

China Economy

On the brink of deflation

China's CPI growth remained close to zero in May amid weak consumer demand and tough supply competition. CPI in durables continued to decline as housing sales and durable consumption further weakened. Employment condition remained tough especially for the youth as housing rent continued to decrease. Healthcare, tourism, recreational service and social-activity-related items were the few bright spots in China's consumption recovery as CPI in those sectors continued to rebound. China's PPI further declined as domestic economy weakened and overseas credit condition tightened. Chinese enterprises continued to reduce inventory and remained cautious on capex expansion. We revise down our forecast for China's CPI and PPI growth rates in 2023 from 1.4% and -1.6% to 0.8% and -2.3%. The deflation pressure indicates aggregate demand remains weak while supply-side competition is tough in most sectors. The deflation shadow will increase debt burden and hurt durable consumption and capex demand. China is likely to mildly cut LPRs and ease property policies to defy the deflation risk and boost the growth in next few months.

- CPI growth remained low as consumer demand was weak.** CPI rose 0.2% YoY in May after rising 0.1% YoY in April. Food inflation mildly rose as food CPI picked up 1% YoY in May after rising 0.4% in April. Energy sector continued with the deflation trend as fuel CPI further declined 11.1% YoY in May after dropping 10.4% YoY in April. Core CPI growth remained low at 0.6% YoY in May as overall consumption was weak. Breaking down sectors, CPI in telecom equipment, transport vehicle and home equipment & facility further declined in YoY perspective, as durable consumption remained weak. Employment condition especially for the youth remained tough as housing rent continued to decline in May. Medicines, medical services, travel services, recreational services and footwear experienced a mild reflation as demand recovered better in those sectors than other sectors.
- PPI further declined as domestic economy weakened and overseas credit condition tightened.** PPI further declined 4.6% YoY in May after dropping 3.6% YoY in April. Domestic economy weakened as housing sales, durable consumption, infrastructure investment and exports all deteriorated in May. Meanwhile, overseas credit condition tightened after the small & medium banks' turmoil in US. In addition, China increased imports of some commodities like coal, adding downside pressure on the PPI. PPI in coal mining, oil & gas mining, ferrous metal and non-ferrous metal respectively fell 13.1%, 19.1%, 16.8%, and 8.4% after dropping 9.3%, 16.3%, 13.6% and 8.6% YoY in April. Meanwhile, prices of general equipment, auto and computer & telecom equipment respectively decreased 0.4%, 1.1% and 1.7% YoY in May. From the MoM perspective, PPI declined 0.9% in May after dropping 0.5% in April. Prices of liquor & beverage increased 0.3% MoM in May. However, prices of coal, ferrous metals, petroleum product and crude oil & gas declined by 5.2%, 4.2%, 3.3% and 2.1% MoM in May.
- We revise down our forecast for 2023 CPI and PPI growth rates from 1.4% and -1.6% to 0.8% and -2.3%.** For one reason, domestic consumption, housing sales and business capex has been much weaker than our expectations. Private business confidence has recovered too slowly due to bearish outlook on demand, tough competition and high policy & geopolitical

Bingnan YE, Ph.D

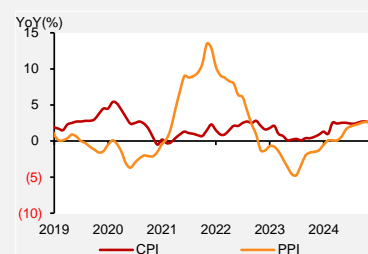
(852) 6989 5170

yebingnan@cmbi.com.hk

Kevin Zhang

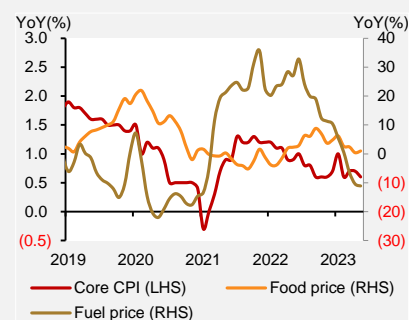
(852) 5336 4682

kevinzhang@cmbi.com.hk



Forecast numbers from Jun 2023

Source: Wind, CMBIGM

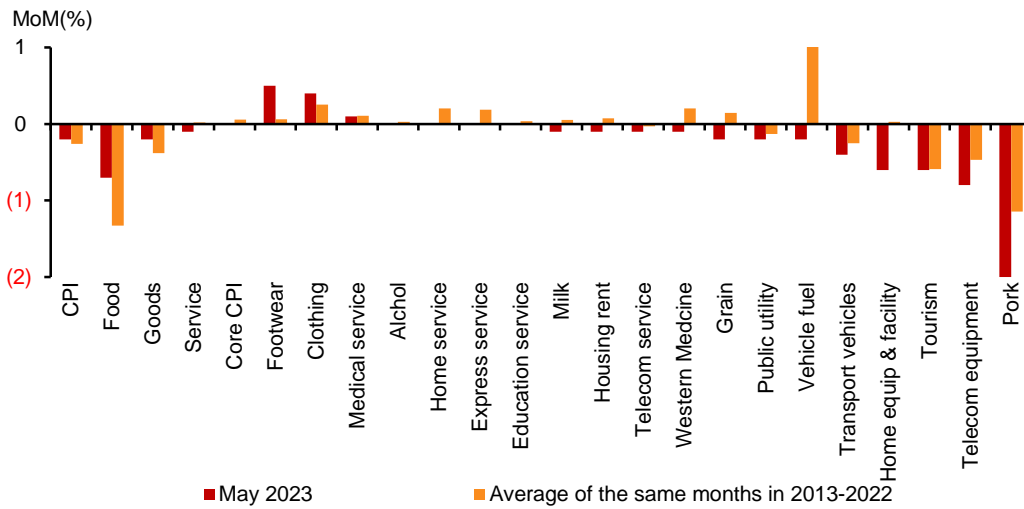


Source: Wind, CMBIGM

uncertainty. Therefore, employment condition has been unsatisfactory, delaying the recovery of consumer confidence and spending. For another reason, service inflation has been stickier than expected in advanced economies as their labor market has remained strong. The liquidity and credit tightening cycle has lasted longer than expected, with more downside pressure on commodity prices.

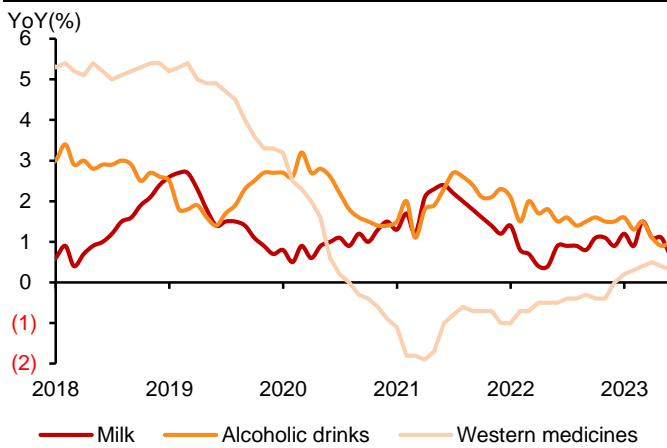
- **CPI and PPI may gradually improve from 2H23.** China's CPI growth may remain low with mild pick-up in 2H23. Due to base effect and further economic recovery, the CPI growth should further rise in 2024. We expect the CPI growth to reach 2.4% in 2024. PPI may narrow its YoY declines in 2H23 and rebound in 2024. We expect the PPI to rise 1.7% in 2024.
- **China may mildly cut LPRs and ease property policies to defy deflation and boost growth.** The deflation pressure indicates demand remains weak while supply competition is tough in most sectors. The deflation shadow will increase debt burden and hurt durable and capex demand. Looking forward, China may mildly cut LPRs and ease property policies to defy the deflation risk and boost the growth. The LPR cut should be mild as the PBOC is concerned about banks' NIMs and the MoF pay attention to banks' profit and dividend growth. The property policy easing should be moderate as the top leaders continue to try to guide more fiscal and credit resources into hard technology and high-end manufacturing, which is the key for Sino-US strategic competition.

Figure 1: MoM Changes of China CPI in May



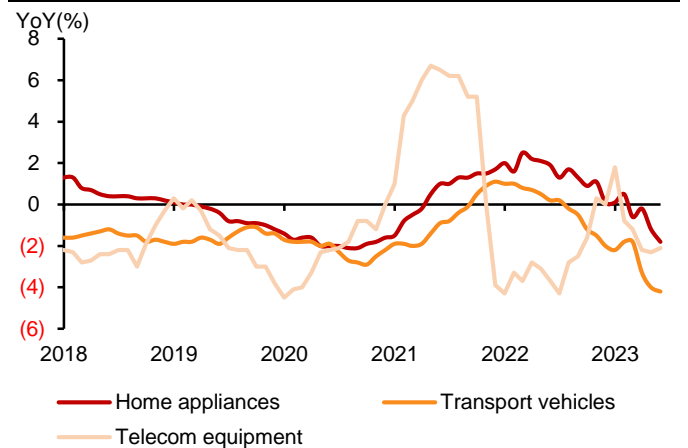
Source: Wind, CMBIGM estimates

Figure 2: China CPI Growth in Staples



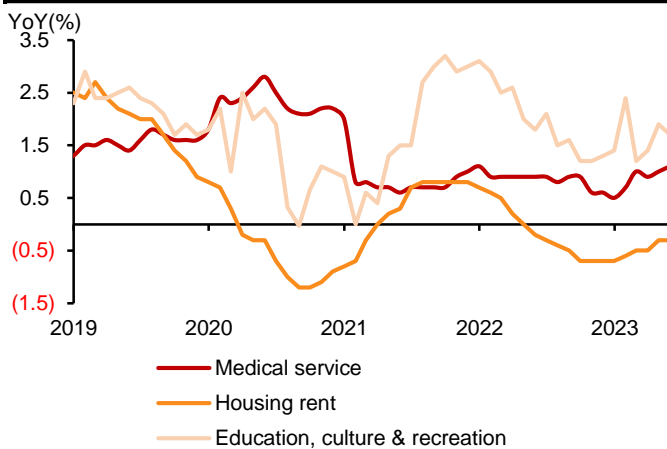
Source: Wind, CMBIGM

Figure 3: China CPI Growth in Durables



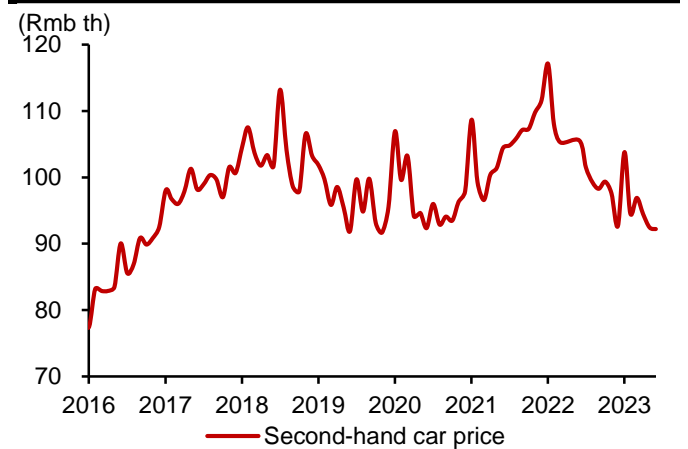
Source: Wind, CMBIGM

Figure 4: China CPI Growth in Services



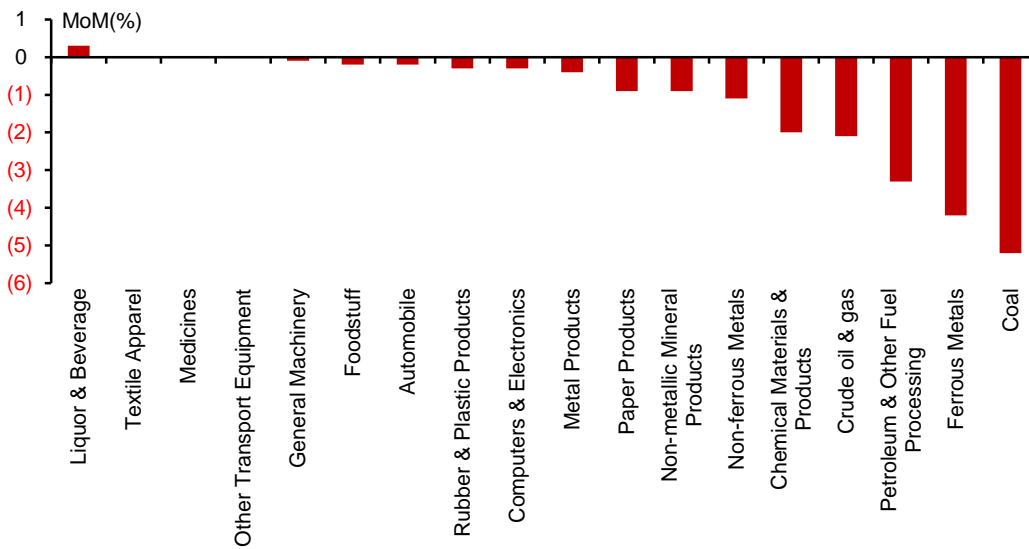
Source: Wind, CMBIGM

Figure 5: Second-hand Car Price in Shanghai



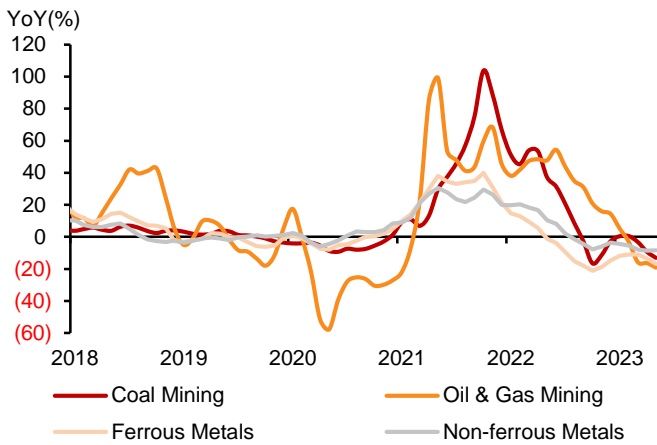
Source: Wind, CMBIGM

Figure 6: MoM Changes of China PPI in May



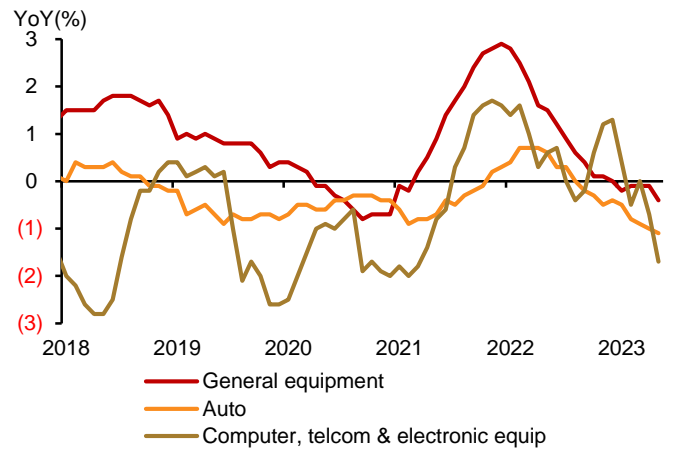
Source: Wind, CMBIGM estimates

Figure 7: China PPI in Energy & Metal



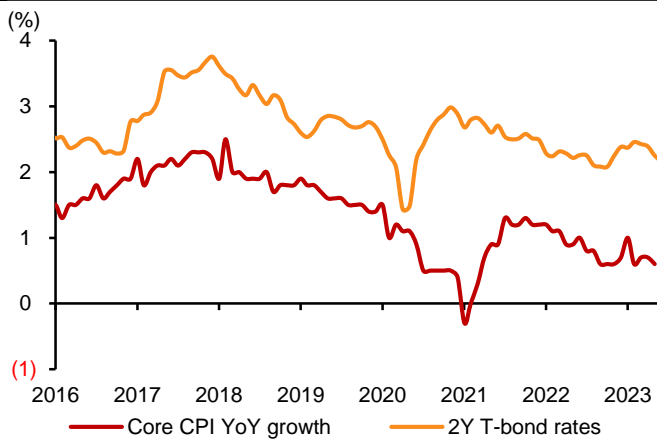
Source: Wind, CMBIGM

Figure 8: China PPI in Equipment



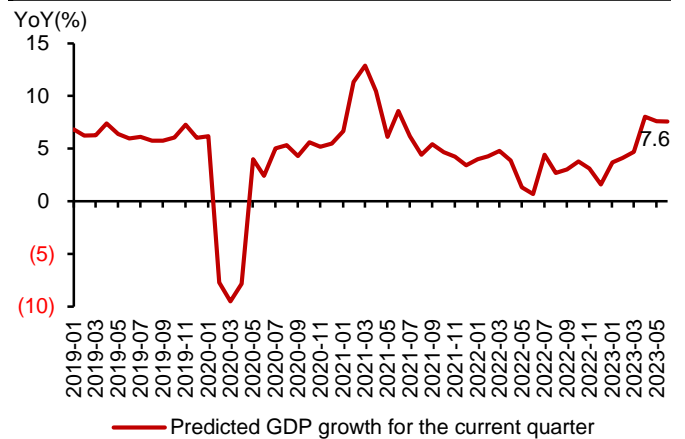
Source: Wind, CMBIGM

Figure 9: China Core CPI Growth & 2Y T-bond Rates



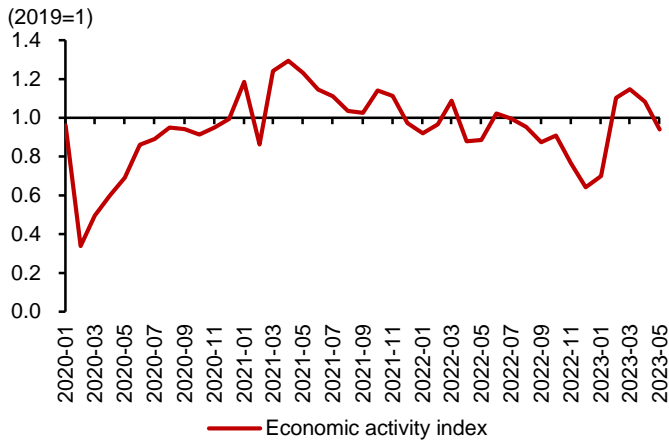
Source: Wind, CMBIGM

Figure 10: China Predicted GDP Growth



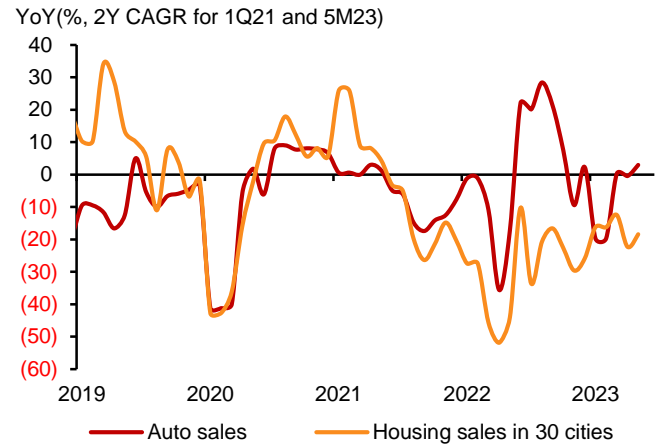
Source: Wind, CMBIGM

Figure 11: China Economic Activity Index



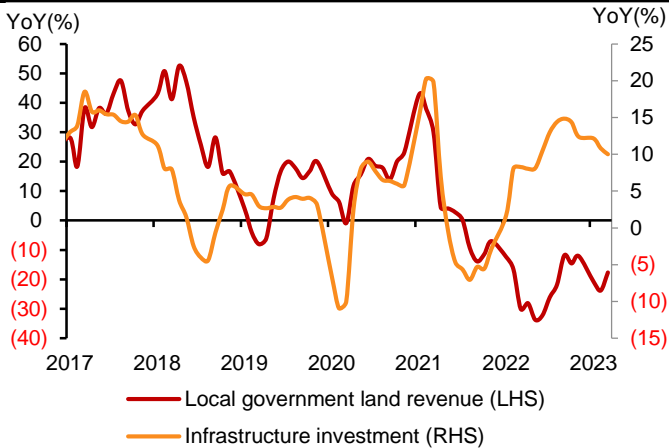
Source: Wind, CMBIGM

Figure 12: China Auto & Housing Sales



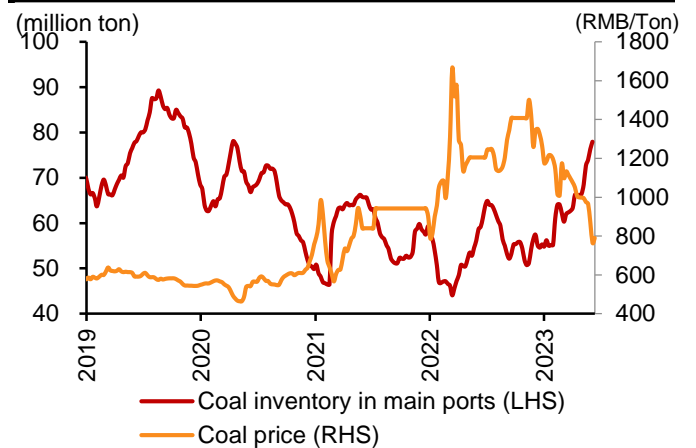
Source: Bloomberg, CMBIGM

Figure 13: Infrastructure Investment in China



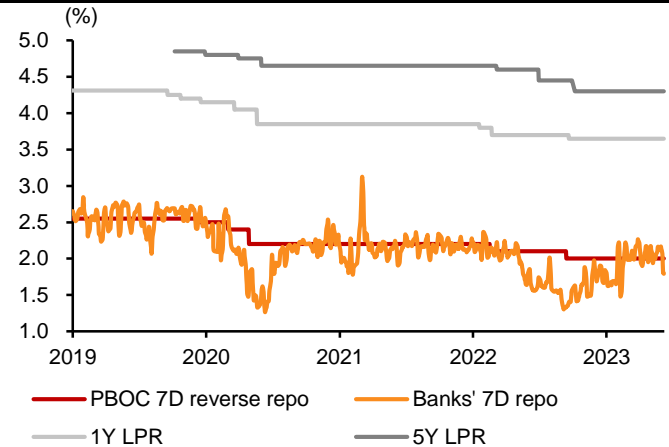
Source: Bloomberg, CMBIGM

Figure 14: China Coal Inventory & Price



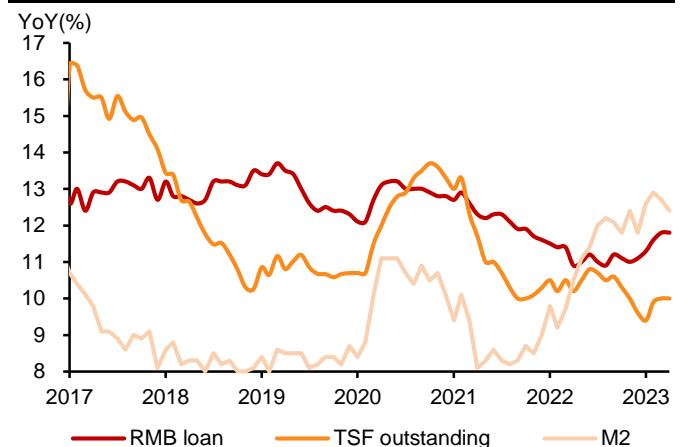
Source: Wind, CMBIGM

Figure 15: PBOC Policy Rates & Liquidity Condition



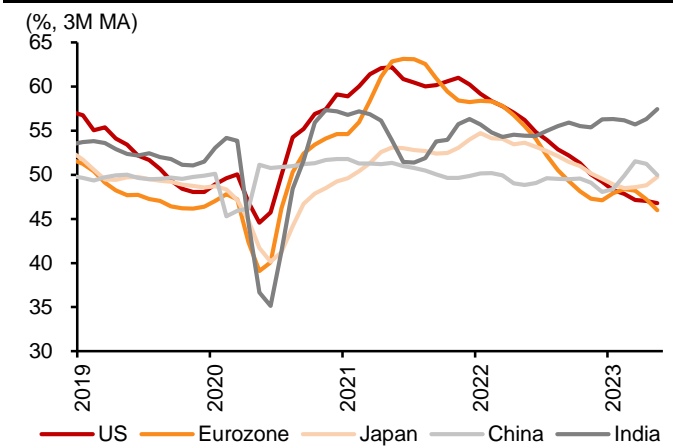
Source: Bloomberg, CMBIGM

Figure 16: China Credit Growth



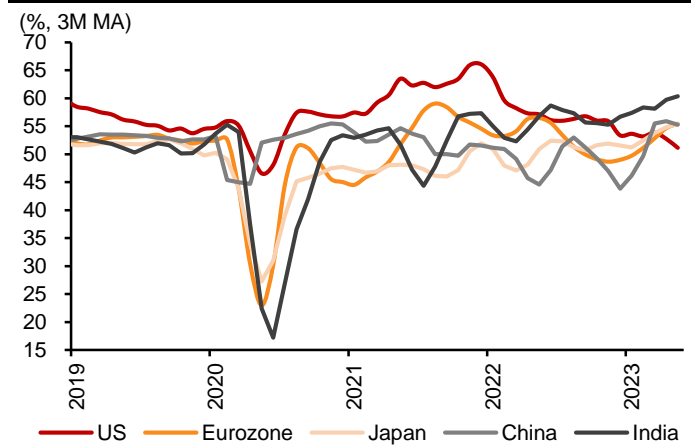
Source: Wind, CMBIGM

Figure 17: Manufacturing Sector PMI of Major Global Economies



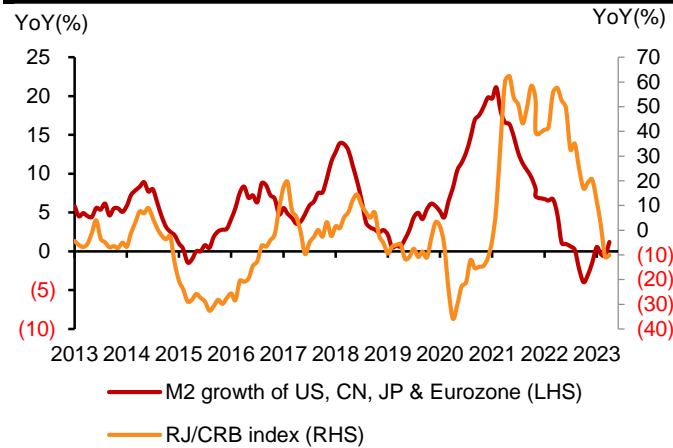
Source: Bloomberg, CMBIGM

Figure 18: Service Sector PMI of Major Global Economies



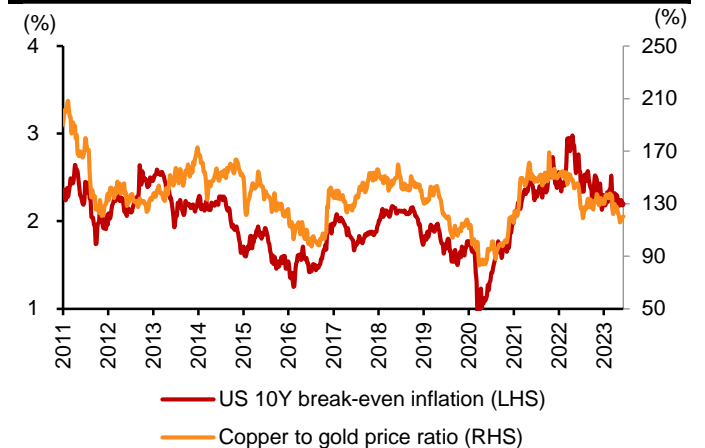
Source: Wind, CMBIGM

Figure 19: Global M2 Growth & Commodity Inflation



Source: Bloomberg, CMBIGM

Figure 20: Copper-to-gold Ratio



Source: Wind, CMBIGM

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CMB International Global Markets Limited

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

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