

China Economy

Edging out of deflation

CPI in Feb rebounded to 1.3% thanks to the base effect and surging tourism price during holidays. Food and goods prices increased less than seasonal patterns would suggest in Jan-Feb, while other service price remained tepid. PPI beat market expectation again driven by surging prices in upstream sectors including crude oil and non-ferrous metals, while PPI of consumer goods remained relatively subdued. China appears to be edging out of deflation, yet the recovery of price-wage transmission remained fragile as reflation remained largely supply-driven, while the final consumption demands were still subdued and the energy inflation driven by Middle East tensions would erode real purchasing power. As price level—corporate earnings—household income transmission remained uneven, we reckon breaking the deflation spiral durably would require sustained fiscal expansion and demand-side stimulus, which came under expectations in the NPC meeting. Looking forward, we expect the CPI, PPI and GDP deflator to reflate from 0.1%, -2.6% and -1% in 2025 to 1.1%, 0.5% and 0.8% in 2026. We expect the PBOC to utilize its structural monetary tools in the near term, and lower the interest rate and RRR by 10bps and 50 bps by the end of 2Q26, as the real estate market continues to soften.

■ **CPI beat market expectation.** China's CPI YoY accelerated to 1.3% in Feb from 0.2% in Jan, notably beating the market expectation of 0.9%. In sequential terms, CPI picked up to 1% MoM in Feb from 0.2% in Jan. Average MoM growth in Jan-Feb rose 0.6%, broadly in line with historical CNY seasonality. Food and goods prices increased less than seasonal patterns would suggest, while service price rose stronger than usual. Vegetables and crops prices dropped -2.5% and -0.2% MoM on average in Jan-Feb, while meat price rose 2.6%. Vehicle fuel prices also rose by 0.8% MoM on average in Jan-Feb, as global crude oil prices surged ahead of the US-Iran conflicts. We expect headline CPI to drop to 1.1% as surging food price and service price driven by the CNY retreat in Mar, while energy price should further rise.

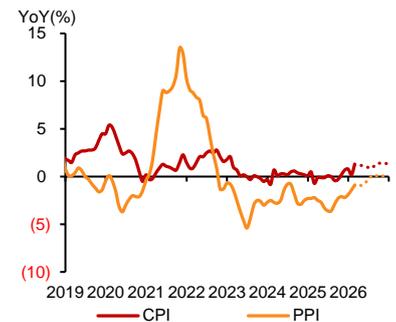
■ **Core CPI rose to the highest in years driven by tourism price.** Core inflation rose to 1.8% YoY in Feb, thanks to the lower base last year, marking the highest reading since 2019. Core CPI MoM expanded to 0.5% on average in Jan-Feb, better than the 0.2% historical seasonality, driven primarily by tourism, which notably rose 8% MoM on average in Jan-Feb, beating its historical seasonality at 2.5% MoM. Other services, on the other hand, remained subdued as housing rent, education and telecom service showed limited growth and were weaker than seasonality. Durable goods saw a mixed picture as auto and telecom equipment rose 0.2% and 0.5% on average in Jan-Feb, while home equipment dropped 0.2%. Non-durable goods edged down in Jan-Feb, as clothing and footwear dropped 0.2% and 0.1% on average. Other supplies and services which include gold jewellery—surged 2.5% MoM in Feb, as gold prices continued to pick up.

■ **PPI sustained its momentum driven by energy and non-ferrous metals prices.** The YoY contraction of PPI narrowed to -0.9% in Feb from -1.4% in Dec, beating market expectations of -1.2%. MoM growth was another 0.4% in Feb driven by reflation in upper stream industries. PPI for producer goods rose 0.5% MoM in Feb, as extraction sector surged 1.2% MoM in Feb, with crude oil & natural gas and non-ferrous metals mining picking up 5.1% and 7.1% in Feb. Raw materials and processing sectors rose 0.2% and 0.6% MoM in Feb, as chemical products manufacturing and non-ferrous metal smelting & processing rose 1.3% and 4.6% MoM. AI-related sectors including semiconductors and storage device saw notable price increases, while anti-involution sectors including lithium batteries, cement and

Frank Liu

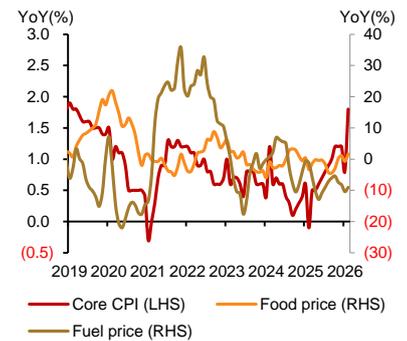
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Forecast numbers from Mar 2026

Source: Wind, CMBIGM

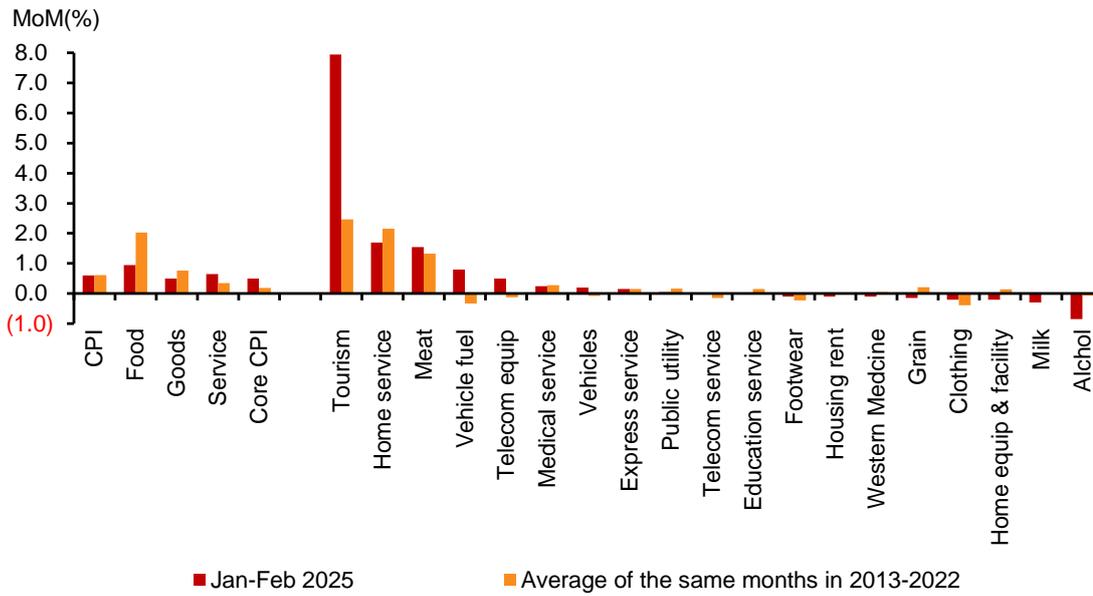


Source: Wind, CMBIGM

photovoltaic equipment continued to see price reflation. However, downstream sectors remained subdued, as PPI of consumer goods stayed nearly flat at 0% MoM. Household necessities and clothing dropped by 0.4% and 0.2% MoM respectively, while durable goods rebounded 0.3% in Feb.

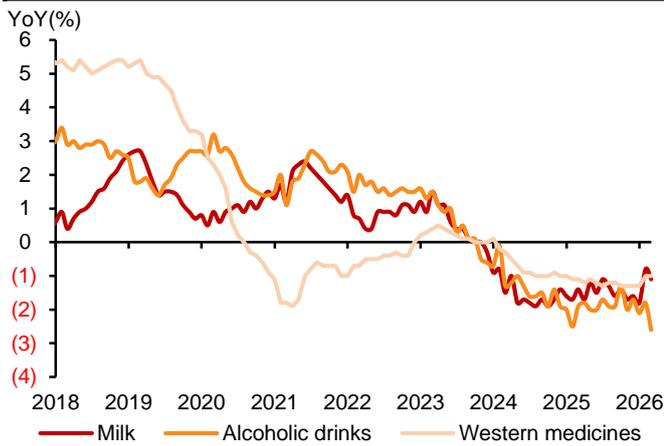
- **China is edging out of deflation, yet reigniting a sustained price-wage spiral remains an uphill task.** China appears to be edging out of deflation, with policymakers committed to returning CPI to positive territory. Yet, the recovery of price-wage transmission remained fragile: price gains in CPI were largely driven by food and gold jewellery, while energy inflation driven by Middle East tensions would erode real purchasing power rather than stimulating it. The PPI divergence between resilient upstream energy and metal prices driven by international commodities prices, against still-weak downstream consumer goods, shows a possible broken transmission mechanism, where rising input costs compress mid- and downstream margins rather than lifting them. Without a self-reinforcing wage-consumption cycle, this structural price uptick is better read as a moderation of deflationary pressure than a genuine inflationary turn, in our view. Breaking the spiral durably will require sustained fiscal expansion to support employment and household incomes, as PPI to corporate earnings transmission remained uneven. Looking forward, we expect the CPI, PPI and GDP deflator to reflate from 0.1%, -2.6% and -1% in 2025 to 1.1%, 0.5% and 0.8% in 2026. We expect the PBOC to utilize its structural monetary tools in the near term, and lower the interest rate and RRR by 10bps and 50 bps by the end of 2Q26, as the real estate market continues to soften.

Figure 1: MoM Changes of China CPI in Jan-Feb



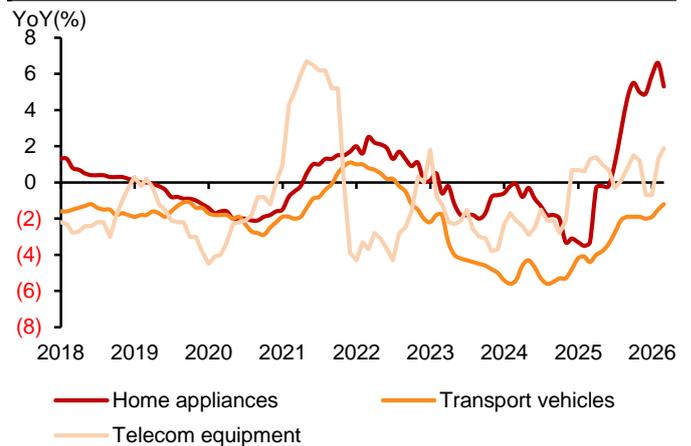
Source: Wind, CMBIGM

Figure 2: China CPI growth in staples



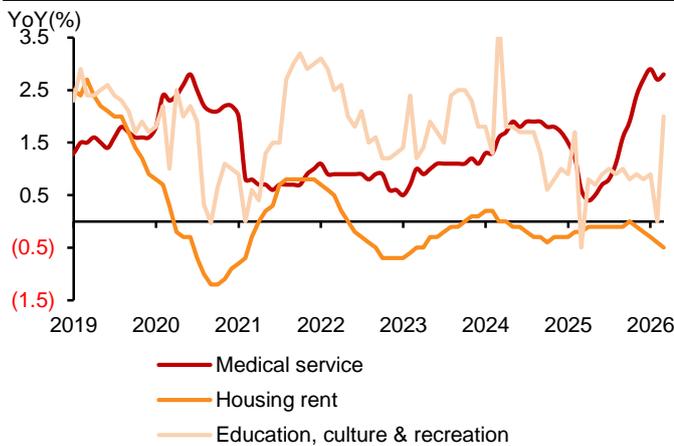
Source: Wind, CMBIGM

Figure 3: China CPI growth in durables



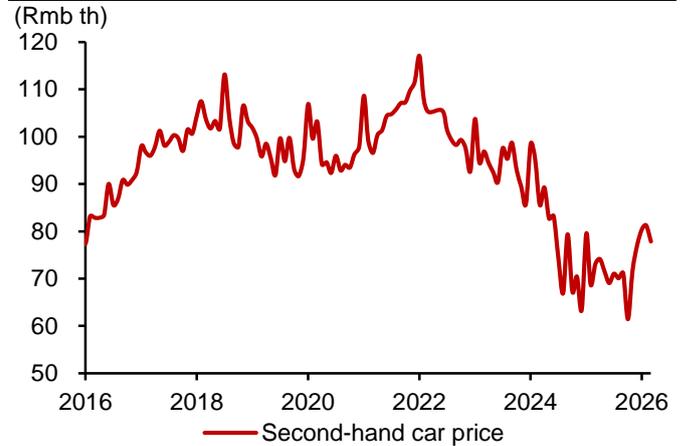
Source: Wind, CMBIGM

Figure 4: China CPI growth in services



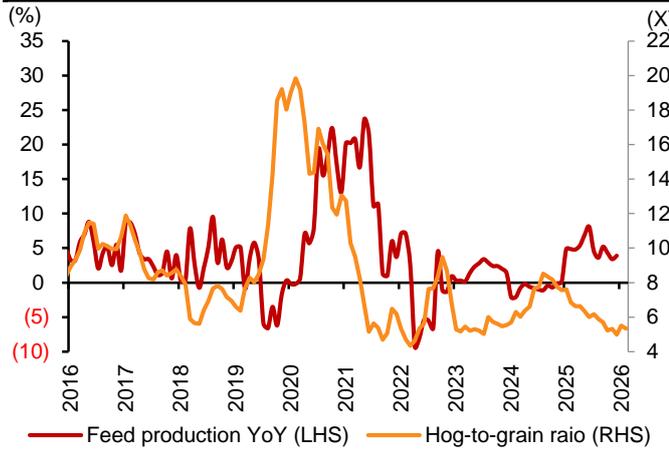
Source: Wind, CMBIGM

Figure 5: Second-hand car price in Shanghai



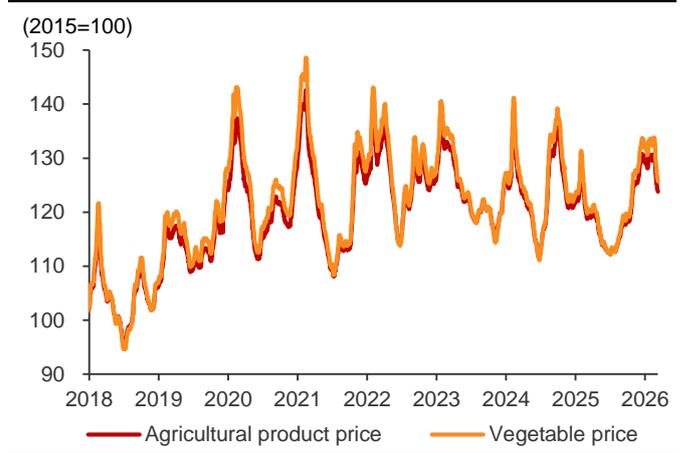
Source: Wind, CMBIGM

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



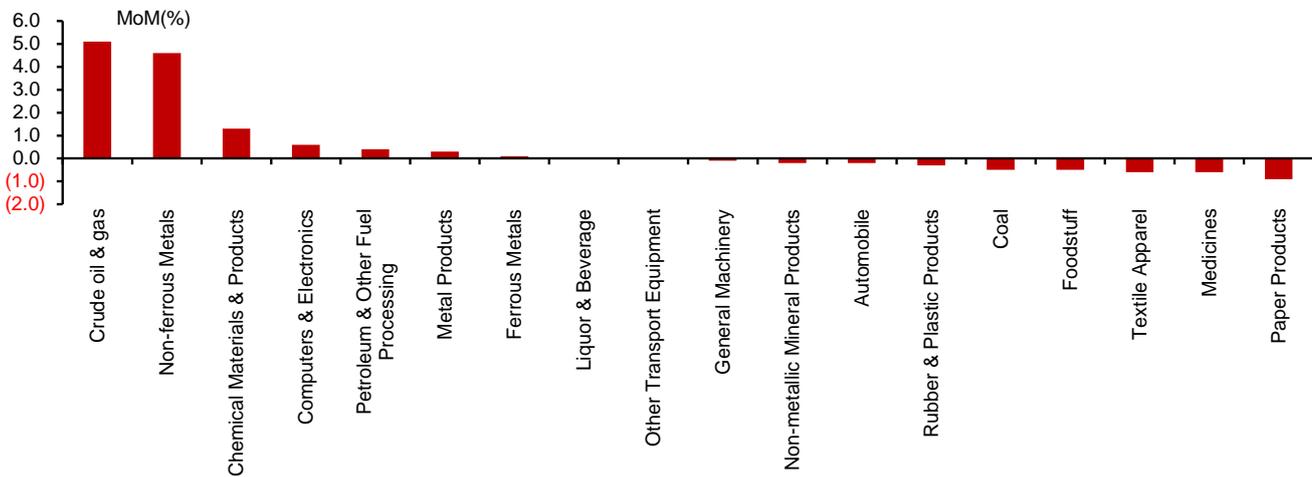
Source: Wind, CMBIGM

Figure 7: Agricultural product and vegetable price



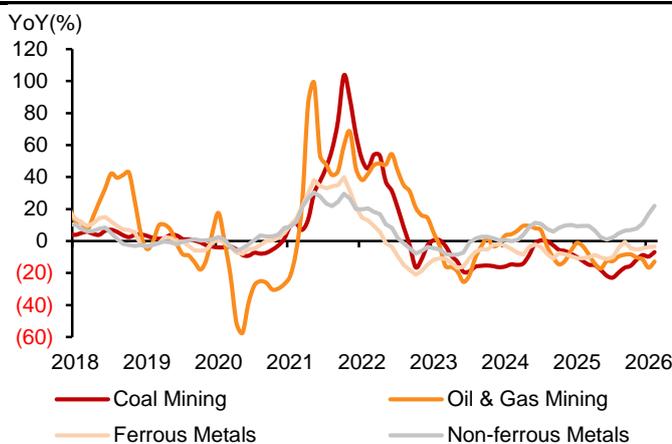
Source: Wind, CMBIGM

Figure 8: MoM changes of China PPI in Feb



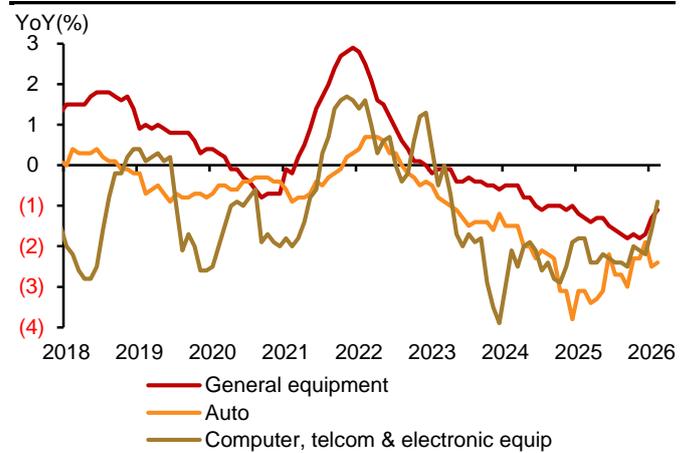
Source: Wind, CMBIGM

Figure 9: China PPI in energy & metals



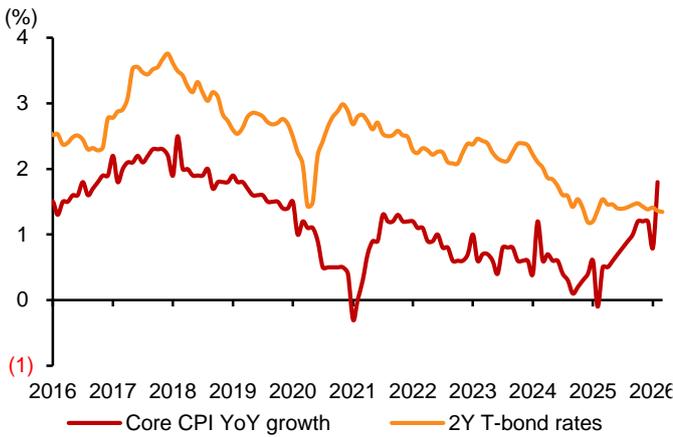
Source: Wind, CMBIGM

Figure 10: China PPI in equipment



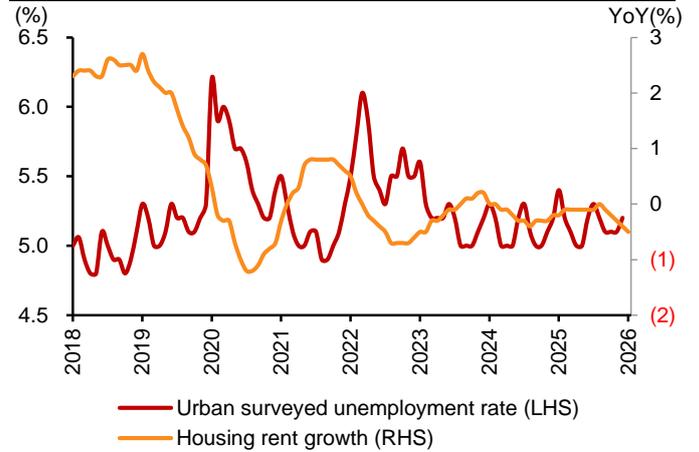
Source: Wind, CMBIGM

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



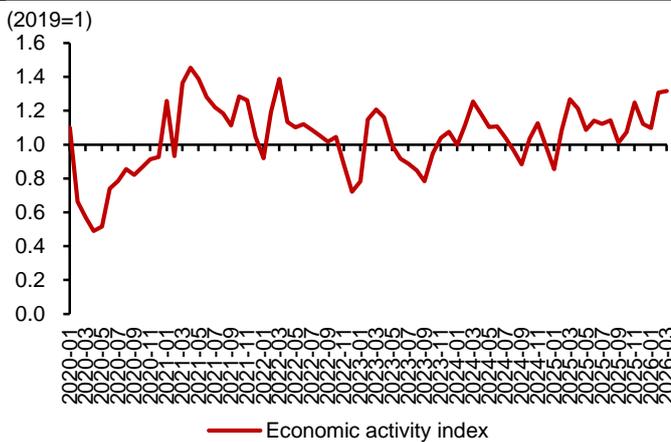
Source: Wind, CMBIGM

Figure 12: Unemployment rate and rent growth



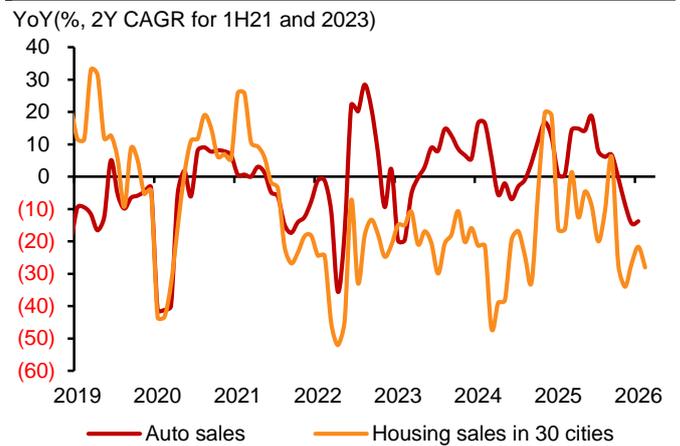
Source: Wind, CMBIGM

Figure 13: China Economic Activity Index



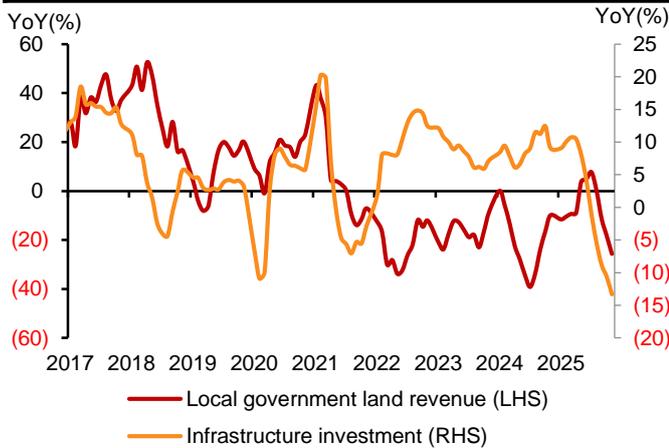
Source: Wind, CMBIGM

Figure 14: China auto & housing sales



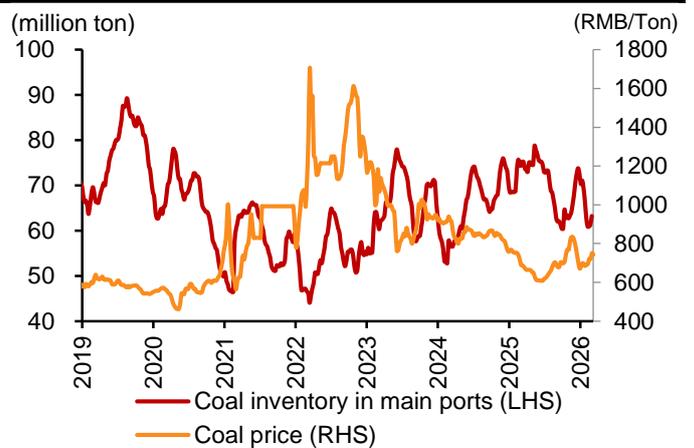
Source: Bloomberg, CMBIGM

Figure 15: Infrastructure investment in China



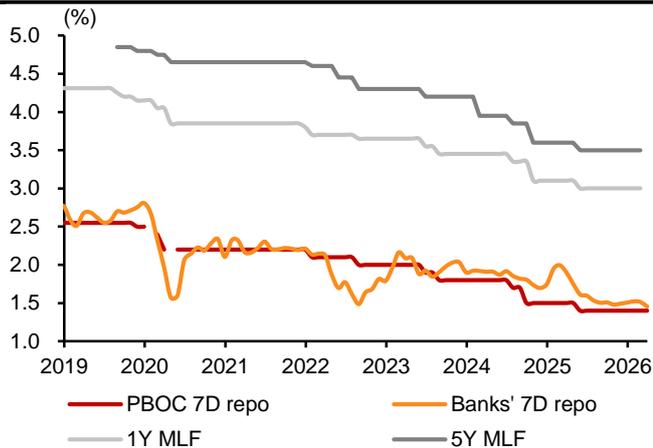
Source: Bloomberg, CMBIGM

Figure 16: China coal inventory & price



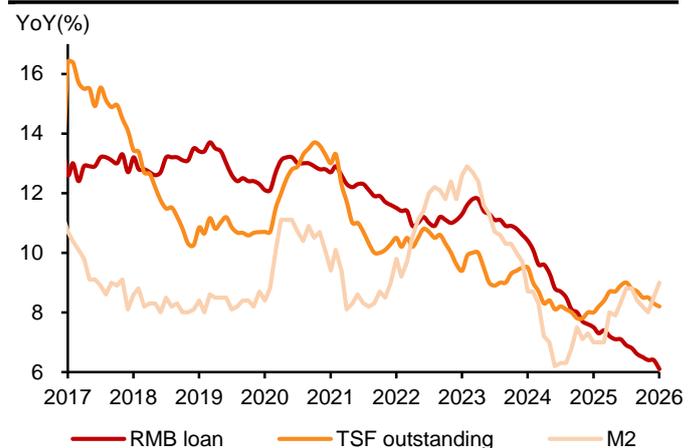
Source: Wind, CMBIGM

Figure 17: PBOC policy rates & liquidity condition



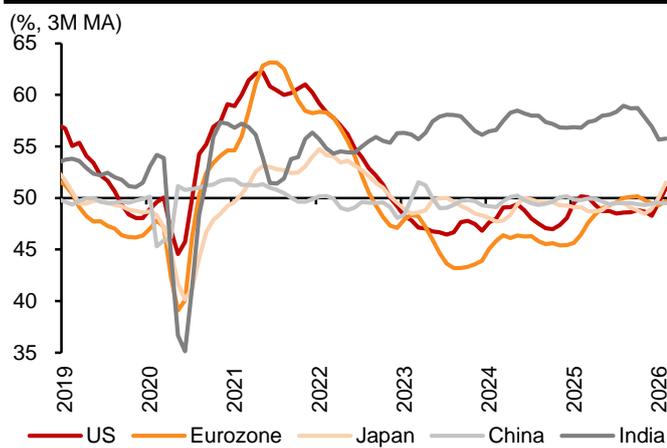
Source: Bloomberg, CMBIGM

Figure 18: China credit growth



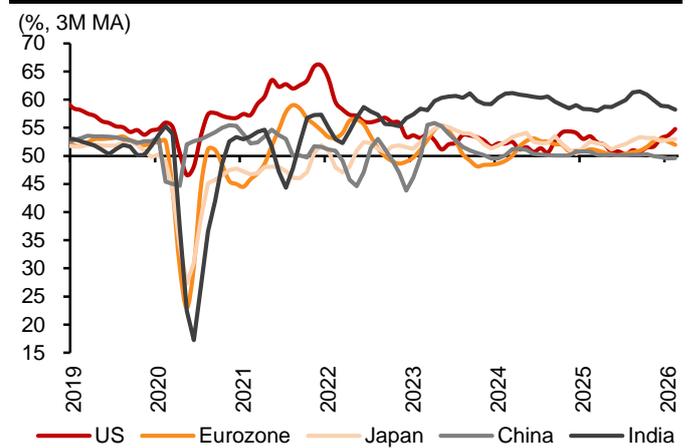
Source: Wind, CMBIGM

Figure 19: Manufacturing PMI of major economies



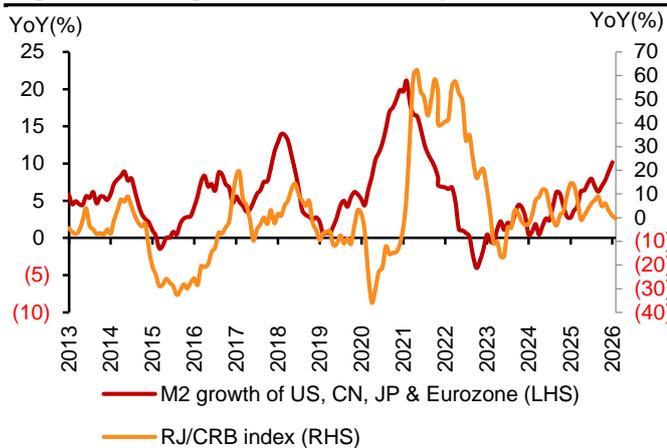
Source: Bloomberg, CMBIGM

Figure 20: Service PMI of major economies



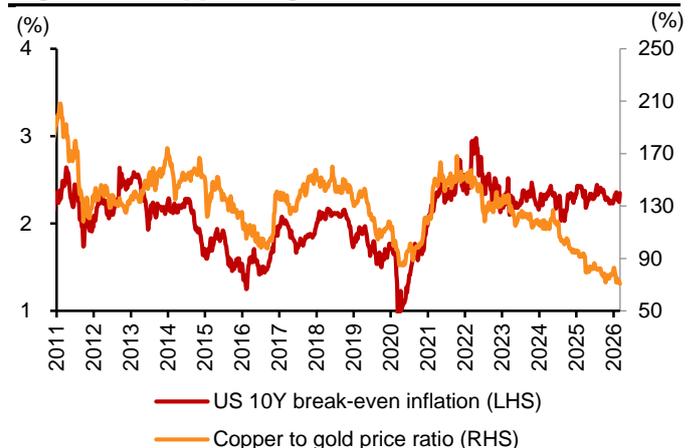
Source: Wind, CMBIGM

Figure 21: M2 growth & commodity inflation



Source: Bloomberg, CMBIGM

Figure 22: Copper-to-gold ratio



Source: Wind, CMBIGM

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