.7 %, a decrease of 2.58 percentage points from the previous year.⁷ The growth of foreign capital investment shrank by 6.3 %, a decrease of 2.6 percentage points from the previous year; this accounted for 1 % of the total investment, the same as the previous year.

In conclusion, we consider the following prospects: (1) In 2015, thanks to excess production capacity and inventory accumulation, the growth in manufacturing and real estate investment will continue to decline. Infrastructure investment should moderately expand in order to stabilize investment. (2) Despite decline in the total social fixed asset investment growth, the proportion of private investment continues to improve; private investment is constantly moving from the secondary industry with excess capacity to the primary and tertiary industry, and there is good momentum of structural adjustment in the manufacturing industry. This shows that under the harsh post-recession market environment, market participants should make a determined effort to adjust inventory and optimize increment, and the private investment structure should gradually optimize under severe market pressure. (3) In 2014, to a certain extent, the large supply of credit slowed down investment growth; the large increase in proportion of investment of self-raised enterprise funds meant that the demand for enterprise investment was expanding. In this background, in 2015, monetary policy should continue to ensure the supply of bank credit resources and the reduction in financing cost. Meanwhile, fiscal policy should focus on lightening the tax burden of enterprises to promote a steady rise in private investment. More importantly, the government should further streamline its administration and delegate power to lower levels, implement negative list management, ease the burden of enterprises and entrepreneurs, and reduce all sorts of investment and entrepreneurship costs. By comprehensively deepening reforms, adjusting policies, and improving its management, the government can reinvent China's economic growth potential.

⁶In 2014, the RMB loans newly increased by 9.78 trillion yuan, against 9.59 trillion yuan in 2009.

⁷In 2008, the proportion of self-raised funds at the disposal of enterprises was 52.1 %. This continued to decline sharply thereafter. It was 43.1 % in 2009, 39.2 % in 2010, 37 % in 2011, and 33.9 % in 2012. The sharp decline in proportion of self-raised funds at the disposal of enterprises illustrated the broadening of the investment channels.

2.3 The Industrial Profit Growth Declined Sharply, and Eliminating Backward Production Capacity Achieved Certain Progress

In 2014, the profit of the industrial enterprises abovementioned grew by 3.3 %, a decrease of 8.9 percentage points from the previous year. Among this, the mining industry’s profits fell by 23 %, a decrease of 2.0 percentage points from the previous year; the profit of goods manufacturing industry, represented by food, textiles and garment, tobacco, and so on, grew by 5 %, an increase of 0.2 percentage points over the previous year. The profit of equipment manufacturing and high-tech manufacturing industries grew strongly, 0.9 % and 12.7 %, an increase of 4.1 % and 6.7 %, respectively, over the previous year’s results (Fig. 2.6).

In 2014, the elimination of backward production capacity in industries with excess capacity continued to progress: the elimination of backward steel by 35.67 million tons, cement by 81.25 million tons, and plate glass by 35.67 million weight boxes accounted for 3.1 %, 3.3 %, and 4.5 % of the total output, respectively (Fig. 2.7).

To some extent, this shows that China’s manufacturing industry is adapting to the change of market environment through structural adjustments and the development of equipment manufacturing and high-technology manufacturing industries with accelerated high added value, eliminating backward production capacity, continuing to make progress in industries with excess capacity, and

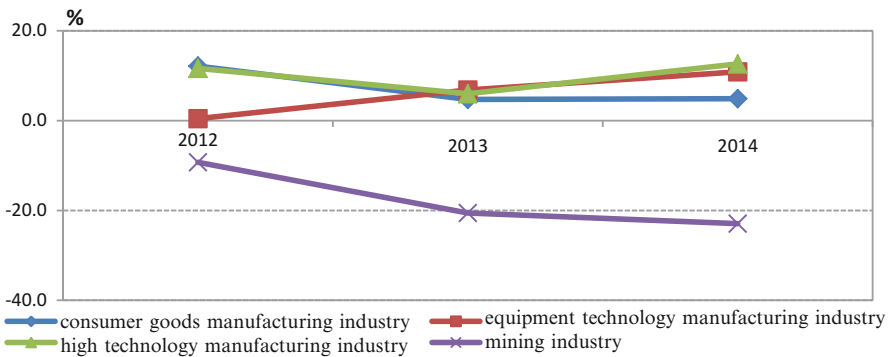


Fig. 2.6 Changes in profit growth rate of part of the above industrial enterprises (In this paper, the equipment manufacturing industry includes general equipment manufacturing, special equipment manufacturing, automobile manufacturing, electrical machinery and equipment manufacturing, fabricated metal products, and other industries; the high-technology industry includes pharmaceutical manufacturing; railway, shipbuilding, aerospace, and other transport equipment manufacturing; computer, communications, and other electronic equipment manufacturing; instrument manufacturing; and other industries) (Data source: CEIC)

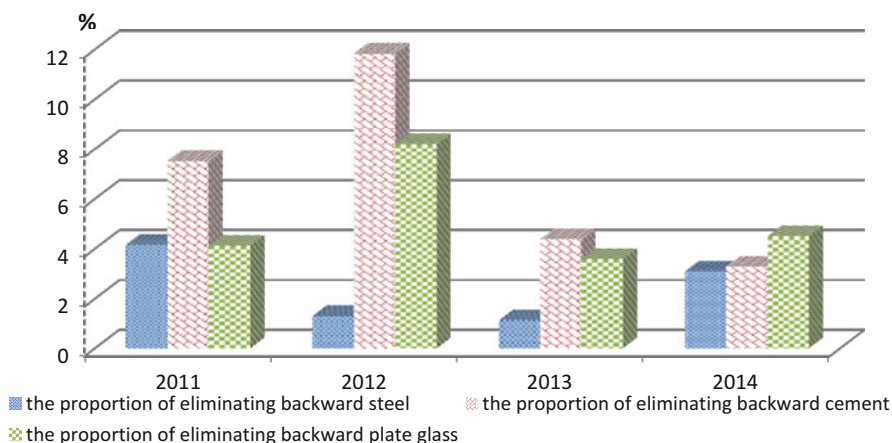


Fig. 2.7 The ratio of quantity of some industries' backward production capacity in industrial production (Data source: Wind Information)

upgrading the industrial structure. The new economic development space is showing signs of positive results.⁸

2.4 Import and Export Growth Fell Sharply, but the Trade Structure Continued to Improve

In 2014, the global economic recovery was weak. The major economies moved separately, and China's goods trade import and export growth fell further. Affected by weak domestic demand and the decline in prices of oil and other staple commodities, the decline in import growth was larger than the decline in export growth, and the surplus in commodity trade increased sharply. China's annual total exports in USD grew by only 6.1 %, a decrease of 1.7 percentage points from the previous year, and its total imports rose by only 0.4 %, a sharp decrease of 6.9 percentage points from the previous year (Fig. 2.8).⁹ Commodity trade surplus expanded significantly to 382.46 billion USD, an increase of 122.71 billion USD over the previous year. The services trade deficit continued to maintain its previous expending trend, with the annual deficit widening to 198 billion USD.¹⁰

⁸In addition, new types of business such as electronic commerce and mobile communications and strategic emerging industries that mainly depended on new energy, biological medicine, and environmental protection technology also develop quickly.

⁹According to Shen Danyang, the spokesman of the Commerce Department, "after stripping out the factor of arbitrage raising high base in 2013, real national import and export grew by 6.1 % year-on-year, the export growth was 8.7 %, import growth was 3.3 %." <http://www.mofcom.gov.cn/xwfbh/20150121.shtml>

¹⁰Among them, in 2014, tourism, transportation, and patent fee exploitation increased to 113.6 billion, 57.9 billion, and 21.9 billion USD, that is, 4.7, 1.3, and 1.6 times higher than 2011, respectively.

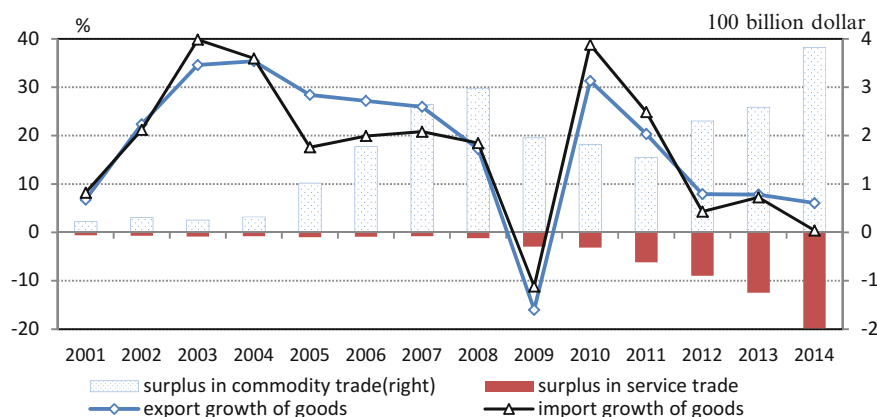


Fig. 2.8 Changes in import and export growth and trade surplus scale (Data source: CEIC)

China's commodity trade surplus and services trade deficit expanded in opposite directions, partly reflecting the changes in the country's current consumer demand structure, the imbalance in industrial structure, and the international competitive differences between different industries, and showed the direction of industrial structure adjustment. In 2014, China newly added 21.7 billion USD in foreign exchange reserves, taking its foreign exchange reserves balance to 3.84 trillion USD by the end of the year. The central parity exchange rate was 6.1190 yuan to the dollar, indicating a depreciation of 0.36 % in RMB compared with that at the end of the previous year.¹¹ The central parity exchange rate was 7.4556 yuan to the euro, an appreciation by 11.44 %.

In 2014, the actual use of foreign capital was 119.56 billion USD, an increase of 1.7 % from the previous year.¹² Among this, the manufacturing industry accounted for 33.4 %, a decrease of 5.34 % from the previous year and 15.52 % lower than that in 2007. The real estate industry accounted for 28.96 %, an increase of 4.47 % over the previous year and 8.5 % higher than that of 2007. The financial industry accounted for 3.5 %, an increase of 1.52 % over the previous year and 7.29 % lower than in 2007. The information transmission, computer services, and software industry accounted for 2.3 %, a decrease of 0.15 % over the previous year but 0.53 % higher than in 2007. After the international financial crisis, foreign investment also started to adjust the investment structure, turning from manufacturing to the tertiary industry and from labor-intensive to technology-intensive industry.

¹¹ Since March 2014, the USD central parity rate against the yuan has been continuously rising; the RMB depreciated by 1.8 % from a year earlier until early June. From June to August, the depreciation rate maintained the range of 0.8–1.8 %. In early September, the depreciation range of the RMB constantly narrowed, showing a depreciation of 0.35 % at the end of the year compared with that at the beginning of the year. Computing the RMB exchange rate based on the annual average value, the average exchange rate of the USD to yuan was 6.142 in 2014, and the RMB appreciated by about 0.86 %. The nominal and real effective exchange rate of RMB maintained the trend of appreciation; the range of appreciation was larger than the range in 2013.

¹² In 2014, China became the world's largest recipient of foreign investment, surpassing the USA.

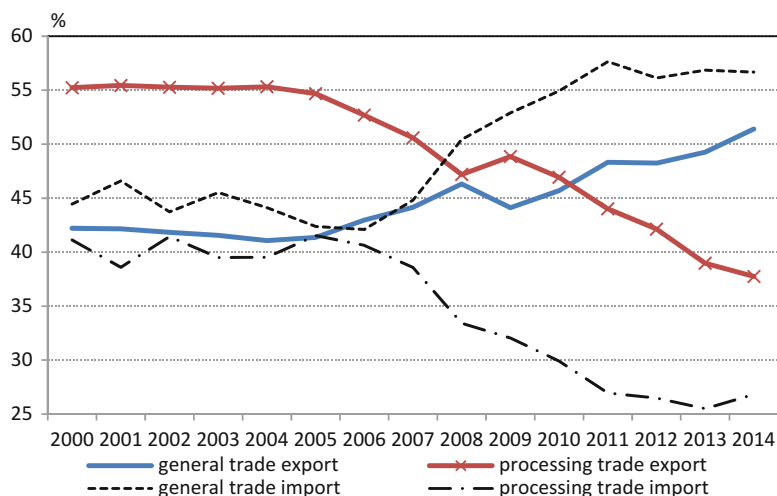


Fig. 2.9 Changes in proportion of general trade and processing trade import and export (Data source: CEIC)

In terms of trade structure, the proportion of general trade continued to improve, whereas that of processing trade continued to fall. In 2014, general trade exports grew by 10.7 %, accounting for 51.4 % of total exports, a 2.2 % increase over the previous year. Processing trade export grew by 2.7 %, accounting for 37.7 % of total exports, a 1.2 % decrease from the previous year. The general trade import growth fell from 8.6 to 0.2 %, accounting for 56.7 % of total imports. The growth of processing trade imports increased from 3.3 to 5.7 %, accounting for 26.8 % of total imports (Fig. 2.9).

In terms of regional structure, in 2014, China's growth of exports to Asia and the USA (in USD) improved sharply, by 10.4 % and 9.9 %, respectively, an increase of 3.8 % and 6.9 %, respectively, over the previous year. Following the slowdown of the EU recovery and euro depreciation, exports to the EU increased by 4.9 %, an increase of only 1 % over the previous year (Figs. 2.10 and 2.12). Compared with 2013, China's exports to Asia and the USA accounted for 52.8 and 16.1 %, an increase of 0.4 % and 0.1 %, respectively; its exports to the EU accounted for 15.2 %, a decrease of 0.7 %. On the import side, China's growth of imports from Asia and the USA fell by -3 and 3 %, a decrease of 8.5 % and 10.4 %, respectively; its growth of imports from the EU increased significantly to 15.4 %, an increase of 8 %. The proportion of China's imports from Asia decreased by 0.4 %, reaching 55.6 %; that from the USA increased by 0.5 %, reaching 9 %; and that from the EU rose to 13 %, an increase of 2 % (Figs. 2.11 and 2.13).

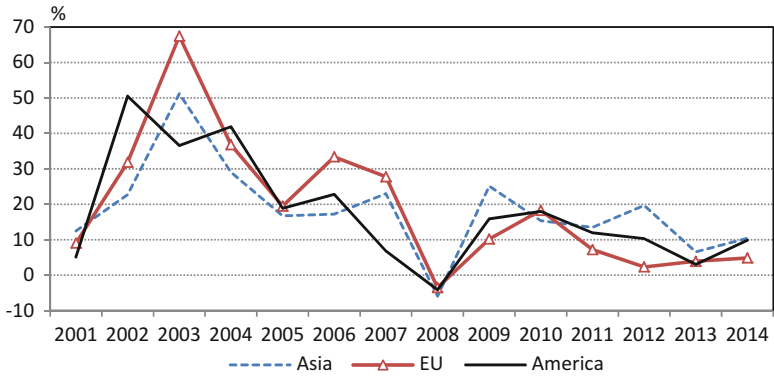


Fig. 2.10 Changes in China's export growth in main areas (Data source: CEIC)

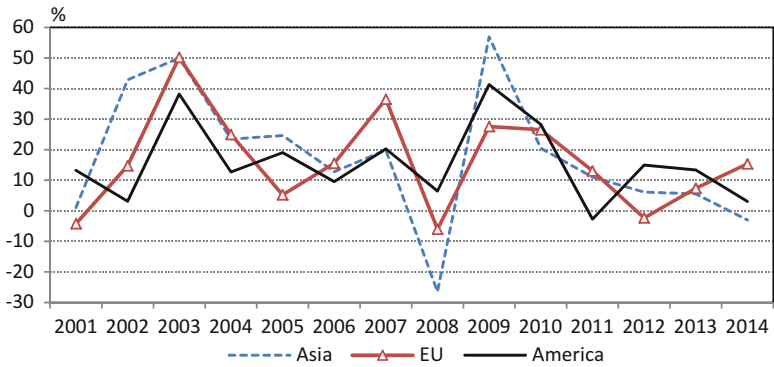


Fig. 2.11 Changes in China's import growth in main areas (Data source: CEIC)

2.5 Resident Real Income Growth was Slowing and the Growth of Total Retail Sales of Consumer Goods Continued to Fall Back

In 2014, the Chinese residents' per capita disposable income grew by 8.0 % in real terms, a decrease of 0.1 % from the previous year. By permanent residence, the per capita disposable income of urban residents grew by 6.8 % in real terms, a decrease of 0.2 % from the previous year; the per capita net income of rural residents grew by 9.2 %, a decrease of 0.1 % from the previous year (Fig. 2.14). The economic slowdown continued to inhibit the growth of the urban and rural residents' real income.

As the per capita income levels rose, the Chinese residents' consumption structure was undergoing new changes, with the growth of material consumption slowing

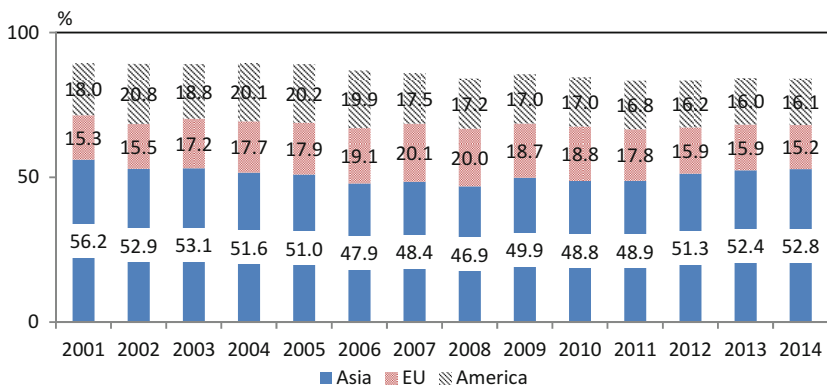


Fig. 2.12 Changes in China's export composition (by region) (Data source: CEIC)

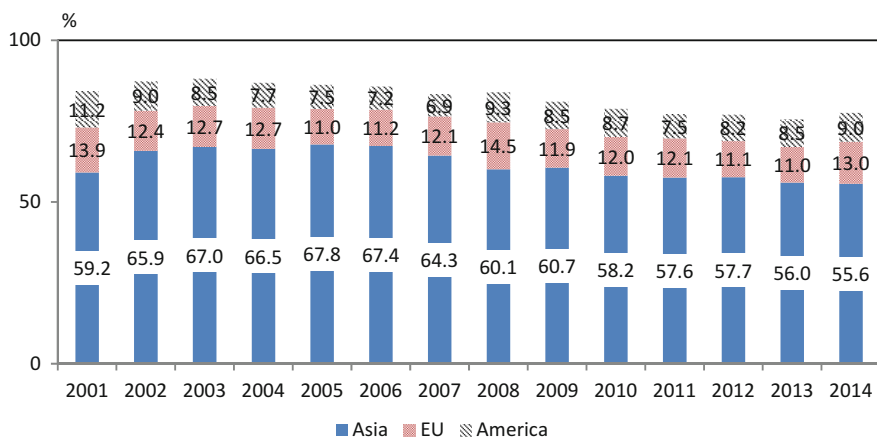


Fig. 2.13 Changes in China's import composition (by region) (Data source: CEIC)

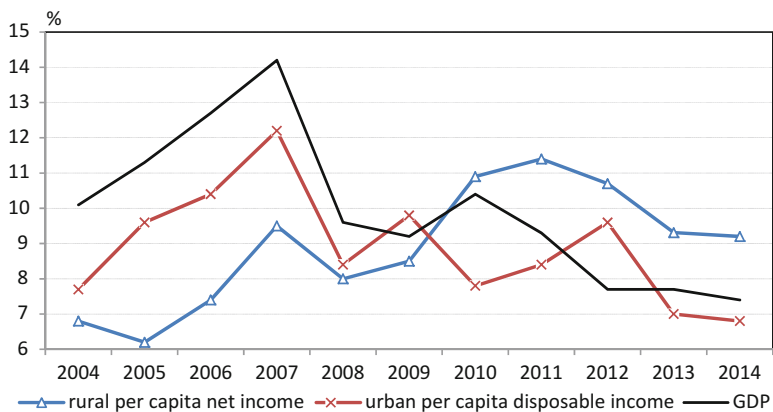


Fig. 2.14 Changes in real growth rate of per capita disposable income in urban areas and net income in rural areas (Data source: CEIC)

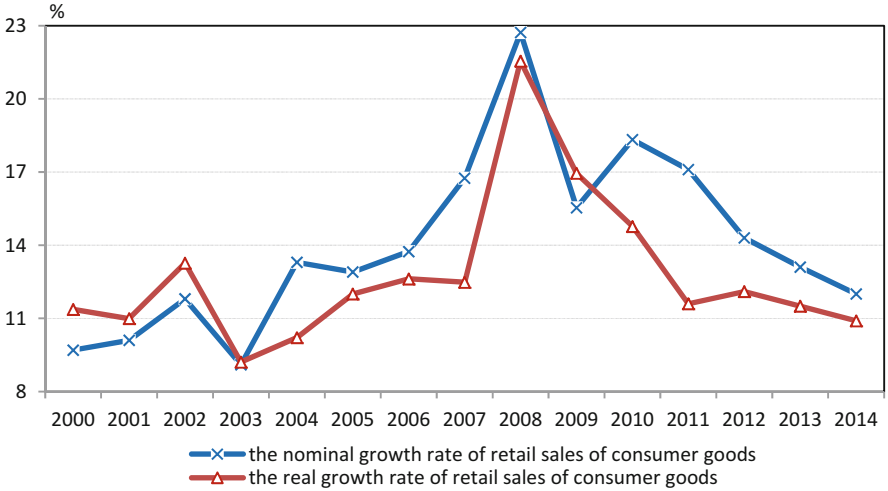


Fig. 2.15 Changes in real growth rate of consumer good retail sales (Data source: CEIC)

down and proportion of service consumption rising. Influenced by the government’s anti-corruption move and restrictions on the three public expenditures, the growth rate of the government’s public service spending in general apparently fell. The total retail sales of consumption goods maintained the falling trend since 2010 and then nominally grew by 12.0 %, a decrease of 1.1 percentage points from the previous year; meanwhile the real growth was 10.9 %, a decrease of 1.6 % from the previous year (Fig. 2.15).

2.6 Price Index Continued the Trend of “Double Down,” and the Structural Deflation was Increasing

In 2014, the CPI was 2 %, a decrease of 0.6 % from the previous year, and the PPI fell by 1.9 %, the same as the previous year (Fig. 2.16). Since 2011, China’s CPI and PPI continued the “double down” trend, but the growth of CPI remained positive, whereas that of PPI continued the negative trend.¹³ The consumer market and intermediate product market faced different downward pressures on the price, and China’s deflation revealed obvious structural characteristics.

In terms of CPI, eight types of consumer goods maintained their positive increase, although the rate of increase dropped. The decreasing price of staple commodities such as food and oil was the main reason for the decrease of CPI; the enlarging demand on services, clothing, traffic, communication, entertainment, education,

¹³ This situation is usually defined as disinflation, rather than deflation.

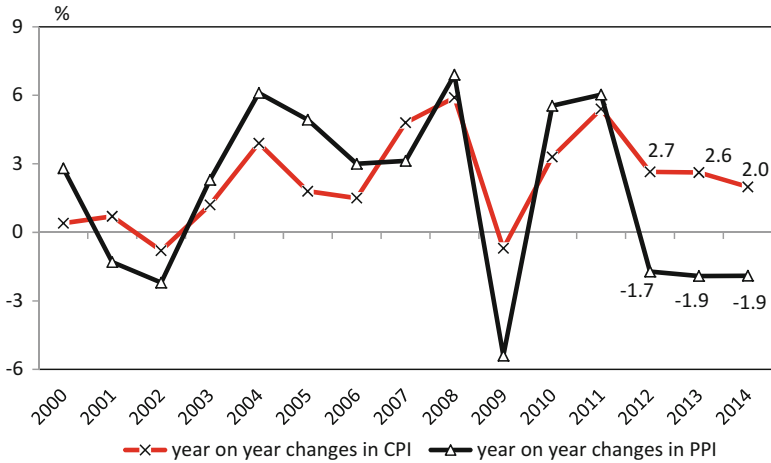


Fig. 2.16 Year-on-year changes in CPI and PPI (Data source: CEIC)

and culture promoted the increase of CPI.¹⁴ In terms of PPI, excess production capacity and the 2014 slump in oil prices were the main reasons for the drop.

2.7 The Monetary Policy Targeted Eased, and Financing Costs Remained High

In 2014, under the premise of adhering to the “total amount control, structural adjustment” through measures such as targeted reserve requirement ratio (RRR) cuts and loan and deposit benchmark interest rate cuts and enlarging the rising ceiling of deposit interest rates, the Central Bank of China implemented a prudent monetary policy.¹⁵ The annual broad money (M2) balance was 122.84 trillion yuan, indicating a growth of 12.2 %, ¹⁶ a decrease of 1.4 % from the previous year

¹⁴At the end of 2014, the consumer confidence index, customer satisfaction index, and consumer expectations index grew by 3.5 %, 5.4 %, and 2.3 % respectively. From the resident survey data, in 2014, the urban per capita disposable income increased by 2381.6 yuan over the previous year, and the per capita consumption expenditure increased by 1945.4 yuan; the marginal propensity to consume was 81.7 %, an increase of 10.6 % over the previous year.

¹⁵In the first half of 2014, the central bank implemented the targeted RRR cuts twice. By creating medium-term lending facilities (MLF) and pledged supplementary lending (PSL) and using other tools, the central bank guided financial institutions to raise their credit availability in some fields such as agriculture, small microenterprises, and shantytown transformation. Since the second half, the central bank reduced the base point of positive repo rate four times, to 60 points; cut the benchmark interest rate for loans and deposits by 40 and 25 base points, respectively, in late November; and expanded the upper limit of deposit interest rates to 1.2 times of the benchmark interest rate.

¹⁶By the end of 2014, the M2 balance reached 122.84 trillion yuan, about twice the GDP at the beginning of year.

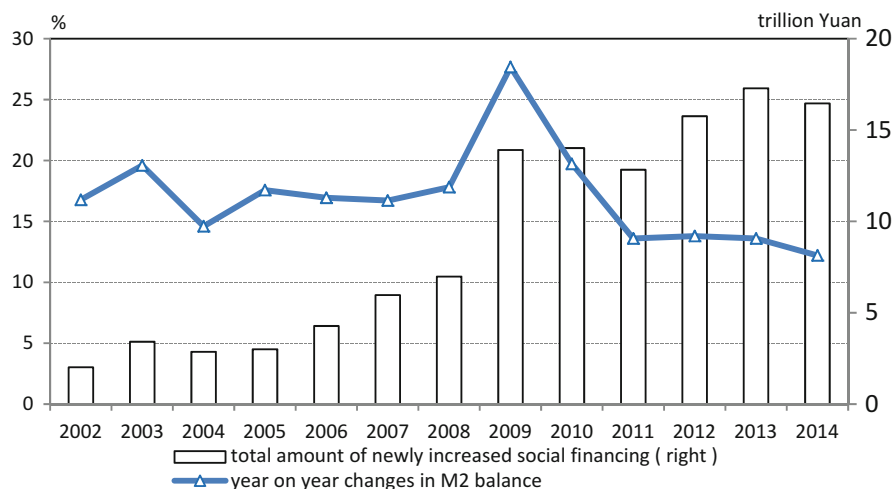


Fig. 2.17 Total amounts of newly increased social financing and year-on-year changes in M2 balance (Data source: CEIC)

(Fig. 2.17). M2 newly increased by 12.18 trillion yuan, a decrease of 1.05 trillion yuan from the previous year. The narrow money (M1) balance grew by 3.2 %, a decrease of 6.1 % from the previous year. Currency in circulation (M0) grew by 2.9 %, a decrease of 4.3 percentage points from the previous year.

In 2014, the scale of social financing was 16.46 trillion yuan, 859.8 billion yuan less than the previous year (Fig. 2.17).¹⁷ The newly increased RMB loans amounted to 9.78 trillion yuan, an increase of 890 billion yuan over the previous year, accounting for 59.4 % of the scale of social financing for the same period, 8.1 % higher than the previous year. From the newly increased RMB loans, 66 % was used to finance nonfinancial companies and other departments,¹⁸ and 28 % was used to finance the real estate sector. In 2014, the general loan-weighted average interest rate of financial institutions on nonfinancial institutions and other departments was as high as around 7 %.

In order to stabilize investment in 2015, monetary policy should cut the interest rates and continue the measures of targeted RRR cuts. The central bank should maintain a modest currency devaluation.

¹⁷ In 2014, the regulators' supervision of service specification restrained the expansion of commercial banks' off-balance sheet business and restricted the expansion of the social financing scale. Trust loans accounted for 3.1 % of total social financing, a decrease of 7.5 % over the previous year.

¹⁸ By the end of 2014, the loan balance of small microenterprises was 15.46 trillion yuan, an increase of 15.5 % from the previous year. The growth rate was 1.3 % higher than the previous year; this was 6.1 % and 4.8 % higher than that of large- and medium-sized enterprise, respectively, the previous year.

2.8 Fiscal Revenue Growth Was Falling, but the Fiscal Expenditure Structure Continued to Improve

In 2014, China's fiscal revenue grew by 8.6 %, a decrease of 1.6 % from the previous year. Fiscal expenditure grew by 8.2 %, a decrease of 3.1 % from the previous year (Fig. 2.18). The financial deficit was 113.12 billion yuan, accounting for 1.8 % of GDP.

In terms of fiscal revenue, the decline in corporate profit growth directly inhibited the increase of tax revenue. The annual tax revenue grew by 7.8 %, a decrease of 2.1 % from the previous year; the ratio of tax revenue to financial revenue was 84.9 %, a decrease of 0.6 % from the previous year. Meanwhile, the growth of non-tax revenue showed an increase, growing by 13.5 %, an increase of 1.2 % from the previous year. The transfer income of state-owned land use right grew by 3.3 % in 2014, a decrease of 41.4 % from the previous year, but accounting only for 30 % of the fiscal revenue. On the tax revenue side, following the decline in corporate profit, the corporate income tax revenue grew by 9.8 % in 2014, a decrease of 4.3 % from the previous year; corporate income tax accounted for 20.7 % of all tax revenue, an increase of 0.4 % over the previous year. The growth of value-added tax revenue was by 7.1 %, a decrease of 2.0 % from the previous year; this accounted for 25.6 % of all tax revenue, a decrease of 0.2 % from the previous year. The business tax revenue grew by 3.2 %, a decrease of 6.2 % from the previous year; this accounted for 14.9 % of all tax revenue, a decrease of 0.7 % from the previous year.

In 2015, following the decline in real estate investment growth, the local government land leasing income is expected to be hard to grow rapidly. Under the slowdown of tax revenue growth, the local government should more strictly and effectively control nontax revenue growth and ease the burden on enterprises and residents, reduce the interference of market operation, and improve the market's economic vitality.

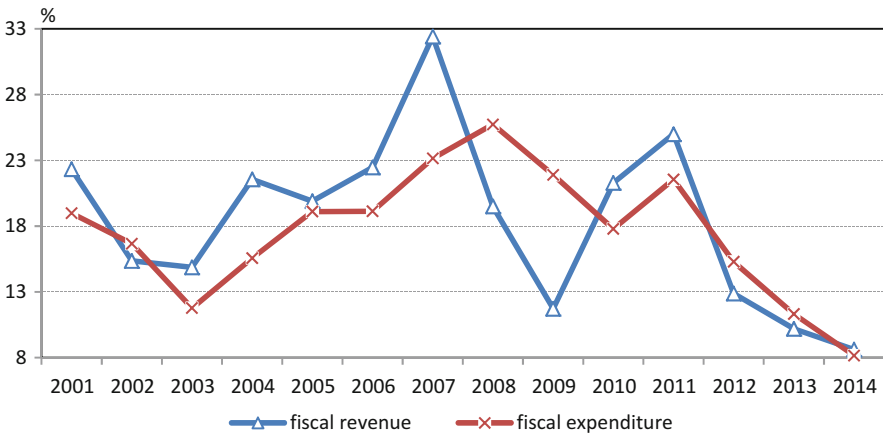


Fig. 2.18 Changes in nominal growth of financial revenue and expenditure (Data source: CEIC)

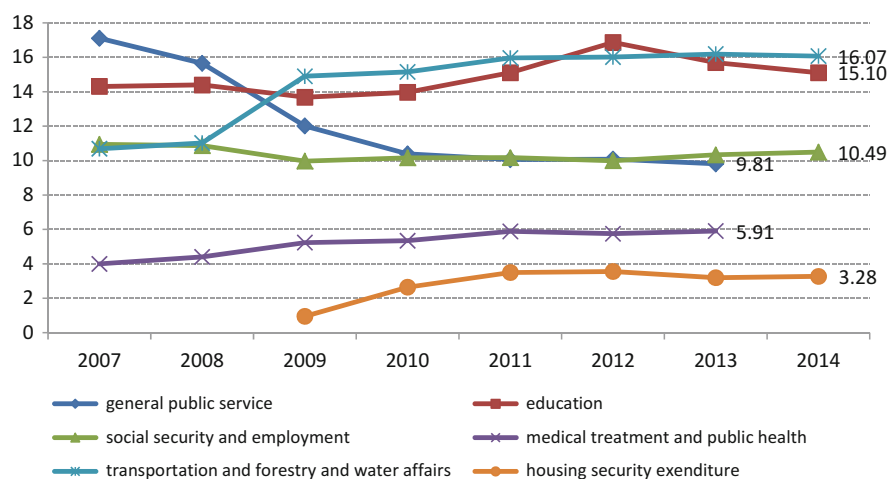


Fig. 2.19 Changes in public financial revenue and expenditure composition (Data source: CEIC)

On the side of fiscal spending (Fig. 2.19), education spending grew by 4.1 %, an increase of 0.5 % over the previous year. This accounted for 15.1 % of fiscal expenditure, a decrease of 0.6 % from the previous year.¹⁹ Social insurance and employment expenditure grew by 9.8 %, a decrease of 5.3 % from the previous year; this accounted for 10.5 % of fiscal expenditure, an increase of 0.2 % over the previous year. The expenditure on transportation and agriculture and forestry and water affairs grew by 7.4 %, a decrease of 5.2 % from the previous year; this accounted for 16.0 % of fiscal expenditure, a decrease of 0.1 % from the previous year. The expenditure on housing security grew by 10.9 %, an increase of 10.9 % over the previous year; this accounted for 3.3 % of fiscal expenditure, an increase of 0.1 % over the previous year.²⁰

In conclusion, we propose the following:

1. In 2014, a significant decline in investment growth led to a continuous drop in GDP growth. The annual real GDP grew by 7.4 %, a decrease of 0.3 % from the previous year. We expect excess production capacity and inventory accumulation in the real estate industry to inhibit investment growth in 2015 as well. Although investment in infrastructure will continue to grow faster, total social fixed assets investment growth will continue to fall and GDP growth will continue to decline.
2. In 2014, the CPI was 2 % and PPI -1.9 %. Following the economic slowdown, the price level is expected to maintain a downward trend in 2015. Although the CPI continues to decline, it will maintain a positive rise. Because excess capac-

¹⁹ In 2014, the proportion of education spending on GDP was 3.6 %; this was still below the level of 4 % established in 1993.

²⁰ For the first 11 months of 2014, the general public service spending cumulatively rose 2.0 %, a decrease of 9.1 % from the previous year for the same period; this accounted for 9.3 % of the total financial expenditure, a decrease of 0.8 % from the previous year.

ity still needs to be digested, the PPI will continue to maintain a negative growth, although the fall will be somewhat less. Structural deflation is expected to continue.

3. Following the economic slowdown, the growth of urban and rural resident income will be restricted. Therefore, although the residents' propensity to consume is relatively stable, the promoting effect of consumption on economic growth in the near future will be limited.
4. Although investment growth dropped dramatically in 2014, the growth of private fixed investment has been faster than that of fixed asset investment of the whole society since 2012, and investment in the tertiary industry is gradually expanding. In terms of capital source, the proportion of investment from self-raised funds in the total investment increased significantly. In terms of industry, the profit from equipment manufacturing and high-tech manufacturing industries grew strongly, the pace of industrial transformation and upgrading accelerated, and investment demand is expected to expand further. Investment demand in the tertiary industry, except in the modern manufacturing and real estate industry, is expected to expand further in 2015. Macro-policy should guarantee that the newly increased credit resources further meet the needs of emerging industrial expansion and private investment demand. Furthermore, the government should reform the financial field and effectively resolve the long-standing problem of "financing difficulty, financing expensive" in private investment. While steadily promoting interest rate marketization, it should also speed up opening up the financial field and improve the capital market.
5. In 2014, the scale of social financing fell dramatically due to both demand and supply effects. On the supply side, the supervisory regulation on banks' off-balance sheet activity was strengthened, making it difficult for banks to expand their off-balance sheet activity. On the demand side, the decline in corporate profit growth inhibited the demand of enterprises for investment funds. However, newly increased RMB loans amounted to almost 10 trillion yuan, and to some extent, this showed that banks still had the strong willingness and ability to provide credit and enterprises the strong demand for investment funds. Monetary policy should take strong measures in 2015 to guarantee that credit resources entered the real economy, especially to meet the needs of private investment, and thus realize the stable growth of investment.

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