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China Economy

Prices recover while demand lags

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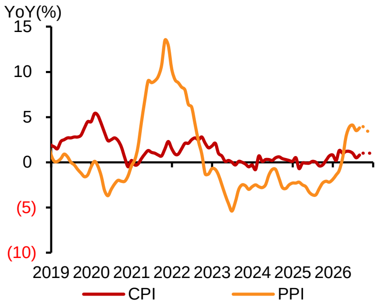
CPI rebounded in August, largely driven by gasoline and gold jewellery prices, which together accounted for around 60% of the monthly increase. PPI inflation accelerated, supported primarily by renewed energy inflation, with tentative signs of price transmission to downstream sectors. Overall, supply constraints are helping restore pricing power in selected commodity and technology industries, while subdued domestic demand continues to weigh on household-facing and construction-related sectors. The policy focus in 2H26 has shifted towards stabilising investment, supported by the deployment of the RMB800bn policy-financing programme and investment in the "six major infrastructure networks". These measures should help arrest the investment slowdown, but a durable consumption recovery still requires stronger household incomes. We expect monetary policy to maintain ample liquidity, although a policy rate cut may not come until 4Q26. Looking forward, we expect the CPI and PPI to reflate from 0.1% and -2.6% in 2025 to 0.9% and 2.5% in 2026.

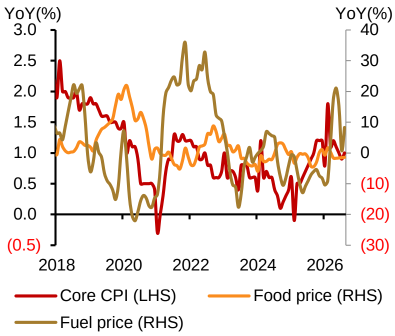
- **CPI recovered in line with market expectations, largely on energy and gold jewellery.** CPI rose to 0.8% YoY from 0.5% in Jul, matching market consensus, while sequential inflation turned positive at 0.4% MoM from -0.1%. Gasoline notably rose 6.6% MoM in Aug; this, together with gold jewellery at 7.6%, accounted for approximately 0.25ppt/60% of the monthly increase of CPI at 0.4%. Food prices rose 0.4% MoM, below the 2013-22 August average of 1.5%, despite weather-related vegetable inflation of 5.5% and a 1.3% MoM increase in pork prices. We have seen some promising rebounds in pork prices, both wholesale and retail, as breeding sows have dropped to the lowest point in 6 years. As headline was primarily pushed by the gasoline and gold jewellery prices, the headline rebound thus offers limited evidence of stronger household demand.

- **Core CPI improved modestly, while the recovery remained uneven.** Core inflation edged up to 1.0% YoY from 0.9%, with prices rising 0.1% MoM. Gold jewellery surged 7.6% MoM. Communication equipment rose 2.1%, mainly reflecting higher electronic component costs amid the global AI boom. Meanwhile, durable goods prices remained tepid as vehicle and home appliance prices fell 0.2% and 0.1% MoM. Footwear and clothing dropped 0.3% and 0.1% respectively. Rents were flat and remained down 0.6% YoY, reflecting weak overall employment conditions. Services inflation rose to 0.1% MoM, as home, telecom and medical services saw 0.1% growth, while tourism prices slipped 0.1% MoM after July's seasonal surge. Core CPI indicated the reflation is largely driven by supply constraints, rather than demand-led, limiting the ability to support a sustained recovery in corporate margins, household incomes and consumption.

- **PPI beat expectations, with only tentative downstream improvement.** PPI rose to 3.8% YoY from 3.5%, above consensus of 3.6%, and rebounded 0.4% MoM after July's 0.7% decline. The momentum was mostly driven by upstream sectors: oil and gas extraction prices increased 6.1% MoM, fuel processing 3.5%, coal mining 2.8% and non-ferrous smelting 0.8%. By contrast, ferrous smelting and non-metallic mineral products fell 0.9% and 0.2%, respectively. Consumer-goods PPI rose 0.2% MoM in Aug, the largest increase in 3 years, with 0.6% rise in durable goods, reflecting some transmission towards downstream sectors finally. Nevertheless, producer purchase prices rose 5.8% YoY against factory-gate inflation of 3.8%, signalling incomplete cost pass-through and increasing pressure on



Forecast numbers from Sep 2026
Source: Wind, CMBIGM

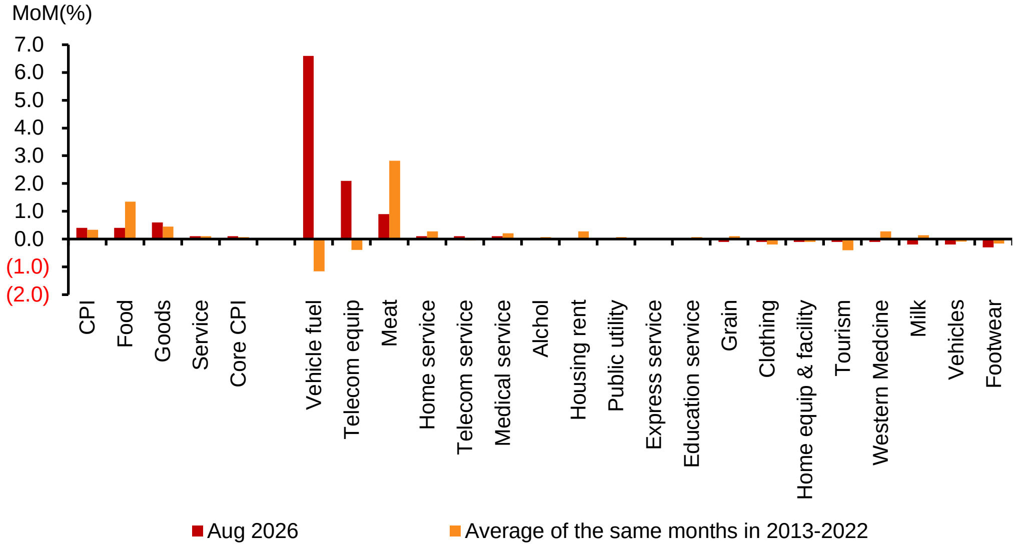


Source: Wind, CMBIGM

margins, especially for downstream firms facing weak demand and intense competition.

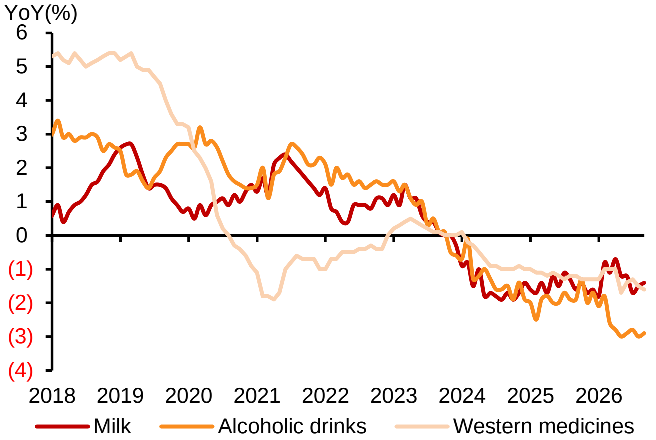
- **Uneven reflation favors selective earnings exposure and continued monetary accommodation.** Corporate earnings continue to recover driven by the rising PPI, as Jan–Jul industrial profits rose 17.6%, with electronics profits more than doubling, while auto profits fell 20.4%. This supports selective exposure to commodity producers and technology suppliers with demonstrable pricing power, while arguing for caution on consumer manufacturers facing higher costs and continued discounting. The major policy pivot in 2H26 has shifted towards stabilizing investment vowed by policy makers, supported by the RMB800bn policy-financing program now being deployed and the "six major infrastructure networks" plans. But a durable consumption recovery still requires stronger household incomes. We expect monetary policy to remain accommodative in liquidity, although the rate cut may not occur until 4Q. For bonds, commodity shocks and fiscal deployment can trigger near-term uptick of 10Y treasury yields, but subdued domestic demand could keep yields on a downward path towards 1.7% by year-end, based on our estimates. Equity performance is likely to remain differentiated, reflecting uneven pricing power and earnings growth. Raw materials, AI hardware suppliers, and leading companies with overseas exposure should continue to outperform, while domestic demand-related sectors including autos, discretionary consumption and real estate may lag amid subdued domestic demand and margin pressure.

Figure 1: MoM changes of China CPI



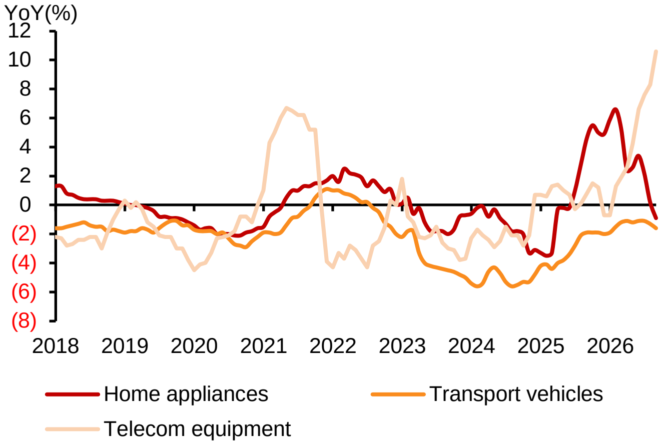
Source: Wind, CMBIGM

Figure 2: China CPI growth in staples



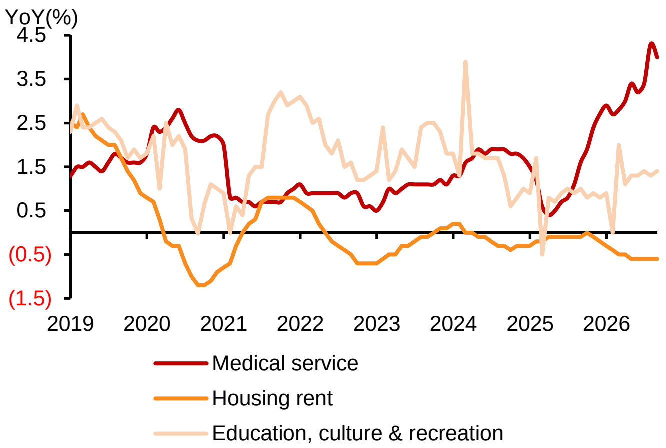
Source: Wind, CMBIGM

Figure 3: China CPI growth in durables



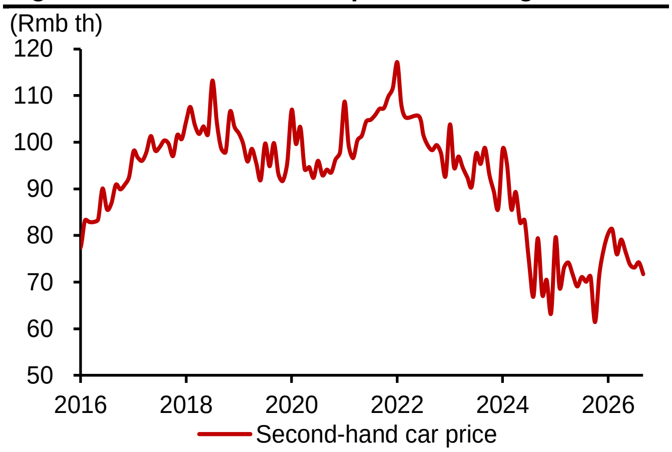
Source: Wind, CMBIGM

Figure 4: China CPI growth in services



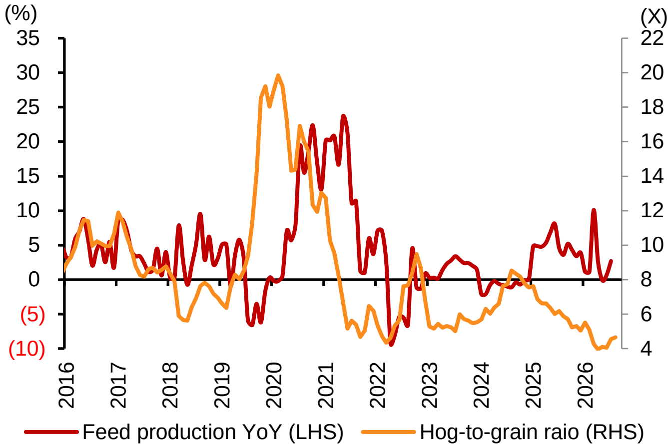
Source: Wind, CMBIGM

Figure 5: Second-hand car price in Shanghai



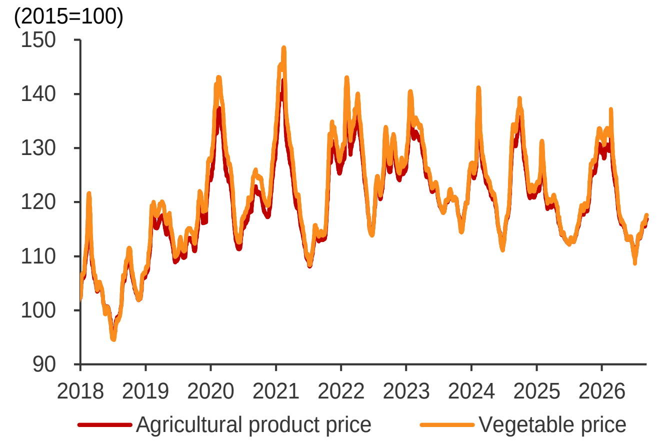
Source: Wind, CMBIGM

Figure 6: Feed production & hog-to-grain ratio



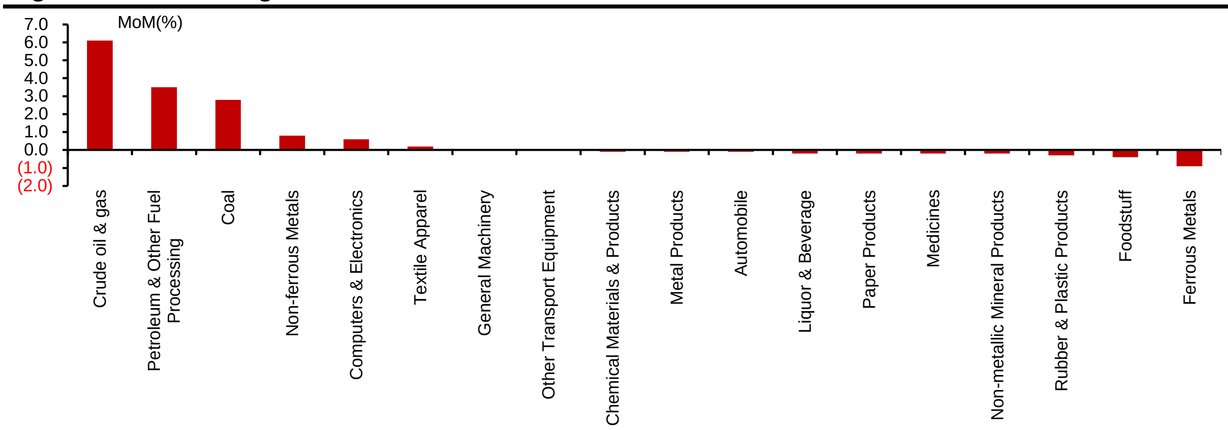
Source: Wind, CMBIGM

Figure 7: Agricultural and vegetable prices



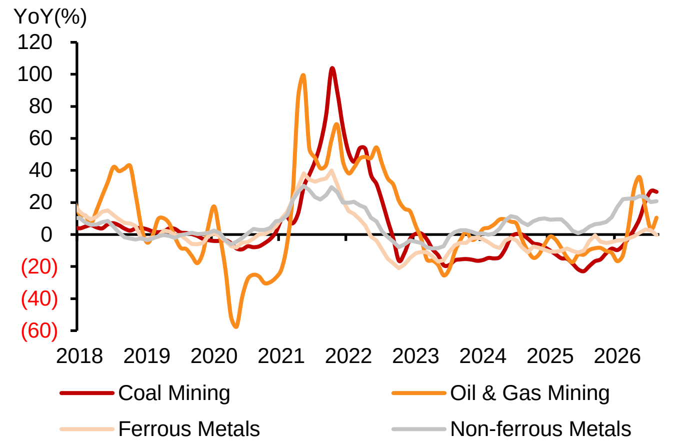
Source: Wind, CMBIGM

Figure 8: MoM changes of China PPI



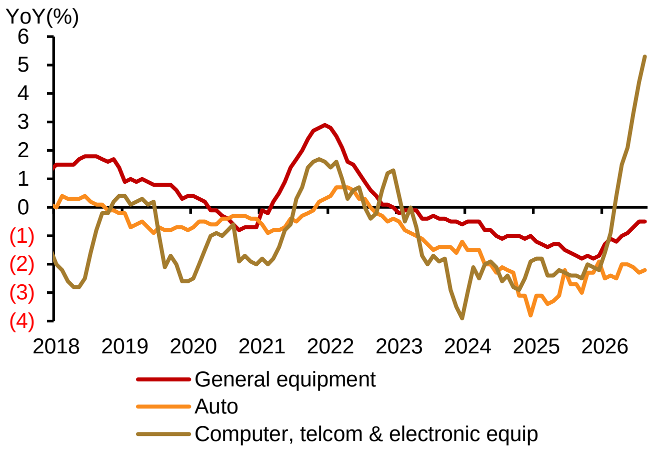
Source: Wind, CMBIGM

Figure 9: China PPI in energy & metals



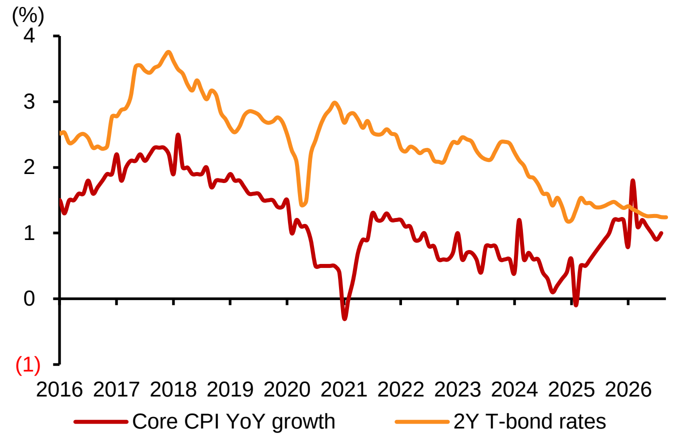
Source: Wind, CMBIGM

Figure 10: China PPI in equipment



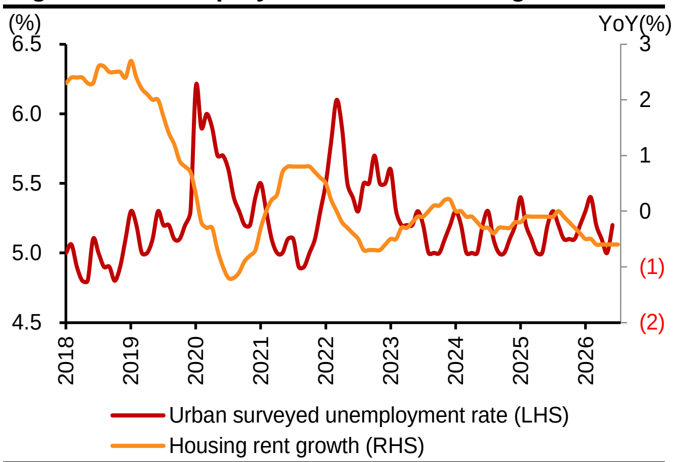
Source: Wind, CMBIGM

Figure 11: China core CPI growth & 2Y T-bond rates



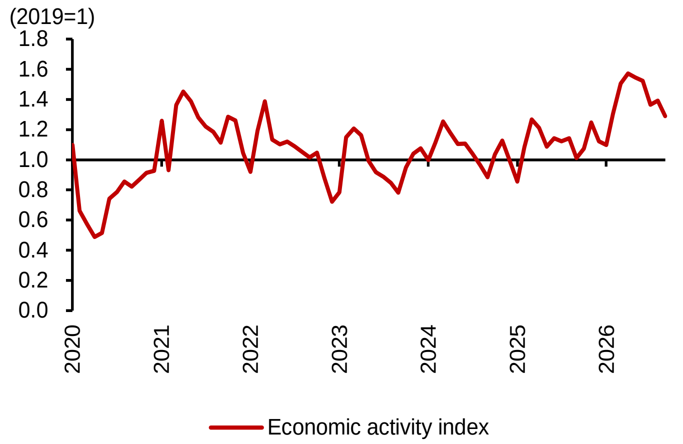
Source: Wind, CMBIGM

Figure 12: Unemployment rate and rent growth



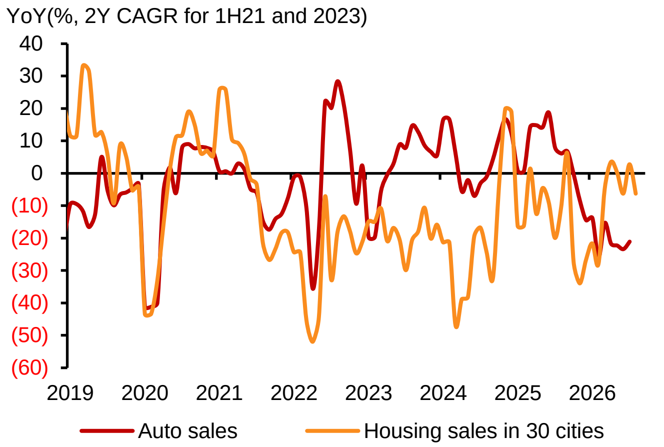
Source: Wind, CMBIGM estimates

Figure 13: China Economic Activity Index



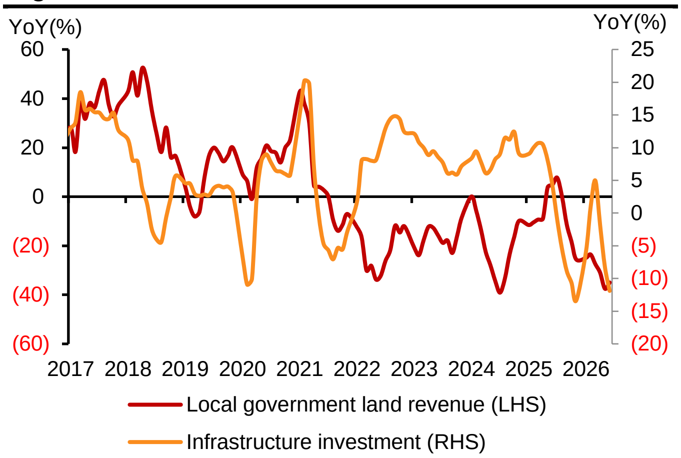
Source: Wind, CMBIGM

Figure 14: China auto & housing sales



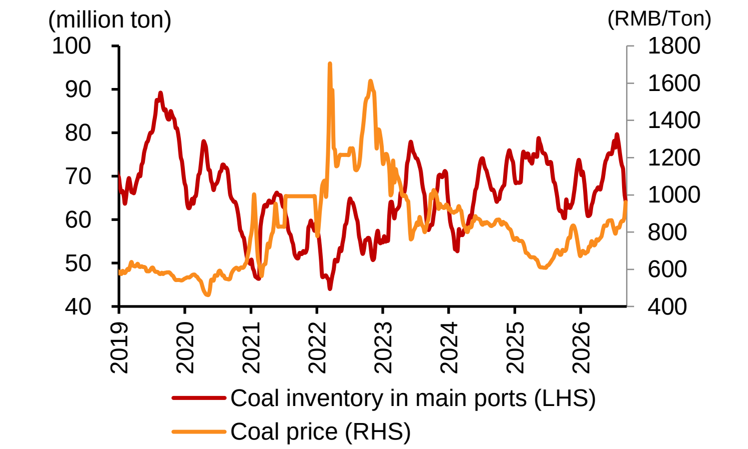
Source: Bloomberg, CMBIGM

Figure 15: Infrastructure investment in China



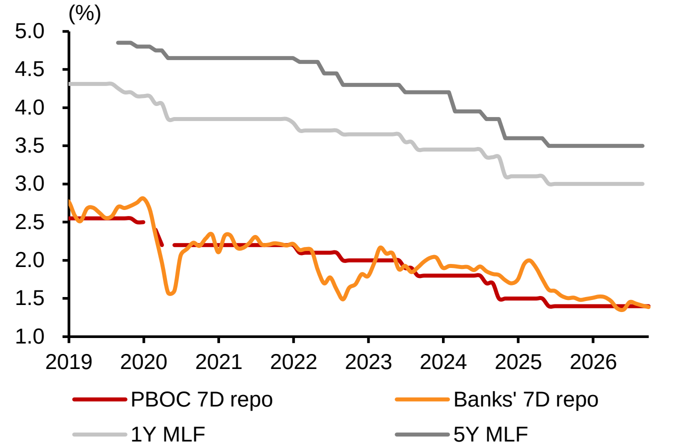
Source: Bloomberg, CMBIGM

Figure 16: China coal inventory & price



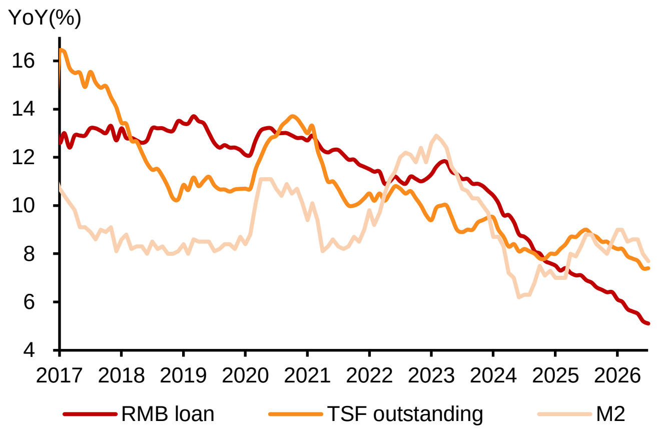
Source: Wind, CMBIGM

Figure 17: PBOC policy rates & liquidity condition



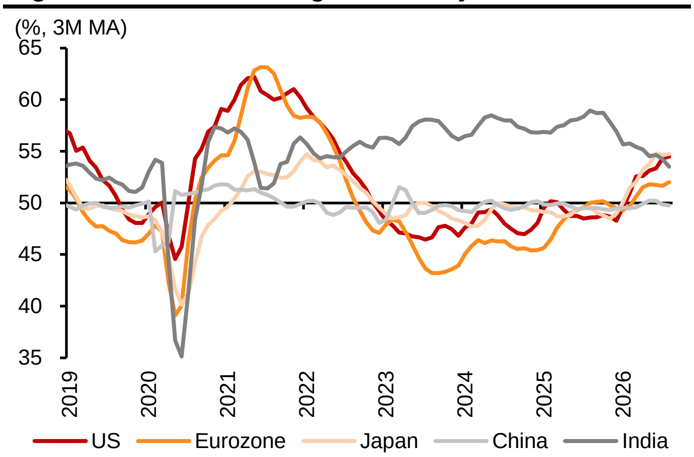
Source: Bloomberg, CMBIGM

Figure 18: China credit growth



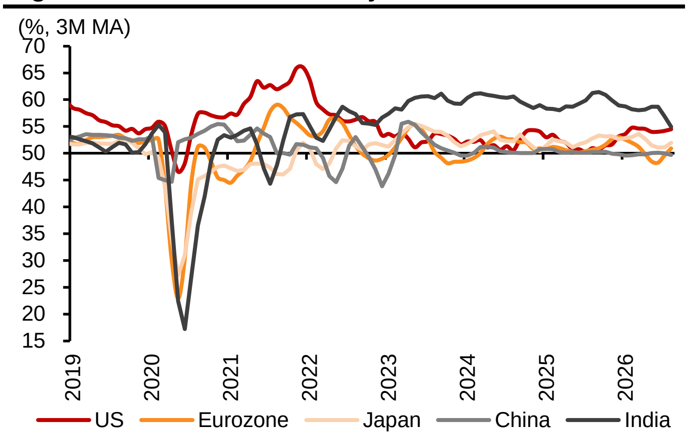
Source: Wind, CMBIGM

Figure 19: Manufacturing PMI of major economies



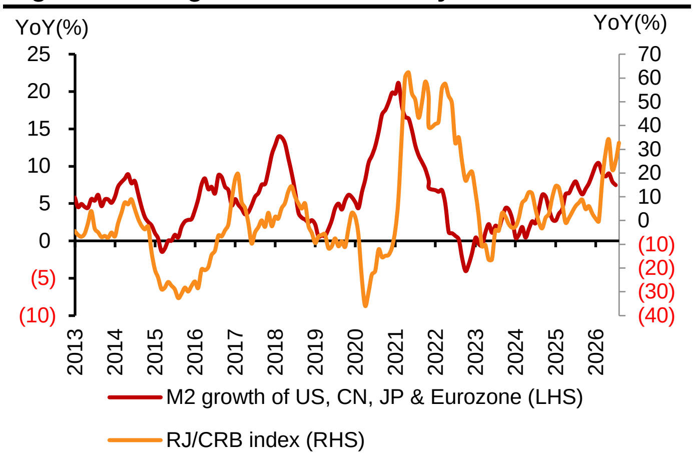
Source: Bloomberg, CMBIGM

Figure 20: Service PMI of major economies



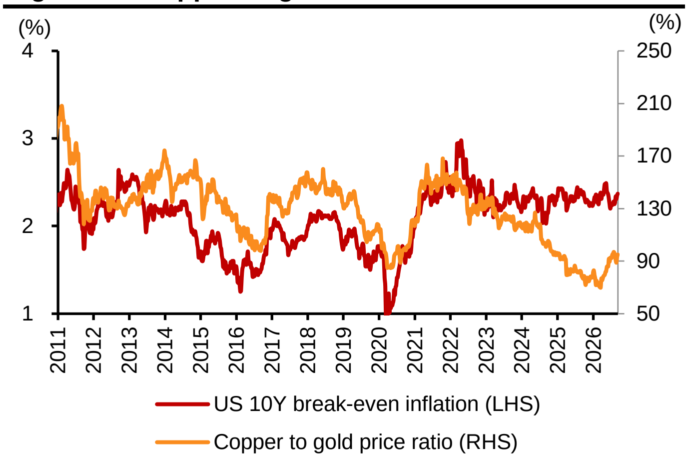
Source: Wind, CMBIGM

Figure 21: M2 growth & commodity inflation



Source: Bloomberg, CMBIGM

Figure 22: Copper-to-gold ratio



Source: Wind, CMBIGM

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