

# China Economy

## The uptrend of CPI adds uncertainty to policy & market

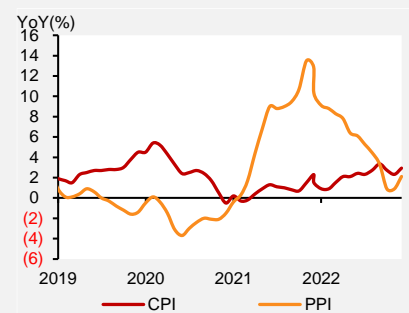
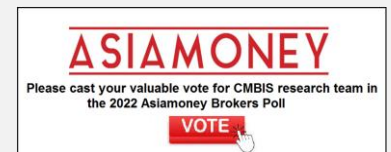
China's consumer inflation will increase in 3Q22 as it may exceed 3% in September. Then it may moderately decline in 4Q22 and rise again in 1Q23. The pick-up of CPI may post a dilemma for PBOC as DR007 may face moderate upside pressure in 2H22. The uncertainty of RRR policy rises, while the possibility of further LPR cut declines in 3Q22. PBOC may use structural or targeted easing policy to support the growth. Chinese stocks may soften or even see moderate corrections in July to August after the rally in May and June due to four reasons. Firstly, the uptrend of consumer inflation reduces room for further liquidity easing. Secondly, the recent rises of Covid-19 cases may make it more difficult for China to further loosen its zero-Covid policy. Thirdly, overseas economic slowdown may bring downside uncertainty for China's exports and capex in manufacturing. Lastly, stocks in some sectors rebounded too fast in the past two months. But Chinese stocks still have upside room if we look into a longer period as the economy should be in the resumption cycle in 2H22-1H23.

- Fuel, food and service inflation all climbed.** Consumer price index (CPI) picked up 2.5% YoY in June after rising 2.1% YoY in May, beating expectations. Fuel inflation and food inflation respectively climbed from 27.1% and 2.3% in May to 32.8% and 2.9% in June. Meat price was on an uptrend as live hog sector faced a de-capacity cycle. Meanwhile, core CPI YoY growth slightly rebounded from 0.9% in May to 1% in June as the reopening gradually supported service prices. From the MoM perspective, gasoline, meat and service price respectively increased 6.7%, 1% and 0.2% in June, compared to the growth of 0.6%, 1.9% and 0% in May.
- PPI further slowed amid divergence for different commodities.** The YoY growth of producer price index (PPI) slowed from 6.4% in May to 6.1% in June. Oil price rebounded as global supply disruptions continued, overseas demand rose in summer holiday and domestic demand also resumed amid reopening. But coal price further declined as domestic output and capacity expanded noticeably to assure energy supply security. Steel and non-ferrous metal prices also further weakened as property development investment remained weak. PPI in equipment sector also slowed due to base effect as well as weak capex and durable demand.
- CPI will be on an uptrend in next three quarters.** The YoY growth of CPI may exceed 3% in September and 1Q23. Firstly, oil & gas prices may remain high if the Ukraine crisis continues and the US does not see a recession this year. Secondly, China's food inflation will rise as live hog sector sees a de-capacity cycle and grain prices face upside pressure amid rising gap between domestic and global markets. Thirdly, service inflation may mildly rise amid a gradual reopening of economy.
- PPI should be in a slowdown with possible fluctuations around the year-end.** The YoY growth of PPI may be lower than the CPI growth around September and further decline to below 2% in 4Q22. Firstly, the base effect will cause a natural decline of the YoY growth. Secondly, metal price has additional downside room as the US Fed continues to tighten policy and China's land market and property development investments remain weak. Coal price may also further decline in 2H22 if its output continues to increase.

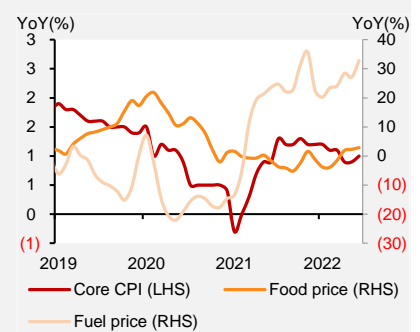
**Bingnan YE, Ph.D**

(852) 6989 5170

yebingnan@cmbi.com.hk



Source: Wind, CMBIGM

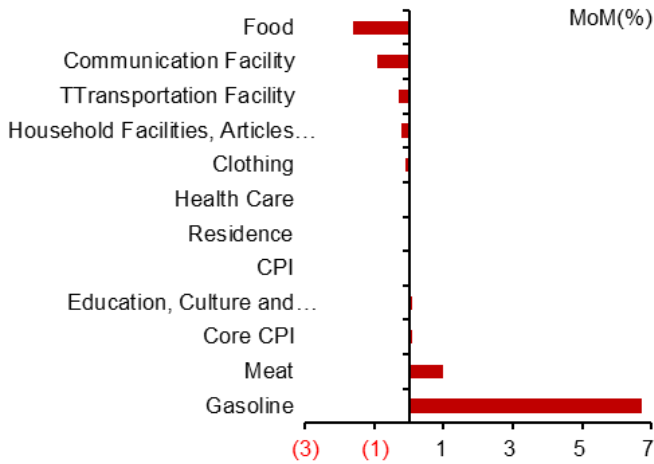


Source: Wind, CMBIGM

Thirdly, capital goods price may see downside pressure if overseas demand slows and domestic supply chain gradually resumes.

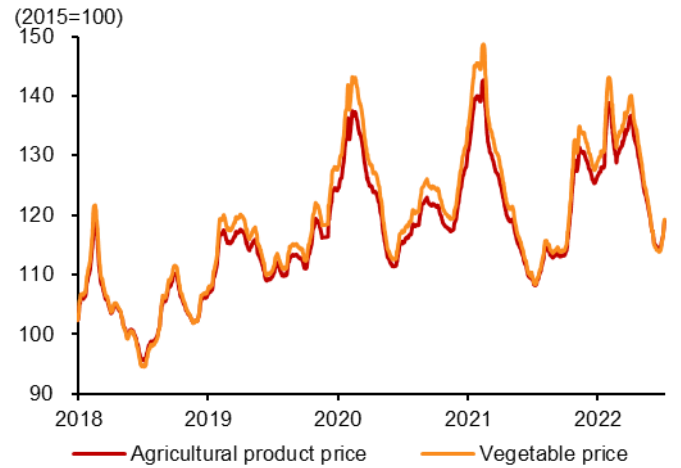
- **Policy implications.** The pick-up of CPI may post a dilemma for PBOC as the central bank has to pay attention to consumer inflation risks while supporting economic resumption. DR007 (7-day repo funding rate as an indicator for money market liquidity condition) has declined to low levels again recently after the seasonal tightening in late June. But it may face upside pressure if the CPI growth continues to beat expectations. For the economy, however, the growth is not so strong that PBOC could sharply tighten the liquidity. The recent rebounding of Covid-19 virus in some cities may cause a softening of economic resumption pace, making the situation more complicated for the central bank. Therefore, we expect a gradual or mild increase of DR007 in 2H22. The uncertainty of RRR policy increases as PBOC needs more time to observe inflation and economic condition. The possibility of LPR cut declines at least in 3Q22. The central bank may use structural or targeted easing policy to support the growth.
- **Implications for the Chinese stock market.** Chinese stocks may soften or even see moderate corrections in July to August after the rally in May and June. Firstly, the upside risk in consumer inflation will reduce the room for further liquidity easing. Secondly, the recent rebounding of Covid-19 cases make it more difficult for China to further loosen its zero-Covid policy, implying a possible softening of reopening effect in 3Q22. Thirdly, overseas economy will slow down, bringing downside uncertainty for China's exports and capex in manufacturing. Lastly, stocks in some sectors rebounded too fast in the rally in May and June. Looking into a longer period, however, Chinese stocks still have upside room as the economy should be in the resumption cycle in 2H22-1H23.

**Figure 1: MoM Changes of China Consumer Prices**



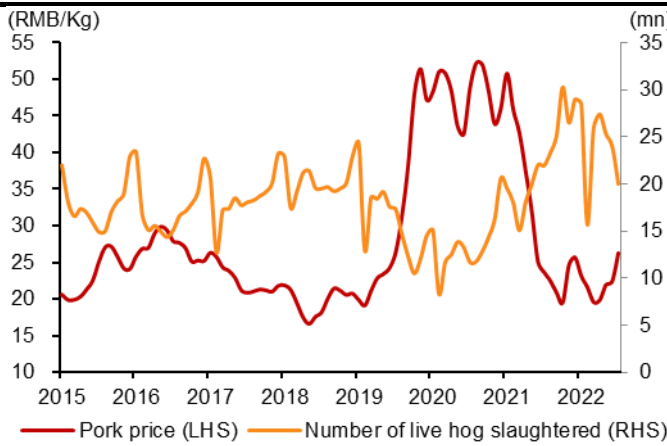
Source: Wind, CMBIGM

**Figure 2: China Agricultural Product Price**



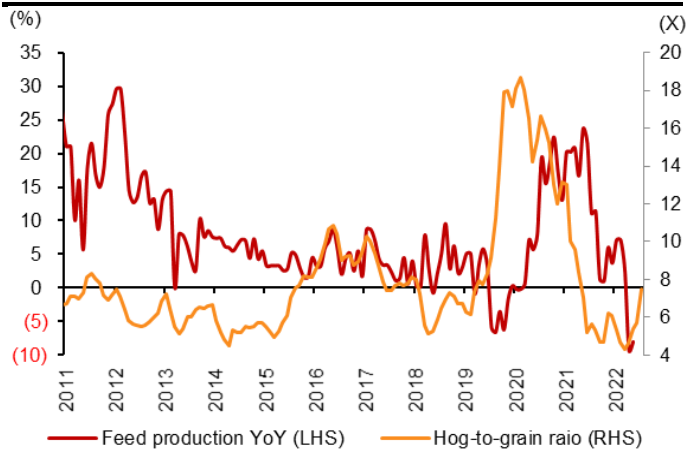
Source: Wind, CMBIGM

**Figure 3: China Pork Price and Supply**



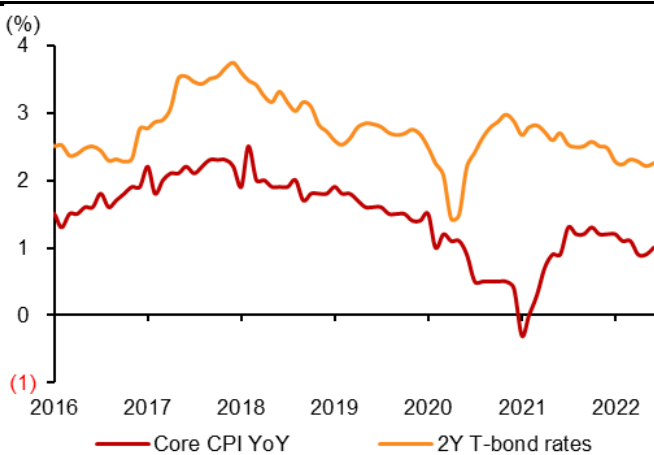
Source: Wind, CMBIGM

**Figure 4: China Feed Production & Hog-to-grain Ratio**



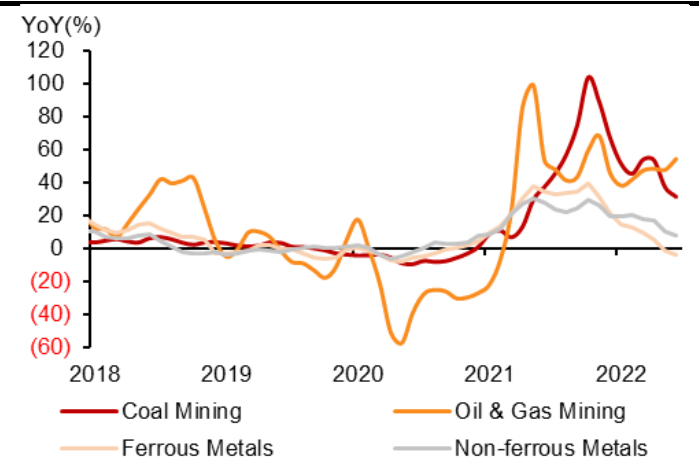
Source: Wind, CMBIGM

**Figure 5: China Core CPI Growth & 2Y T-bond Rates**



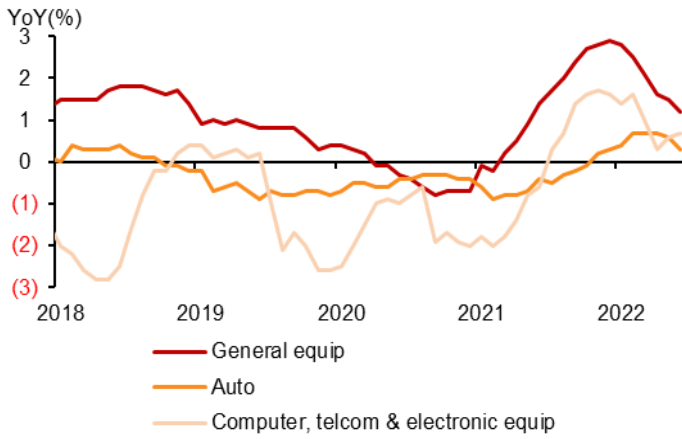
Source: Wind, CMBIGM

**Figure 6: China Producer Price Growth in Commodity**



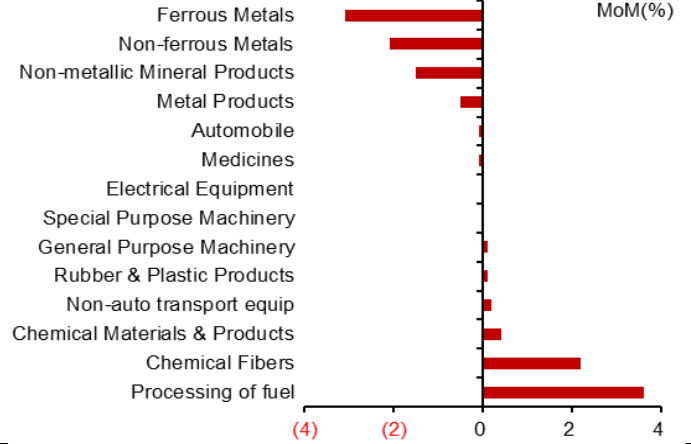
Source: Wind, CMBIGM

**Figure 7: China Producer Price Growth in Equipment**



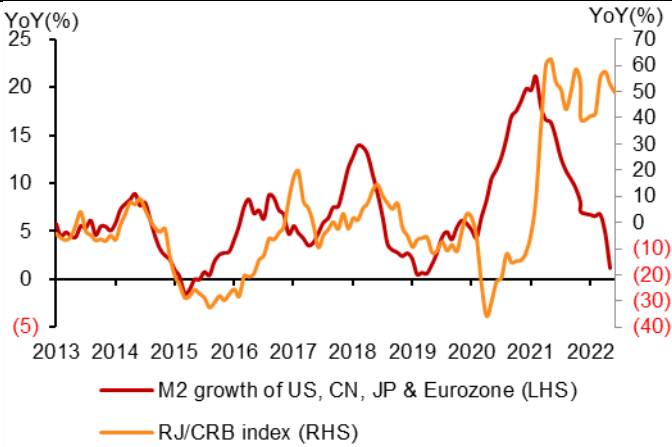
Source: Wind, CMBIGM

**Figure 8: China's Producer Price**



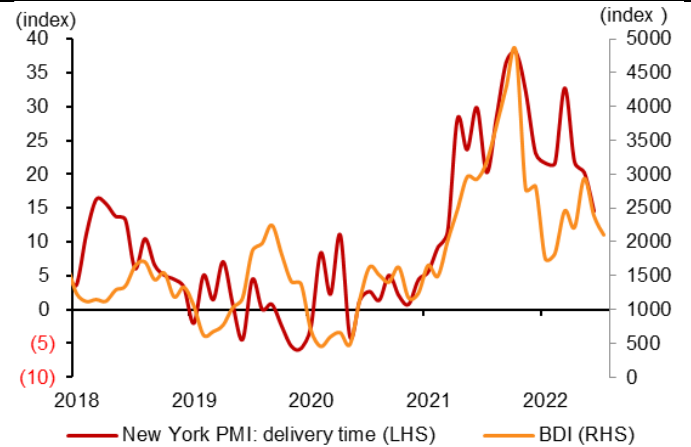
Source: Wind, CMBIGM

**Figure 9: Global M2 Growth & Commodity Price**



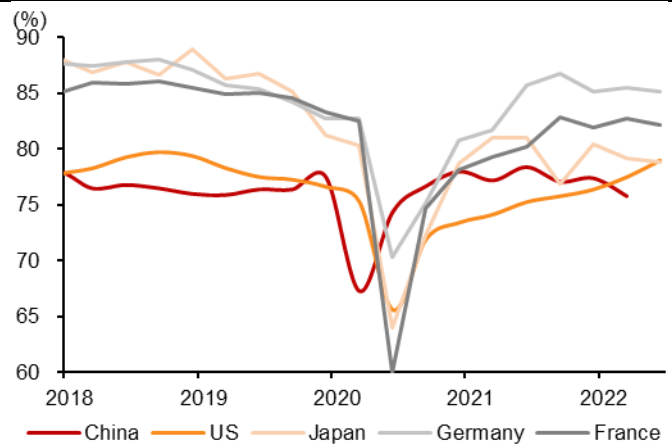
Source: Wind, CMBIGM

**Figure 10: Global Supply Chain Pressure**



Source: Wind, CMBIGM

**Figure 11: Manufacturing Capacity Utilisation Ratio**



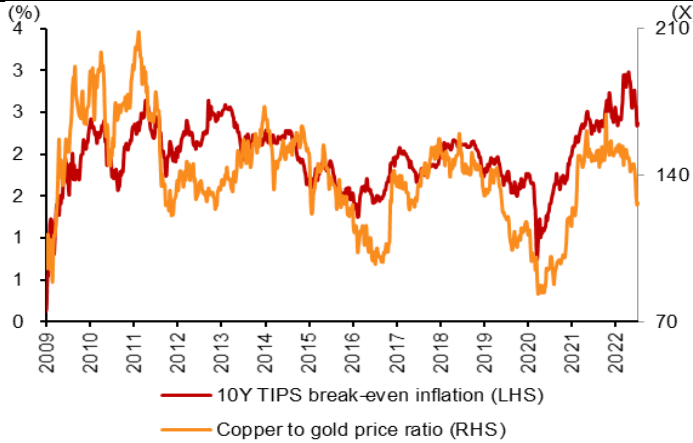
Source: Wind, CMBIGM

**Figure 12: Gold Price and US\$ Real Interest Rates**



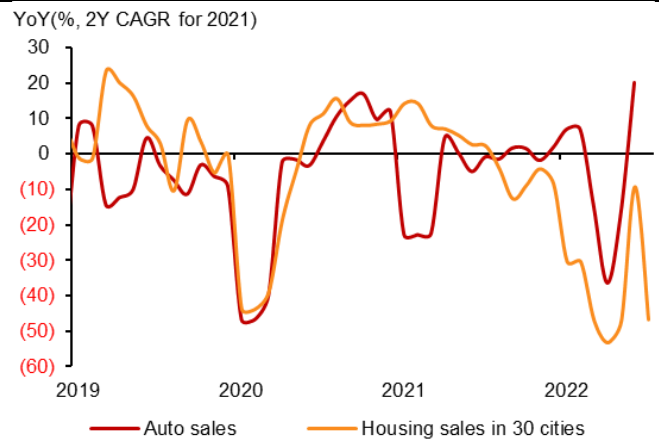
Source: Wind, CMBIGM

**Figure 13: Copper-to-gold Ratio & Inflation Expectation**



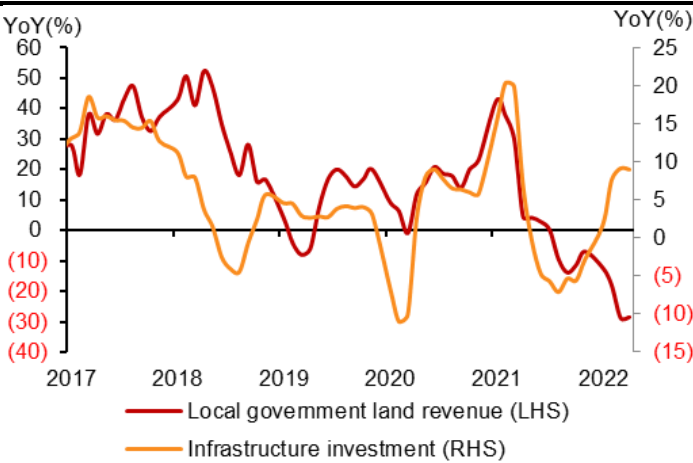
Source: Wind, CMBIGM

**Figure 14: China Auto & Housing Sales Growth**



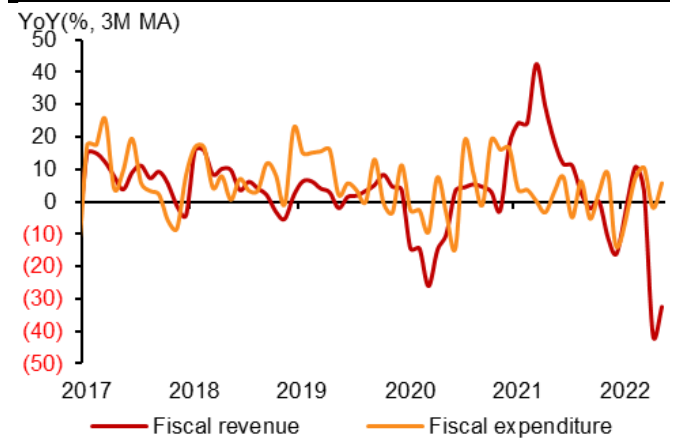
Source: Bloomberg, CMBIGM

**Figure 15: China Land Revenue & Infrastructure Investment**



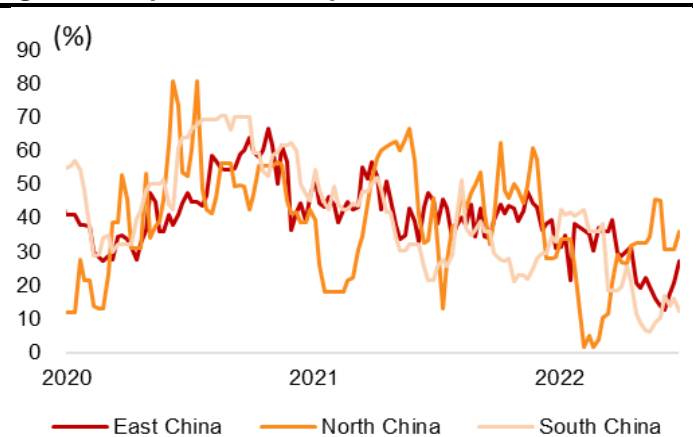
Source: Bloomberg, CMBIGM

**Figure 16: China Fiscal Revenue & Expenditure**



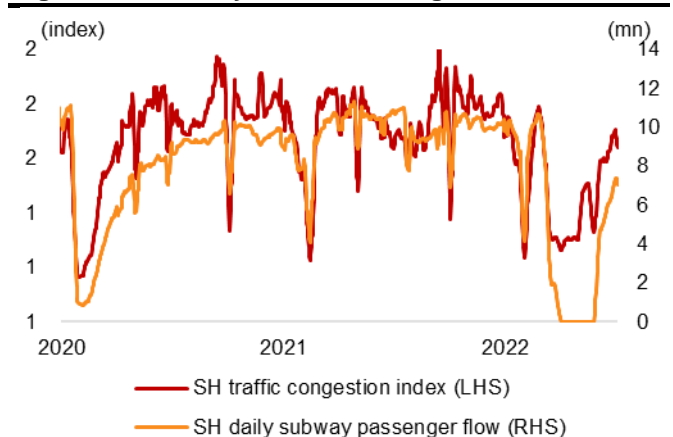
Source: Wind, CMBIGM

**Figure 17: Operation of Asphalt Plant in China**



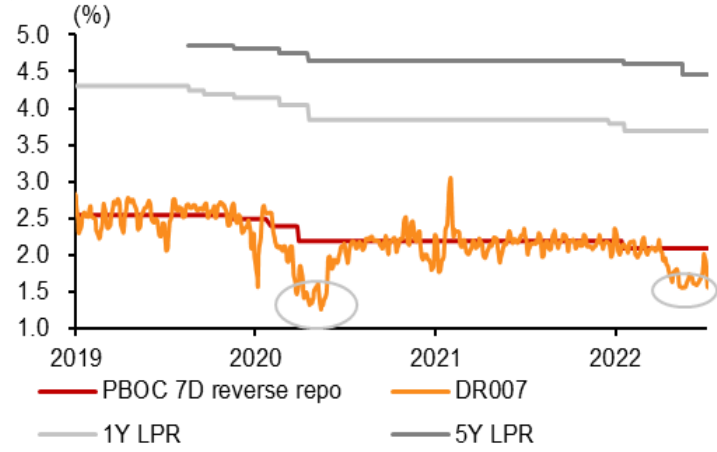
Source: Bloomberg, CMBIGM

**Figure 18: Mobility Index in Shanghai**



Source: Wind, CMBIGM

**Figure 19: PBOC Policy Rates**



Source: Bloomberg, CMBIGM

**Figure 20: Liquidity Easing & M2 Expansion**



Source: Wind, CMBIGM



# Disclosures & Disclaimers

## Analyst Certification

The research analyst who is primary responsible for the content of this research report, in whole or in part, certifies that with respect to the securities or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about the subject securities or issuer; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific views expressed by that analyst in this report.

Besides, the analyst confirms that neither the analyst nor his/her associates (as defined in the code of conduct issued by The Hong Kong Securities and Futures Commission) (1) have dealt in or traded in the stock(s) covered in this research report within 30 calendar days prior to the date of issue of this report; (2) will deal in or trade in the stock(s) covered in this research report 3 business days after the date of issue of this report; (3) serve as an officer of any of the Hong Kong listed companies covered in this report; and (4) have any financial interests in the Hong Kong listed companies covered in this report.

## CMBIGM Ratings

**BUY** : Stock with potential return of over 15% over next 12 months  
**HOLD** : Stock with potential return of +15% to -10% over next 12 months  
**SELL** : Stock with potential loss of over 10% over next 12 months  
**NOT RATED** : Stock is not rated by CMBIGM

**OUTPERFORM** : Industry expected to outperform the relevant broad market benchmark over next 12 months  
**MARKET-PERFORM** : Industry expected to perform in-line with the relevant broad market benchmark over next 12 months  
**UNDERPERFORM** : Industry expected to underperform the relevant broad market benchmark over next 12 months

## CMB International Global Markets Limited

**Address:** 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

**CMB International Global Markets Limited ("CMBIGM") is a wholly owned subsidiary of CMB International Capital Corporation Limited (a wholly owned subsidiary of China Merchants Bank)**

## Important Disclosures

There are risks involved in transacting in any securities. The information contained in this report may not be suitable for the purposes of all investors. CMBIGM does not provide individually tailored investment advice. This report has been prepared without regard to the individual investment objectives, financial position or special requirements. Past performance has no indication of future performance, and actual events may differ materially from that which is contained in the report. The value of, and returns from, any investments are uncertain and are not guaranteed and may fluctuate as a result of their dependence on the performance of underlying assets or other variable market factors. CMBIGM recommends that investors should independently evaluate particular investments and strategies, and encourages investors to consult with a professional financial advisor in order to make their own investment decisions.

This report or any information contained herein, have been prepared by the CMBIGM, solely for the purpose of supplying information to the clients of CMBIGM or its affiliate(s) to whom it is distributed. This report is not and should not be construed as an offer or solicitation to buy or sell any security or any interest in securities or enter into any transaction. Neither CMBIGM nor any of its affiliates, shareholders, agents, consultants, directors, officers or employees shall be liable for any loss, damage or expense whatsoever, whether direct or consequential, incurred in relying on the information contained in this report. Anyone making use of the information contained in this report does so entirely at their own risk.

The information and contents contained in this report are based on the analyses and interpretations of information believed to be publicly available and reliable. CMBIGM has exerted every effort in its capacity to ensure, but not to guarantee, their accuracy, completeness, timeliness or correctness. CMBIGM provides the information, advices and forecasts on an "AS IS" basis. The information and contents are subject to change without notice. CMBIGM may issue other publications having information and/or conclusions different from this report. These publications reflect different assumption, point-of-view and analytical methods when compiling. CMBIGM may make investment decisions or take proprietary positions that are inconsistent with the recommendations or views in this report.

CMBIGM may have a position, make markets or act as principal or engage in transactions in securities of companies referred to in this report for itself and/or on behalf of its clients from time to time. Investors should assume that CMBIGM does or seeks to have investment banking or other business relationships with the companies in this report. As a result, recipients should be aware that CMBIGM may have a conflict of interest that could affect the objectivity of this report and CMBIGM will not assume any responsibility in respect thereof. This report is for the use of intended recipients only and this publication, may not be reproduced, reprinted, sold, redistributed or published in whole or in part for any purpose without prior written consent of CMBIGM.

Additional information on recommended securities is available upon request.

For recipients of this document in the United Kingdom

This report has been provided only to persons (I) falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended from time to time) ("The Order") or (II) are persons falling within Article 49(2) (a) to (d) ("High Net Worth Companies, Unincorporated Associations, etc.") of the Order, and may not be provided to any other person without the prior written consent of CMBIGM.

For recipients of this document in the United States

CMBIGM is not a registered broker-dealer in the United States. As a result, CMBIGM is not subject to U.S. rules regarding the preparation of research reports and the independence of research analysts. The research analyst who is primary responsible for the content of this research report is not registered or qualified as a research analyst with the Financial Industry Regulatory Authority ("FINRA"). The analyst is not subject to applicable restrictions under FINRA Rules intended to ensure that the analyst is not affected by potential conflicts of interest that could bear upon the reliability of the research report. This report is intended for distribution in the United States solely to "major US institutional investors", as defined in Rule 15a-6 under the US, Securities Exchange Act of 1934, as amended, and may not be furnished to any other person in the United States. Each major US institutional investor that receives a copy of this report by its acceptance hereof represents and agrees that it shall not distribute or provide this report to any other person. Any U.S. recipient of this report wishing to effect any transaction to buy or sell securities based on the information provided in this report should do so only through a U.S.-registered broker-dealer.

For recipients of this document in Singapore

This report is distributed in Singapore by CMBI (Singapore) Pte. Limited (CMBIGMG) (Company Regn. No. 201731928D), an Exempt Financial Adviser as defined in the Financial Advisers Act (Cap. 110) of Singapore and regulated by the Monetary Authority of Singapore. CMBIGMG may distribute reports produced by its respective foreign entities, affiliates or other foreign research houses pursuant to an arrangement under Regulation 32C of the Financial Advisers Regulations. Where the report is distributed in Singapore to a person who is not an Accredited Investor, Expert Investor or an Institutional Investor, as defined in the Securities and Futures Act (Cap. 289) of Singapore, CMBIGMG accepts legal responsibility for the contents of the report to such persons only to the extent required by law. Singapore recipients should contact CMBIGMG at +65 6350 4400 for matters arising from, or in connection with the report.