



MERICS ECONOMIC INDICATORS

Quarterly analysis of economic trends in China

Q1/2018:

Stable economic growth to face headwinds in 2018

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MERICS Q1 analysis

Economic reforms reflect CCP's approach to capitalism

This year's National People's Congress (NPC) laid the groundwork for sweeping changes to the government structure, which will shape China's economic system. The CCP has further centralized power and expanded its control over the economy as part of its ambitious project to transform China into a leading economic power by 2049. It is time to become realistic about what China really intends to accomplish.

Foreign governments and companies had largely misunderstood China's economic reform announcements of 2013 as a commitment to strengthening market forces. Yet, Western style market liberalization was never on the table. Instead the recent NPC extended the Communist Party's (CCP) grip on the economy, for example by elevating the status of the former "Leading Small Groups" dealing with finance and economics as well as economic reforms. These bodies were renamed "commissions," effectively institutionalizing the CCP's power over the economy.

Other policies introduced in 2017 include expanding the influence of party organs in companies, including private and foreign enterprises, or the introduction of the Cyber Security Law, which will likely lead to greater access to company data for the government. Most importantly, China is working on the forceful implementation of Made in China 2025, the strategy at the heart of a state-backed pursuit of technological upgrading in China's industry.

In his recent speech before the Bo'ao economic forum, President Xi Jinping sought to reassure the international community of China's continued opening process with a mix of vague promises and small policy changes. In the spirit of good marketing, these efforts will then be oversold to the international audience. As a result, full scale liberalization will always remain just around the corner. The problem is that radical economic liberalization would not be compatible with the CCP's version of Chinese capitalism. Economic policy is guided by a deep distrust of free markets, which the CCP associates with volatility and potential instability.

Rather than breaking with the old state-backed economic model, China is reshaping it. The current reforms adopt some elements of the open market to optimize Chinese-style capitalism, which is dominated by a state that is increasingly synonymous with the party. China is reinforcing its economic model that is geared towards pursuing strategic national targets while minimizing structural risks. Controlling debt, consolidating state-owned enterprises, aligning the private sector with national targets in favored industries, and reducing overcapacities are just some examples of how the Chinese leadership under Xi Jinping attempts to modernize state planning. Market mechanisms will be used to some extent, but they will continue to be eclipsed by the ongoing shift towards greater control by the CCP.

Through policy and statements, China's leaders have made it clear they consider the extension of state control of the economy necessary for China's aim to reclaim its leading position in the world. Suspicion of Chinese acquisitions of technology companies in Europe or the United States as well as the looming trade war with the United States are the first signs of an emerging clash of competing economic systems. The international pushback is something Chinese state planners will need to adapt to. Businesses should brace themselves for increasing frictions between the major economic blocks.

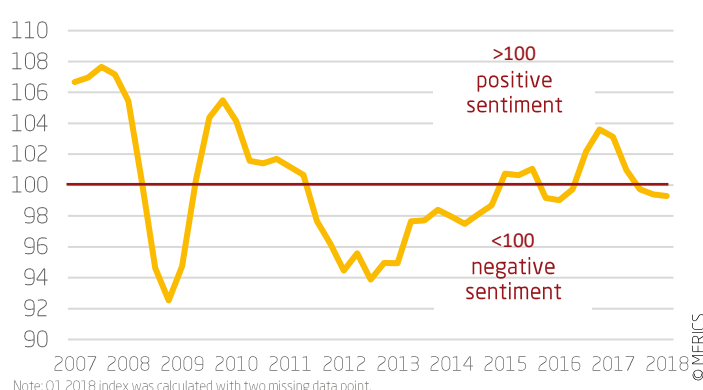
The MERICS China Confidence Index (MCCI)

The MERICS China Confidence Index measures households' and businesses' confidence in future income and revenues.

The index is weighted between household and business indicators. It includes the following indicators: stock market turnover, future income confidence, international air travel, new manufacturing orders, new business in the service sector, urban households' house purchase plans, venture capital investments, private fixed asset investments and households' consumption share of disposable income. All components have been tested for trends and seasonality.

The MCCI was first developed in Q1 2017.

MCCI falls in anticipation of slower GDP growth
MERICS China Confidex Index

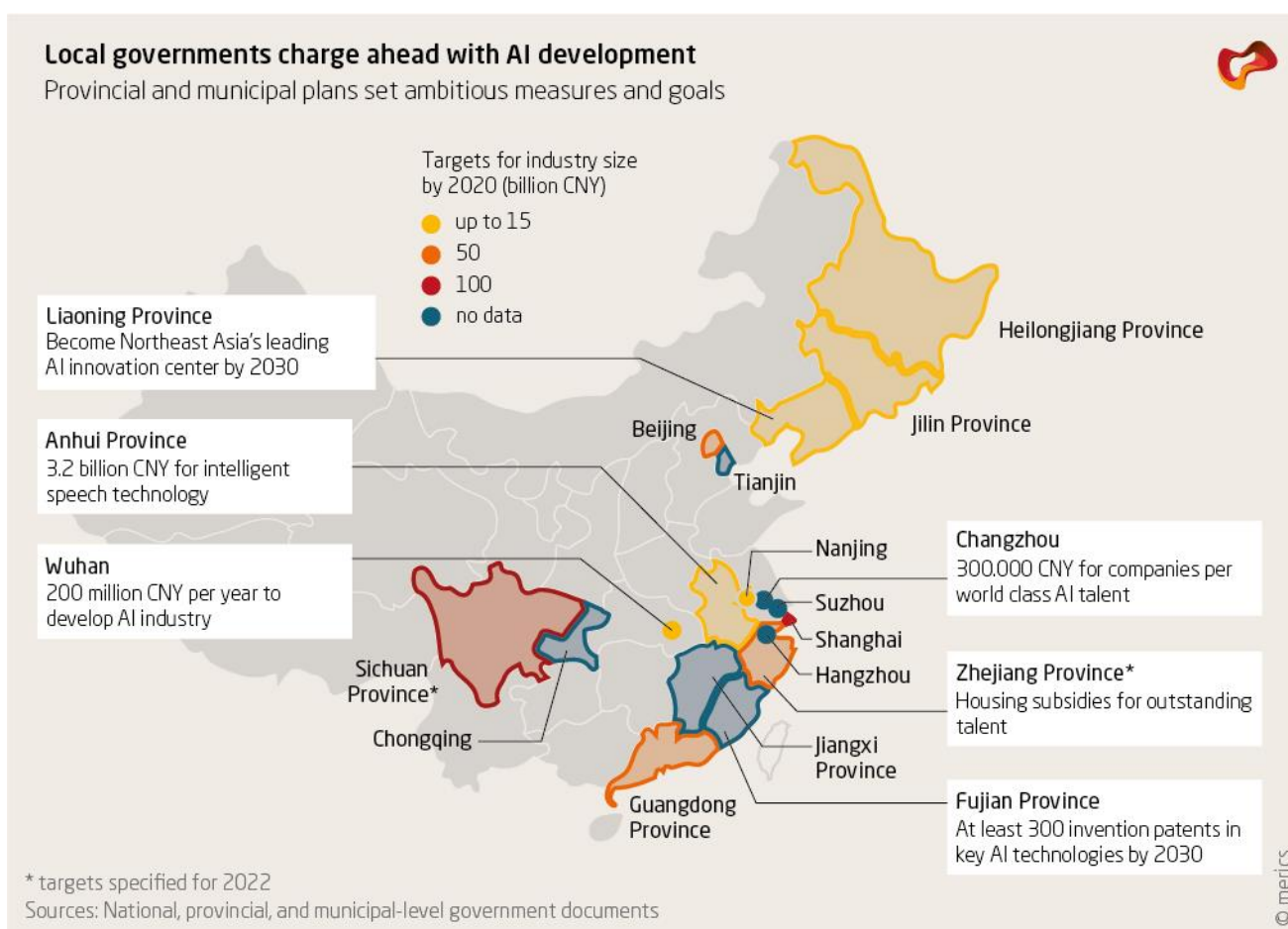


Focus topic: Artificial Intelligence

Local governments power up national agenda

By Anna Holzmann and Jaqueline Ives

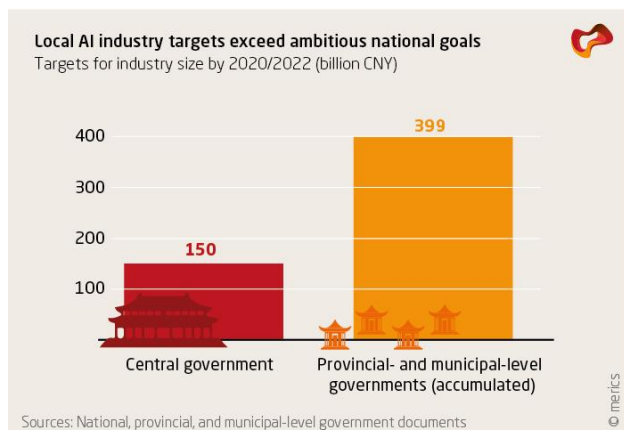
China's government has identified Artificial Intelligence (AI) as a key technology to push its Made in China 2025 agenda and leapfrog to global technological leadership. When the State Council published its "New Generation of Artificial Intelligence Development Plan" in July 2017, it kickstarted its top-down industrial policy routine which is currently unfolding at full speed. The overarching goals are for China to catch up with advanced countries and create an AI core industry worth 150 billion CNY by 2020, to achieve major technological breakthroughs in AI by 2025, and to become the globally-leading innovation center for AI by 2030. With the overall framework set, China's industrial AI policy has entered the next crucial phase, trickling down from the national level to individual provinces, municipalities and cities. By mid-April 2018, governments within 18 provinces and municipalities had released AI plans to promote their local AI industries.



In the pursuit to outbid each other, their local targets even exceed ambitious national goals. 11 local governments published targets for their AI core industries for 2020. Accumulated, this would create an AI core industry of almost 400 billion CNY in 2020, exceeding the national target of 150 billion CNY more than twofold. While the unparalleled enthusiasm of local governments will accelerate China's AI development considerably, it also carries the risk of creating overcapacities.

Frontrunners in the AI race are China's most advanced economic centers Beijing, Shanghai and Shenzhen. As tech hubs and headquarters of the pioneers of China's AI drive such as Baidu and Tencent, and of major AI startups including leaders in facial recognition technology SenseTime and Megvii, these cities will harness a massive impetus with powerful state backing.

The municipal government of Shanghai drew up the most ambitious AI plan of all, aiming for an AI core industry size of more than 100 billion CNY by 2020. To achieve this, Shanghai is building AI industry zones in multiple locations across the city. Last December,



Shanghai's Lingang Area Development Administration signed agreements with 15 leading Chinese AI firms, including Baidu Innovation Center, iFlyTek, Horizon Robotics, and Cambricon. Beijing thus sees its position as China's leading science and technology hub with its stronghold in Zhongguancun seriously challenged. In response to Shanghai's advances, Beijing's government announced a 14 billion CNY AI industrial park in Mentougou district in January 2018.

Beyond first tier cities, other localities are also well positioned to compete for dominance in specific AI technologies. In Hefei, for example, the AI-focused industrial base called "China Speech Valley" (中国声谷)

is already in full swing, hosting around 200 companies including China's global champion in speech recognition, iFlyTek. The Anhui provincial government and the municipal government of its capital city Hefei are now joining forces to turn the industrial park into the country's largest and strongest hub for speech recognition technology products. Together they plan to spend 3.2 billion CNY on R&D and application of intelligent speech and AI technology until 2020.

Provinces that have thus far kept a lower profile now desperately try to jump on the AI bandwagon as well. For example, China's economically struggling northeastern provinces of Heilongjiang, Liaoning and Jilin all issued their own AI plans at the beginning of this year. According to the ambitions set forth in its plan, Liaoning seeks to transform from a blank spot on the AI map into the biggest AI innovation center in Northeast Asia by 2030.

China's various AI plans feature a common narrative: governments at all levels mobilize a lot of money to attract the cream of the crop of AI companies and talent. Changzhou in Jiangsu province, for example, plans to hand out between 200,000 and 300,000 CNY to companies and research institutions for each world-class or national-level AI talent who settles down in Changzhou Science and Education Town. In another example, Hangzhou tries to lure highly skilled workers with subsidies e.g. for auctions of highly-contested car license plates.

The message is clear: China is aware of its limited pool of AI experts. The run on exceptional AI talent, however, is a global phenomenon. Chinese and US companies try to snatch talent away from each other by establishing AI research centers in proximity to one another in Silicon Valley, Seattle and Shenzhen. As a result, salaries in the field of AI have skyrocketed. By entering an already fierce and pricy battle over such a small talent pool, China's local governments more than ever risk burning through a lot of cash without yielding the envisioned results.

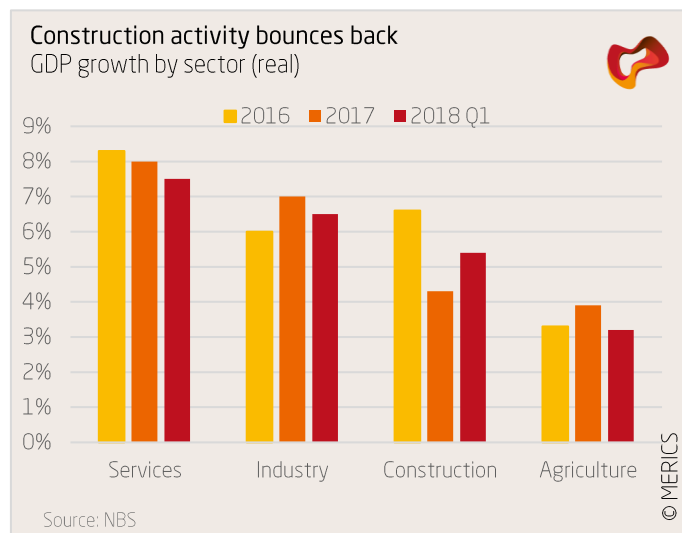
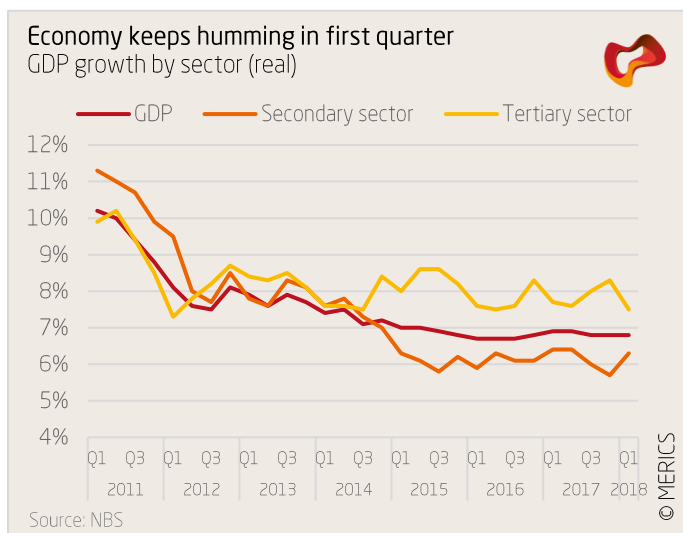
In its effort to tackle the talent shortage in AI, China's national government is also looking to attract foreign experts. In the annual work report for the National People's Congress last month, Premier Li Keqiang pledged to accelerate efforts to surpass the United States in advanced technologies such as AI by wooing overseas talent as one of the state priorities for 2018. A set of initiatives already underway includes express green cards to foreign high-end talent and their families (see also p. 11). Foreigners of Chinese descent as well as Taiwanese have been a special focus of China's efforts to attract talent to work or set up companies on the mainland.

China is determined to play a leading role in global AI development. The country's dynamic tech environment benefits from the sheer amount of data generated by its 800 million smartphone users and a legal system that does not provide effective protection of private data. Even though the AI sector is currently dominated by private companies, the national strategic interests in AI business applications and AI usage in defense as well as public security have prepared the ground for more active state involvement. The current top-down approach in China's AI industry is thus in line with the country's overall industrial policy, in that it mobilizes massive amounts of capital and labor towards a specific target even at the risk of creating inefficiencies and wasting resources.

Economy

Economic growth remains robust for now

- Trade frictions, strong CNY and deleveraging campaign do not yet affect real economy
- Rising construction activity lifts secondary sector growth, while service growth slows



According to official statistics, the Chinese economy expanded at 6.8 percent in the first quarter. In Q1, consumption contributed 77 percent of economic growth. This does not signal a structural shift, as consumption usually contributes the most to growth in the first quarter. A sharp increase of private sector investments also contributed considerably to growth. Net exports, which had lifted growth in 2017, served as a brake in Q1 amid stronger import growth.

Industrial sector and construction growth, which had both slumped in the second half of 2017, have picked up speed, growing at 6.5 and 5.4 percent respectively. This caused growth in the secondary sector to increase from 5.7 percent in Q4 last year to 6.3 percent in Q1.

Having grown at 8 percent in Q4, the largest sector, the tertiary or service sector, slowed down slightly, growing at 7.5 percent. Despite the slowdown, it is still the fastest growing sector. The slowdown was across the board, as most sectors grew at a lower pace than in the previous quarter. IT-related services (29.2 percent), transport and logistics (7.7 percent) and business services (10 percent) were the only sectors that expanded above the headline service sector growth.

There are several clouds on the horizon. The Chinese government's still somewhat cautious campaign to reduce the use of credit has slowed but not reversed the growth of credit-to-GDP. So far, the deleveraging campaign has not affected growth in the real economy. But growth is bound to take a hit should the campaign accelerate.

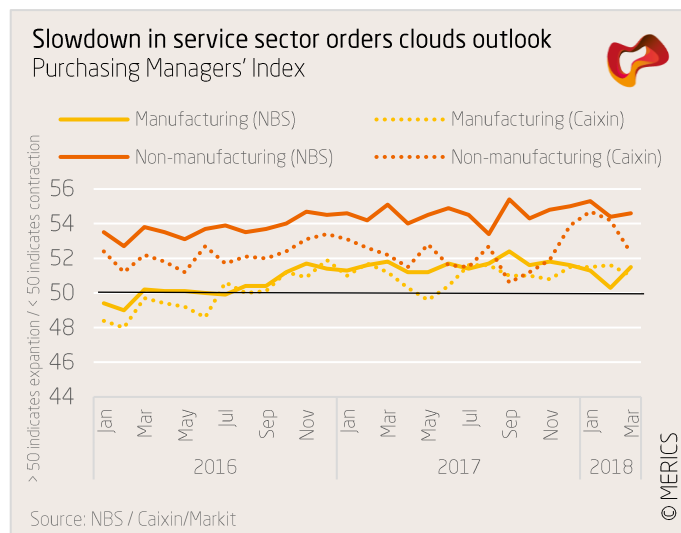
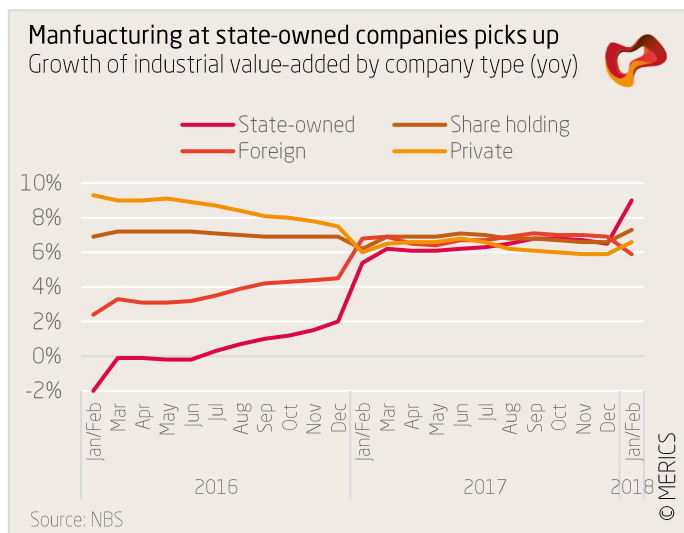
A second concern is the mounting trade pressure from the United States. The Trump administration has proposed tariffs on a long list of Chinese exports. If these measures are implemented growth will be hurt. In the meantime, the threat of tariffs could have the opposite effect. There are signs that some Chinese companies attempt to maximize their exports before getting hit by potential tariffs.

The fact that growth so far this year has exceeded the official target of about 6.5 percent, gives the Chinese government some room to implement further structural reforms and press on with its deleveraging campaign. Growth of around 6.5 percent is necessary to comfortably reach the goal of doubling the size of the real economy from 2010 levels by 2020. Although GDP growth is likely to slow following a strong first quarter, it is extremely unlikely that the government would let growth decelerate too sharply.

Business

Made in China 2025 boosts high-tech manufacturing

- Government announces tax breaks for producers
- New orders for services slump in first quarter



Strong expansion of manufacturing in the first two months helped lift growth of industrial production to 6.8 percent in the first quarter, up from 6.2 percent in the previous quarter. The expansion came as the government eased policies to reduce supply in an effort to curb overcapacities and combat environmental pollution. 36 of the 41 industries tracked by the National Bureau of Statistics (NBS) maintained year-on-year growth. Output growth was highest for pharmaceuticals (11.4 percent), special machinery (10.7 percent) and IT (12.5 percent).

Output growth in these sectors is in line with the government's focus on industrial upgrading and more "high quality" growth by manufacturing higher value-added products. Growth in what is classified as strategic emerging industries by the NBS was 9.6 percent in the first quarter, outpacing the labor-intensive areas of the economy such as textiles (2.1 percent).

The composition of industrial growth is in line with the Made in China 2025 strategy. The government is ramping up its efforts towards industrial upgrading and has released an updated road map in January for its Made in China 2025 strategy. According to the plan China should be a global leader in manufacturing telecommunication equipment, railway and electrical power equipment by 2025.

Perhaps signaling the strong state involvement in the industrial policy push, output of state-owned enterprises recorded a noticeable uptick in 2018, expanding by 7.9 percent in the first quarter and outpacing all other ownership categories. In contrast Chinese private companies expanded by 6.6 percent (data only available for first two months), while foreign-owned enterprises grew 5.5 percent.

In an effort to maintain the growth momentum in manufacturing, the government has announced a cut of about 400 billion CNY in value-added tax rates effective May 1. The tax reduction will particularly benefit high-end manufacturing and can also be seen as a direct response to a tax cut in the United States. The Chinese government operates in an environment of increasing trade frictions with Washington. The recent decision by the US government to ban US companies from selling key components to telecommunication giant ZTE highlights possible speed bumps for China's industrial policy targets.

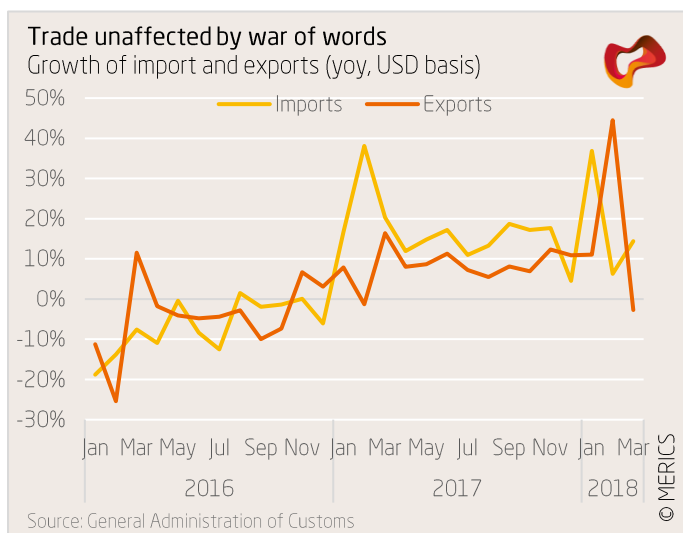
Business confidence as measured by the Purchasing Managers Index (PMI) remained positive for both manufacturing and services. Manufacturing orders recovered following a seasonal slump over the Chinese New Year period. However, new business for the service industry has steadily declined over the first three months, falling to the lowest point since August 2016.

Related MERICS analysis: [China's way to an innovative superpower](#)

International trade and investment

Trade resilient in face of mounting trade frictions

- Imports and exports expand amid robust domestic and global demand
- Proposed US tariffs target technology push under Made in China 2025 strategy



For the moment trade is resilient in the face of a potential trade war between the United States and China. Driven by the synchronized global economic boom Chinese imports and exports grew by 19.2 and 17.6 percent respectively in dollar terms. In Q1 imports grew at a faster rate than the overall economy, putting a slight dent in economic growth. However, the calm before the storm might soon be over.

The United States recently published an extensive list of sectors, which are proposed to be subject to a 25 percent duty. The tariffs are to be implemented after a 60-day review period. The tariffs would apply to 1,333 products worth 50 billion USD, affecting around 10 percent of imports from China to the United States. China has threatened to retaliate by imposing tariffs of equal value on 106 American products ranging from agriculture to cars and aircraft, that are produced in states that are important for the Republican Party. These tariffs could also be expanded if the United States introduces further tariffs as Trump recently threatened.

For now these threats remain a war of words, and all the measures could still be shelved or watered down. President Xi seemed to give some minor concessions (specifically with regards to investment and tariffs in the automobile industry) at his recent speech at the Bo'ao Forum. It is unlikely that this will be enough to cause US President Donald Trump to back down.

The Trump administration has frequently stated that the purpose of the tariffs is to reduce the United States' enormous current account deficit with China, as well as to fight back against alleged IP theft and forced technology transfers. The proposed tariffs mostly target high-tech industrial sectors that covered by Made in China 2025, China's master plan for industrial upgrading. They focus less on the existing trade deficit and more on potential future imports from China in the high-tech sector. Following increasing scrutiny of acquisitions of technology companies abroad by Chinese companies, the threatened tariffs are part of growing headwinds for Made in China 2025 not only in the United States, but also in Europe. Because of its impact on global supply chains, a US-China trade war would likely cause the synchronized global growth boom to end. This could also affect the European Union, which has so far stayed outside of the trade conflict.

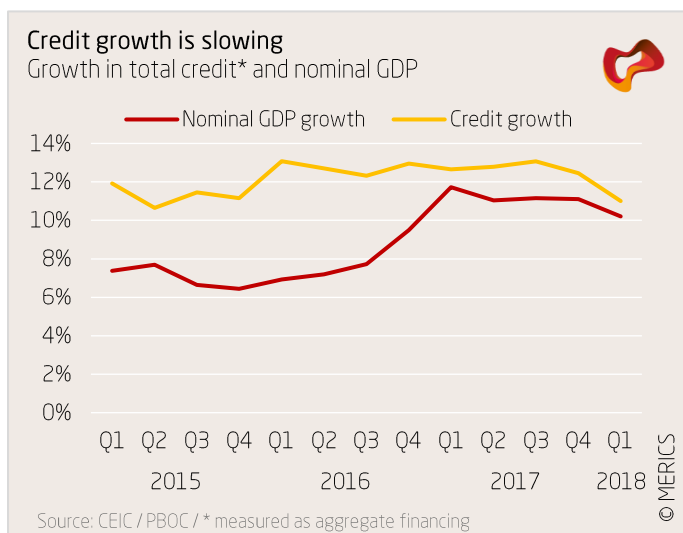
The quarter also saw noteworthy exchange rate movement. Hovering around 6.3 against the USD, the CNY has stayed remarkably strong through the tumult, at its strongest level since 2015. It is not likely that this state will persist. There are many signs that capital flight could return, and crucially, if the CNY keeps appreciating, exports could be hurt. If this happens the government will likely either allow the currency to depreciate or devalue as it did in 2015.

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Financial markets

Tighter regulations moderate credit growth

- Crackdown on shadow banking leads to reshuffle of credit structure
- Major reorganization and staff changes in regulatory agencies announced during NPC



Financial markets have seen policy action intended to contain risk and will continue to do so for the remainder of the year. During their speeches at the National People’s Congress in March both President Xi Jinping and Premier Li Keqiang reiterated the importance of financial stability. The NPC then acted by reorganizing the financial regulatory bodies and by introducing new policies to target risky lending practices.

Two key staff changes stand out. After serving for 16 years, the previous governor of the People’s Bank of China (PBOC), Zhou Xiaochuan, was succeeded by his previous deputy Yi Gang. Yi reiterated the bank’s commitment to “prudent and neutral” monetary policy.

After the reshuffle, the bank’s neutrality seems more in question than ever before. Guo Shuqing, who previously chaired the banking regulatory commission, was appointed as chairman of the newly merged banking and insurance regulatory commissions as well as the Party secretary of the PBOC. It is unlikely that Yi Gang will be able to be as outspoken as his predecessor in the face of such a powerful CCP presence in the bank.

China’s dilemma of maintaining high levels of growth while reducing the reliance on credit remains. However, in contrast to 2017, in which only regulatory tightening was used, the regulators also used some cautious monetary tightening in Q1.

A number of new policies are intended to combat excessive risk taking as well as to provide implicit government guarantees. Some of the most remarkable steps are: state-owned financial institutions can no longer directly issue loans to local governments, they must instead buy their bonds; new rules restricting wealth management products (WMPs) with guaranteed returns have been introduced; non-compliant banks have been issued large fines and the debt-to-equity swap program has been continued and extended.

On the monetary side the PBOC raised the controlling rate incrementally, and reduced liquidity substantially. Despite monetary tightening and new regulation, both long-term treasury and corporate bond yields have trended downwards since the beginning of the year. The falling rates are likely an indicator of high demand, especially as treasury issuance saw no big changes.

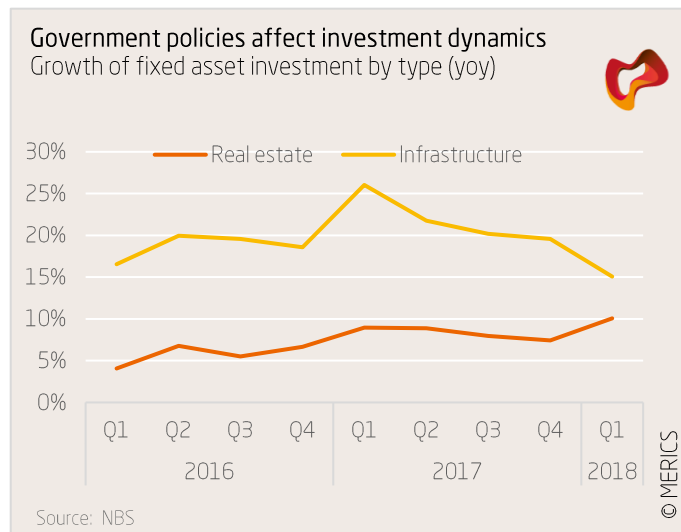
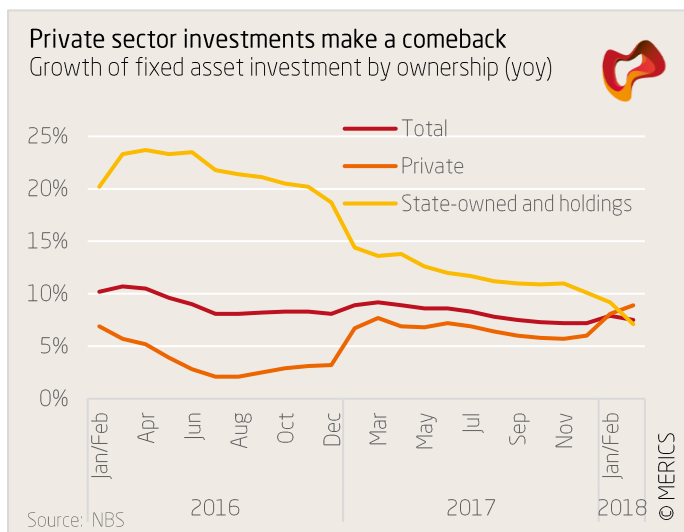
Despite regulatory and monetary tightening, total credit growth continued outpacing nominal GDP growth. In Q1 nominal GDP grew at 10.2 percent while total credit grew at 11 percent, down from 12.4 in the previous quarter.

The extra regulation appears to have caused a reshuffle in financing sources. The growth of corporate bond financing and bank financing were both largely unaffected. The growth of trust loans on the other hand, a form of financing favored by local governments, fell from 29 to 22 percent.

Investment

Private sector stabilizes investment growth

- Investment growth from state-owned enterprises falls below private sector
- Real estate sector investment picks up pace



Fixed asset investment picked up from 7.2 percent in Q4 2017 to 7.7 percent in Q1. However, a shift has taken place. Having previously grown at a slower pace than investment originating in state-owned enterprises (SOE), in Q1 private investment growth accelerated growing at the fastest pace in two years. SOE and private investment grew at 7.1 and 8.9 percent respectively.

There are two major explanations for the shift. First, the government’s campaign against overcapacities has begun to taper off, allowing the private sector to once more increase capacity in several previously targeted sectors. A striking example of this is the private sectors’ investments in coal mining which increased by 60 percent. Second, the central government, through its campaign to reduce credit growth in the economy has reduced local governments’ ability to take on credit to finance new projects. Despite this, infrastructure investment growth grew at 15 percent in Q1.

Notable, real estate investment expanded by 9.9 percent, the fastest pace since the beginning of 2015. Investment in residential buildings accounted for 8 percent to total fixed asset investments in Q1. The increasing construction activity reflects the government’s aim to increase supply in order to control rising housing prices. Although real estate prices have stabilized they remain highly elevated and a concern for the government.

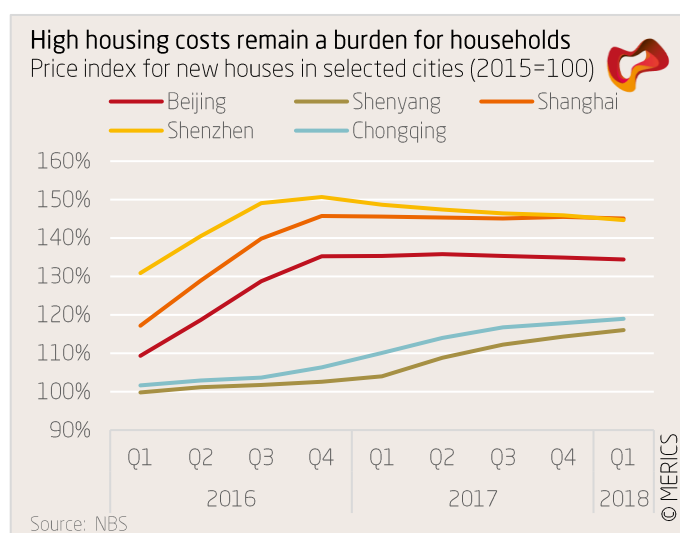
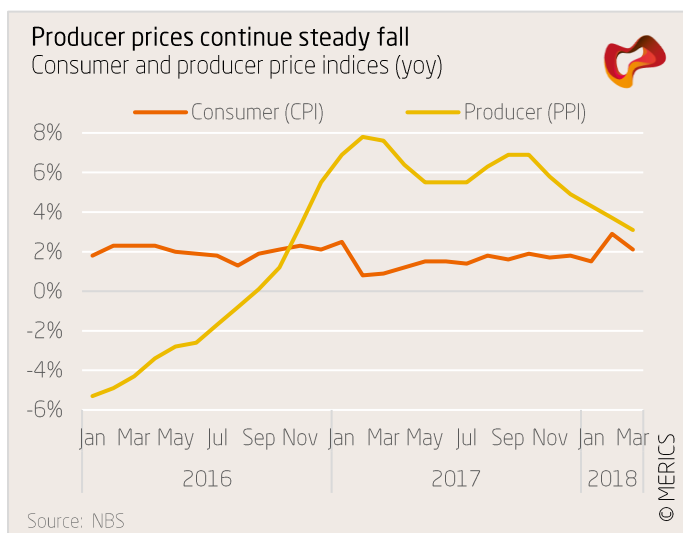
Investment across industries has been highly uneven. The share of total investment in the primary, secondary and tertiary sectors was 2.7, 34.5 and 62.8 respectively. The share of investments in the tertiary, or service sector stands out, this was the highest share since 2003. Meanwhile the share of investments in the secondary sector was the lowest since the same year.

The uneven investment across sectors can also be seen in the investment growth rates. Accentuating China’s slow shift away from manufacturing, the primary and tertiary industries enjoyed high levels of investment growth of 24.2 and 10 percent, respectively. Investment growth in the secondary industry grew by only 2 percent. The largest growth in the tertiary sector was in air transports which grew by almost 60 percent.

Price levels

Inflationary pressure remains muted

- CPI trends upward but well below government's 3-percent target
- Producer price increases slow for fifth consecutive month



Consumer prices and inflation continued their slow climb upwards in Q1, growing at 2.2 and 2.1 percent, respectively. Core inflation, which does not include volatile food and fuel prices, hit a small peak in February when price growth was the highest since 2011. Despite these increases, the People's Bank of China's (PBOC) long-standing inflation goal of 3 percent was once more missed in the first quarter of 2018. Inflation is likely to slowly climb higher, but it is unlikely to move above the PBOC's target.

Reflecting the demand of China's growing middle class, the cost of medical services outpaced most all other categories, expanding at 6 percent. Food prices increased by 2 percent, but the increase was unevenly distributed: the prices for beef, eggs, fish, grain, lamb, and vegetable prices increased, while the price of pigs and pork products fell. However, if China should impose tariffs on food imports from the United States, prices for items such as soy and pork could accelerate.

The overall mild consumer price increase does not capture asset price inflation, in particularly rising housing prices. Much of the excess liquidity in China's financial markets has made its way into the real estate market, where prices have recently begun to stabilize due to government intervention. Housing prices, however, remain at highly elevated levels compared to 2015. Taking the scarcity of affordable housing into account, households, in particularly middle-income families in urban areas, are confronted with rising housing costs, which are not fully captured by the CPI.

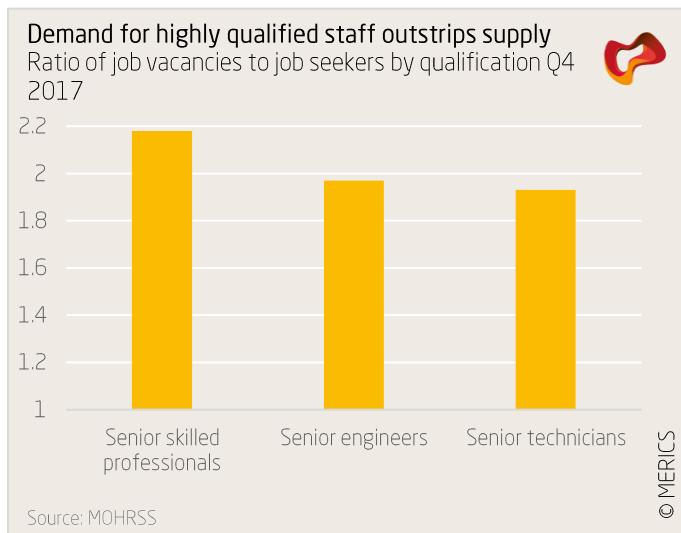
Following a rapid rise of producer prices (PPI) growth at the beginning of last year, the trend of cooling prices, which started at the end of 2017, continued into Q1. Producer prices grew at an average of 3.7 percent in Q1, compared to 7.4 percent during the first three months of 2017. The slowdown was partially due to a dialing back of the environmental protection and reduction of overcapacities campaigns. If industrial output continues to increase, factory gate prices will continue to fall, potentially affecting corporate profits and slowing the deleveraging campaign.

In line with overall PPI development, input price growth has slowed down. The average price of industrial inputs grew by 4.4 percent in Q1, compared to 8.1 percent in 2017. The prices of building materials, ferrous and non-ferrous metals and wood products grew the most at 11.9, 7.1, 8.5 and 6.6 percent respectively. The prices of farm products and semi-finished products fell by 0.4 percent and increased by 1.5 percent.

Labor market

Skills mismatch leaves companies struggling to fill positions

- Tight labor market conditions continue due to lack of qualified personnel
- Government steps up efforts to attract global talent of Chinese descent



A stable labor market will remain a key priority for the Chinese government. A record of 8.2 million university graduates are expected to enter the job market in 2018, while the number of students returning from abroad is also increasing. Despite record numbers of university graduates, the lack of highly qualified talent remains a bottleneck for China's economic transformation towards high tech. Companies struggle to fill positions: The demand for employees with high levels of technical qualification is nearly twice as high as the supply (see graph).

Improving education is seen as vital for achieving key policy goals for industrial upgrading as well as eliminating poverty. Reaching these targets will require a more qualified workforce. In the first quarter the government announced reforms of vocational training and education reform targeting at China's largely low skilled 350 million workers in rural areas. Municipal governments of cities such as Beijing, Shenzhen and Shanghai introduced programs to attract highly qualified workers from within and outside of China by offering cash incentives and residency permits as well as by relaxing visa conditions and work permits for foreigners. The efforts to attract foreigners come after visa conditions and requirements for foreigners' work permits have become more restrictive in previous years.

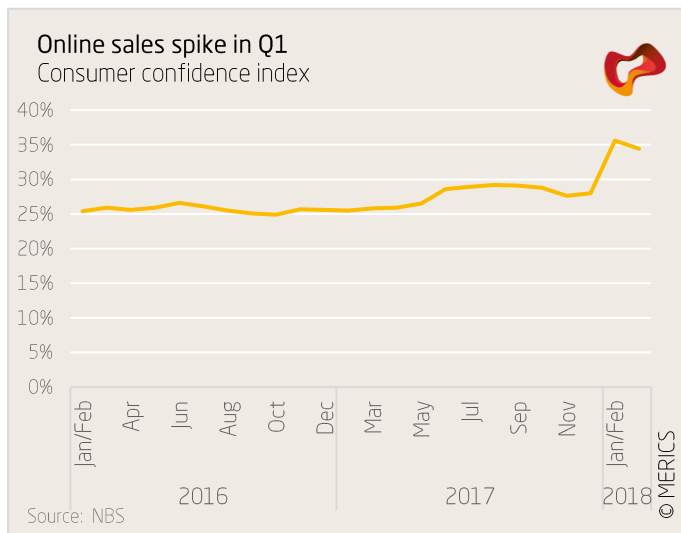
Efforts have been particularly aimed at highly qualified foreigners of Chinese descent. As of February 1, those meeting the requirements may be granted residency permits of up to 5 years. On February 28, China's Taiwan Affairs Office also announced specific measures designed to attract Taiwanese to work in China. During the National People's Congress (NPC), China announced steps to gradually grant Taiwanese the same rights as Chinese citizens in areas such as employment and residency benefits. As part of the government reorganization during the NPC, a new Immigration Bureau was created, and the Ministry of Science and Technology will be responsible for managing foreign work permits. As of 2017 there are an estimated 900,000 foreigners working in China, less than 1 percent of the total workforce.

Over the past year, the Chinese labor market had recorded a sharp uptick in demand for workers. The ratio of job vacancies to job seekers jumped to 1.22 by the end of 2017 (latest data available), the highest level on record. China's shrinking workforce was a factor that contributed to low levels of unemployment. The total labor force fell from 907 million in 2016 to 902 million in 2017. Moreover, job losses caused by the government's continued efforts to reign in overcapacities in the steel and coal sector, an induced slowdown in construction activity as well as tougher regulation on polluting industries have so far been offset. Employment demand was lifted by strong demand in real estate services (+24.8 percent compared to the same period last year), leasing and business services (+18%) and IT (+13.4%). However, 9 of the 12 industries tracked by the Ministry of Human Resources and Social Security (MOHRSS) indicated weakening demand for labor going forward.

Retail

Expanding online sales drives up retail spending

- Consumer confidence climbs to record level
- Government remains concerned about consumer loans amid rising household debt



The consumer confidence index measured by the Chinese National Bureau of Statistics continued to etch upwards, reaching a new all-time record of 124 in February (latest data available). The optimistic outlook is reflected in retail sales, which have returned to higher growth rates following a slight slowdown towards the end of 2017. Retail growth expanded by 9.8 percent in the first three months, slightly below the 10 percent recorded for the same period in 2017, and returned to double digits in March (10.1 percent). Growth increased across all product categories. Sales of household and consumer electronics (11.4 percent), pharmaceuticals (10.4 percent) and cosmetics (16.1) were among the fastest growing items in the first quarter.

The increasing trade war rhetoric has led to calls on social media as well as publications such as the Global Times to shun US brands. In 2017, political frictions around the Korean Peninsula resulted in boycotts for South Korean companies, effectively pushing retailer Lotte out of the market. Japanese brands have also previously been affected by a backlash, at least in the short-run. So far there seems no immediate impact on demand for US goods, but this might change should the trade tensions escalate.

Following consistent elevated growth of around 25 percent over the past two years, online sales growth spiked at 34.4 percent in the first quarter. Outpacing sales at brick and mortar stores, e-commerce now accounts for 16.1 percent of total retail sales, up from 12.4 in the first quarter 2017. The shake-up of China's retail sector is shaped by its e-commerce giants. In an innovative and highly competitive environment companies are battling for market share. This includes improving efficiency in logistics and delivery of goods online. Apart from online sales, companies such as Alibaba, Tencent and JD.com have made advances into traditional retail business including grocery and home improvement stores.

China's internet giants are also engaging in P2P lending activity. Companies such as Ant Financial have been major players in supplying households with consumer loans. The risks associated with rapidly increasing household debt however continues to concern the government, as Guo Shuqing, chairman of the China Banking and Regulatory Commission, stressed in a recent speech during the National People's Congress. Online providers of micro-loans have faced increasing regulation since the end of 2017.

Meanwhile, in an effort to ease the tax burden and free up spending, the Ministry of Finance has suggested lifting the threshold for personal income tax as well as increasing the deduction of medical and educational costs. Details of the proposed policies have yet to emerge. A lower tax base could increase consumption expenditure in the coming quarters.