Key Developments in Brief

**Economic Development**
- GDP growth was targeted at 6.5% in 2018
- Fourth quarter GDP growth fell to 6.4%
- GDP in 2018 added up at 6.6%

**Drivers of Growth**
- Service and modern production grew faster than average
- Innovative environment
- Continuously high consumer spending, though losing traction

**Risks**
- Escalating trade war damages investment and consumption
- Financial deleveraging damps growth in real economy
- Pledged shares and bond defaults increase financial risks

**Price Levels**
- Fourth quarter consumer inflation at 2.1%
- Producer price increases continued to slow down

**Foreign Trade**
- Foreign trade slowed down in Q4
- Import decelerated faster than export, resulting in recessionary trade deficit in Q4

**Labor Market**
- Employment index made 28-month low in December PMIs
- Pressure on job creation will only increase in 2019

**Macroeconomic Indicators**

<table>
<thead>
<tr>
<th>Growth in %</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
<td>7.7</td>
<td>7.4</td>
<td>6.9</td>
<td>6.7</td>
<td>6.9</td>
<td>6.6</td>
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<tr>
<td>Investment and Output</td>
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<tr>
<td>Utilized FDI</td>
<td>5.3</td>
<td>1.7</td>
<td>5.6</td>
<td>-0.2</td>
<td>4.0</td>
<td>3.0</td>
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<tr>
<td>Fixed Asset Investment</td>
<td>19.6</td>
<td>15.7</td>
<td>10.0</td>
<td>8.1</td>
<td>7.2</td>
<td>5.9</td>
</tr>
<tr>
<td>Industrial Production</td>
<td>9.7</td>
<td>8.3</td>
<td>6.1</td>
<td>6.0</td>
<td>6.6</td>
<td>6.2</td>
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<tr>
<td>Price Levels</td>
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<tr>
<td>Consumer Prices (CPI)</td>
<td>2.6</td>
<td>2.0</td>
<td>1.4</td>
<td>2.0</td>
<td>1.6</td>
<td>2.1</td>
</tr>
<tr>
<td>Producer Prices (PPI)</td>
<td>-1.9</td>
<td>-1.9</td>
<td>-5.2</td>
<td>-1.4</td>
<td>6.3</td>
<td>3.5</td>
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<tr>
<td>Foreign Trade</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Export</td>
<td>7.9</td>
<td>6.1</td>
<td>-2.9</td>
<td>-7.7</td>
<td>7.9</td>
<td>9.9</td>
</tr>
<tr>
<td>Import</td>
<td>7.3</td>
<td>0.4</td>
<td>-14.2</td>
<td>-5.5</td>
<td>15.9</td>
<td>15.8</td>
</tr>
</tbody>
</table>

Source: National Bureau of Statistics, MoFcom
Economic Development

2018 ended with a decelerating final quarter in China, though without missing the official target. Although well expected, the rapid deceleration in some sectors still alarmed many.

In the fourth quarter 2018, China’s economy expanded by 6.4% over a year before, slightly short of expectations. Despite this, the 2018 growth still managed to 6.6%, a notch higher than the official target of 6.5%. Although well expected, 6.6% was the lowest growth rate in three decades. The government is dealing with pressures from multifront: growing trade tensions with the US, financial deleveraging, increasingly losing traction of old growth engines, as well as a nationwide crackdown on environmental pollution.

Retail and Consumption

The service sector accounted for 52.2% of the GDP in 2018. Continuously growing, the tertiary sector’s share in China’s GDP increases each year. At 7.6%, it grew stronger than both other sectors in 2018 of 3.5% and 5.8%.

Consumer spending gradually slowed down over the year to 9.0% by 2018, from the 9.8% in the first quarter. The uptick in March turned out seasonal, while the consumer market is struggling to catch up the two-digit growth of the past decade. Also gradually slowing over 2018, online retail sales saw a 23.9% expansion by 2018 from 2017, much lower than the 27.0% growth by September. Among the few positive spots, online sales of physical goods expanded to account for 18.4% of all retail sales, from the 17.5% during the first three quarters.

Due to the slowdown in consumption in the fourth quarter, final consumption accounted for 76.2% of GDP by 2018, scaling down from the 78% in the first three quarters.

Industrial Production

Industrial output started off strong in the first quarter with an average growth of 6.8%. It increased again in the second quarter but flattened out toward yearend. While the aggregate growth rate of 6.2% in 2018 was only 0.4% lower from 2017, the notable shifts seem suggesting worsening economic conditions.

As manufacturing grew slower at 5.5% versus 6.5%, old growth engines picked up pace. Not only the mining sector turned from contraction to expansion of 3.6%, the utilities sector controlled by the government accelerated to 9.6% vs 8.2%. Output growth of the automotive sector slowed down significantly in the first quarter over the same period last year (15.3% to 6.8%), then picked up slightly, and ended with a contraction by 4.1%. While the overall market share of new energy vehicles is still small, it is worth noting that their output surged with a paramount growth rate of 139.4% in the first quarter and ended at 40.1% by 2018. Their total output for the first time exceeded 1 million, totally 1.29 million.

Fixed Asset Investment

Fixed asset investment underlines the shifting targets of the government and the private sector. In line with the rural rejuvenation policy, the government is increasing investment in the countryside. Despite repeated government efforts, infrastructure investment slowed to 3.8% in 2018 comparing to the 19% growth in 2017. After sharp slowdowns inspiring public outcry in 2016, investment by private companies recovered from the 3.2% in 2016 to 6.0% and 8.7% in 2017 and 2018.

Price Levels

Consumer inflation saw a seasonal uptick in the first quarter but slowed again in the sec-
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Recovering again in the third quarter, it closed with an overall value of 2.1% in 2018, comparing to 2.5% for the first three quarters. Producer prices have softened continuously from October 2017, reflecting a weaker demand for industrial goods. The sharp drop from 2.7 in November to 0.9 in December surprised many, raising alarms against deflation.

Foreign Trade

2018 saw a trade war with the United States playing out and escalating. Increasing Chinese exports to the US are covered by punitive tariffs, from less than 10% in July to almost 50% in September. The tariffs on the third tranche of $200 bn Chinese products were scheduled to more than double from 10% in September to 25% from 1 January 2019.

As the negative impact from the US trade tensions emerged after exporters finishing front-loading, trade slowed to 8.8% in the fourth quarter from the 9.9% of the first three quarters. To be specific, export sharply slowed in November and contracted in December.

Thanks for repeated tariff cuts during the year, import saw six months with higher than 20% year on year growth. However, after the one-time-off effect from tariff cuts faded and weak domestic demands started to emerge, import decelerated faster than export in November and December. The faster deceleration of import than export also resulted in a new record of deficit in 2018.

In terms of contribution to GDP, net export contributed negatively to total growth in 2018, following the trend started from 2015.

Nevertheless, Chinese foreign trade further expanded in 2018, making a new record of $4.62 tn. Export grew 9.9% and import 15.8% in USD from 2017, faster than the 2017 growth.

German-Chinese trade went off to a strong start in 2018. Though with swings, monthly trade volumes stayed in the range of about $15bn to $19bn. Latest data shows a growth of 10.4% of German exports to China, while imports from China grew by 4.8% in October.

RMB

Thanks to the 90-day truce from December 1 when US and China president met in Argentina, the RMB finally won some breathing space from the strengthening USD. It was traded at the range of 6.92 to 6.86 per dollar in December after jumping from 6.50 in later June and plummeting to 6.97 by early November.

Labor Market

The surveyed unemployment rate in urban areas in 2018 stood at 4.9%, down 0.08 percentage points from a year earlier. Official data show more than 13.61 million new jobs were created in 2018, 100,000 higher than 2017.

Job pressure remained strong as 8.2 million university graduates entered the labor market in 2018 and additional unemployed people and redundant workers in millions need to find jobs. Despite the demographic change, the number of graduates entering into the job market is increasing every year. Yet the shortage of skilled workers remains and some industries, e.g. the coal and steel sectors, are severely impacted by structural changes of the economy and the reduction of overcapacities, which leads to lay-offs.

The per capita disposable income in 2018 went up 6.5% in real terms (after deducting price factors). While rural incomes increased slightly faster than urban households for the seventh consecutive year, urban households’ incomes are still 2.79 times higher than those of their rural counterparts.
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Risks and Growth Drivers in 2019

Multifront pressure will complicate China’s slowdown, challenging policymakers’ economic management capacity. As traditional engines increasingly lose traction and new ones yet mature, China’s growth could scale down by another notch in 2019.

Even if some kind of deal made by the US and Chinese government before the March 2nd deadline, the increasing confrontation between the US and China is set to undermine domestic demands and hang over trade. Likely reversing the negative growth at end 2018, export could remain subdued in 2019, complicated by underwhelming global demands. As import decelerated faster than export at the yearend in 2018, import will suffer from both punitive tariffs and falling demands at home.

After a turbulent 2018, China’s financial market would remain under pressure from bonds and stocks. Although the stock market may feel less weight from pledged shared as many companies redeemed theirs in later 2018, the remaining ones will continue to be a timebomb. As at least 15% more bonds are due for payback in 2019 than 2018, risks of bond default could rise significantly. Although the default rate is still low - RMB 115.45 bn bonds defaulted out of RMB5.34 tn in 2018, growing financial costs and shrinking profits will put more pressure on companies in 2019 when RMB 6 tn bonds are due.

Dragging down fixed asset investment, infrastructure investment fell sharply from 19% in 2017 to 3.8% in 2018. Increased government efforts at the turn of 2018-19 in approving projects and issuing local government debt may bring up infrastructure investment to 5 to 10%. But FAI remains uncertain in 2019, thanks to ever cooling housing market and growing uncertainty for manufacturers.

As Chinese households picked up more debt without making much more, domestic demands could suffer in 2019. This round of housing stimulation in 2016-17 has eroded Chinese households’ savings and increased their debts from mortgage without improving their incomes much. As increasing debts crowd out consumption, sales of Chinese all-time favorites would either slow down or contract. With the first contraction in 2018 in three decades, car sales may stay flat in 2019. The case may be true for smartphones.

Chinese government is set to cut corporate burden to boost investment in 2019. Behind its 2018 schedule, the promised big reduction in VAT and business tax may finally materialize in 2019. As local tax authorities start to collect social security fees, contribution ratios are set for reduction during the March two meetings.

Weak domestic demands may urge the government to reduce import tariffs in 2019, as in 2018. However, already at much lower rates now, there is limited room left for tariff cuts on consumer goods. Authorities may have to rely on other schemes like international consumption hubs and duty-free stores.

The government is planning to attract more foreign investment by targeting high-profile projects worth more than $50 million. As the encouraged sectors in the foreign investment catalog are revised, foreign investors may get more incentive doing business in China.

For further inquiries please contact:

WANG Xinling, senior policy researcher
Email: wang.xinling@bj.china.ahk.de
Phone: +86 10 6593 6616
Key Economic Indicators

Growth rate in percent on year-on-year basis, except PMI (index)
Source: NBS

### GDP

![GDP Graph]

### Price Level

![Price Level Graph]

- Consumer Price Index (CPI)
- Producer Price Index (PPI)
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Q4 2018

Key Economic Indicators

Growth rate in percent on year-on-year basis, except PMI (index)
Source: NBS

Foreign Trade

Imports and exports growth rates from 2016 to 2018.

Industrial Production

Industrial production growth rates from 2016 to 2018.

5%
6%
7%
8%
8%
8%
8%
7%
7%
7%
6%
6%
6%
5%
Key Economic Indicators

Growth rate in percent on year-on-year basis, except PMI (index)
Source: NBS

**Retail Sales**

**Fixed Asset Investment**
Key Economic Indicators

Growth rate in percent on year-on-year basis, except PMI (index)
Source: NBS

Foreign Direct Investment (USD)

An index above 50 indicates expansion, while an index below 50 indicates contraction

Purchasing Manager Index

An index above 50 indicates expansion, while an index below 50 indicates contraction