

China Economy

Deflation may gradually alleviate after credit loosening

China's CPI growth slightly edged down from 0.1% in Aug to 0% in Sep, which fell short of market expectation at 0.2%. The slowdown of food and energy prices is the major drag of softened CPI. Core CPI remained unchanged at 0.8% as consumer demand slowly improved. The YoY decline of China's PPI continued to narrow thanks to rallying raw material prices especially in mining and energy sector. The PBOC was concerned about the deflation as the Monetary Policy Committee said in September to facilitate a rebound of price ahead. The deflation increased real-term interest rates and debt burden of the real sector. It also had negative impact on durable consumption and business capex. Looking forward, we see a gradual alleviation of deflation as CPI may mildly pick up while PPI may continue to narrow the YoY declines thanks to credit loosening, gradual demand improvement and base effect ahead. We maintain forecast on CPI growth at 0.6% for 2023 and 2% for 2024. The PPI is expected to drop 2.7% in 2023 and rise 1.3% in 2024. The shrinkage of producer deflation points to a probable gradual improvement of industrial earnings ahead.

- CPI growth dropped to zero due to the drag of food price and slowdown in energy price.** CPI came in short of expectation, edging down to 0% YoY in Sep after rising 0.1% in Aug. In sequential terms, CPI moderated to 0.2% from 0.3% in Aug. The retracted CPI YoY growth is mainly driven by the food price due to a higher year-ago base. Food CPI noticeably dropped 3.2% YoY from 1.7%, as the pork price dropped 22% YoY in Sep from 17.9% drop in Aug. Pork sequential growth moderated from 11.4% MoM to 0.2% in Sep. As number of live pigs in stock and breeding sows is still elevated, we expect the drag from pork price food CPI will not end just yet. The surge in energy price slowed down as vehicle fuel narrowed its YoY decline from 4.5% to 1.1% while public utility price expanded 0.5% after rising 0.3%. MoM growth of vehicle fuel moderated from 4.8% to 2.3%. Core CPI growth remained unchanged at 0.8%. Demand in durables, which had the greatest impact on production output, was still weak as CPI in transport vehicles, home appliances and telecom equipment stayed soft. Services CPI growth stayed unchanged in Sep at 1.3% YoY although its MoM growth slowed from 0.1% in Aug to -0.1% in Sep, after two months of robust growth during the summer holiday. MoM growth of tourism further deteriorated to -3.4% from -1.1%. Employment condition remained challenging as housing rent fell into contraction.
- PPI continued to narrow its YoY declines although the growth of energy and commodity prices softened.** PPI declined 2.5% YoY in Sep after dropping 3% YoY in Aug, which has been in contraction for a year. PPI in coal mining, oil & gas mining, ferrous metal respectively dropped 15.6%, 3.3% and 5% in Sep after decreasing 16.2%, 10.6% and 6.6% in Aug. Meanwhile, PPI in non-ferrous metal picked up 2.7% after rising 1.4%. From the MoM perspective, PPI continued to increase 0.4% in Sep after rising 0.2% in Aug. The MoM growth of crude oil & gas and petroleum eased to 4.1% and 3.1% from 5.6% and 5.4%. Prices of non-metal mineral products, rubber & electronics, metal products and medicines declined 0.8%, 0.3%, 0.1% and 0.1% MoM in Sep. The moving trend of PPI growth is highly related to the inventory cycle as the shrinkage of PPI decline as well as the expansion of PMI indicate an alleviation of de-stocking in most manufacturing industries.

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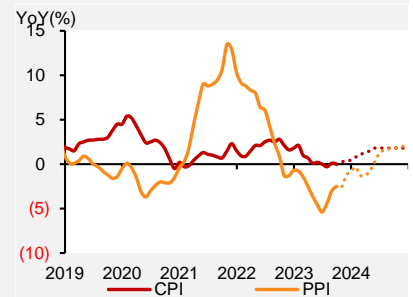
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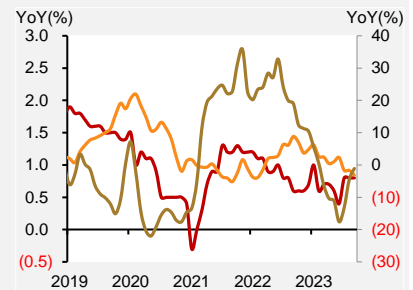
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Forecast numbers from Aug 2023

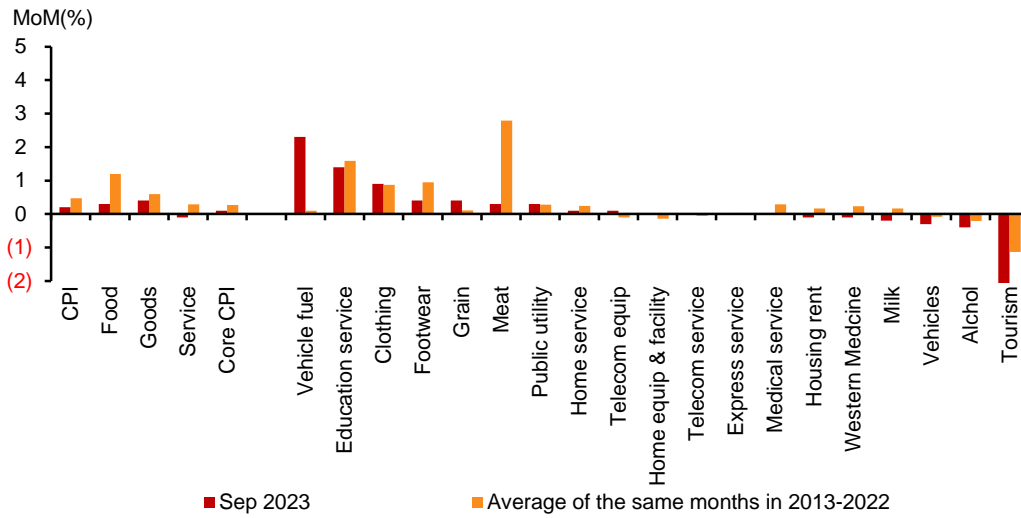
Source: Wind, CMBIGM



Source: Wind, CMBIGM

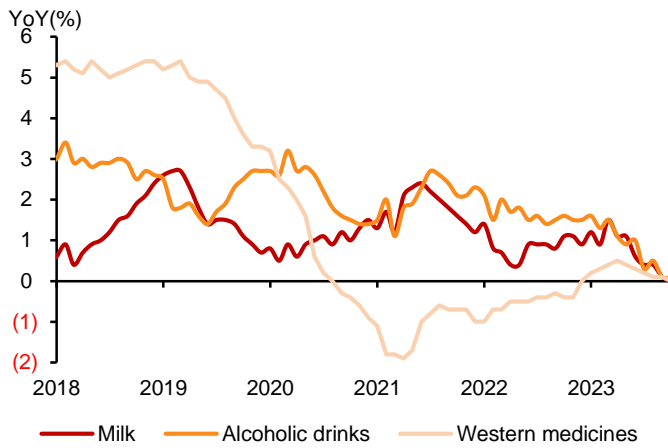
- **We expect a mild reflation in CPI and PPI with continuous credit loosening, gradual demand improvement and base effect ahead.** The PBOC showed its concern about deflation by vowing to boost the price rebound. We expect the central bank to maintain easing liquidity and credit policy with additional cuts in RRR, LPRs and deposit rates in next three quarters to facilitate credit expansion. Fiscal policy will be more proactive as the central government has allowed provincial governments to issue special bonds to repay the matured hidden debts. China's economy may gradually improve with an alleviation of deflation in the future. We maintain the forecast for CPI growth at 0.6% in 2023 and 2% in 2024. The PPI is projected to drop 2.7% in 2023 before rising 1.3% in 2024.

Figure 1: MoM Changes of China CPI in Sep



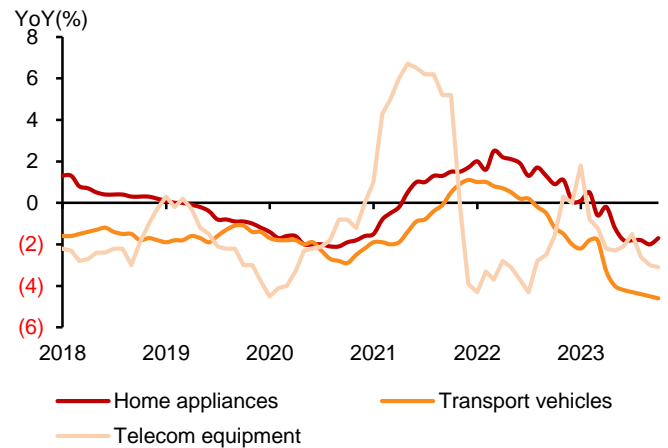
Source: Wind, CMBIGM estimates

Figure 2: China CPI Growth in Staples



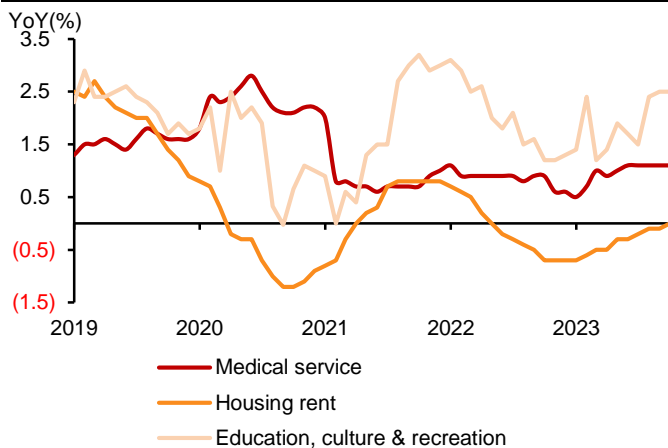
Source: Wind, CMBIGM

Figure 3: China CPI Growth in Durables



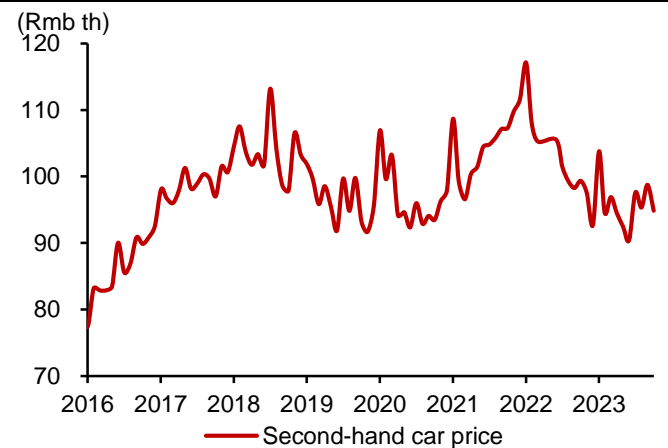
Source: Wind, CMBIGM

Figure 4: China CPI Growth in Services



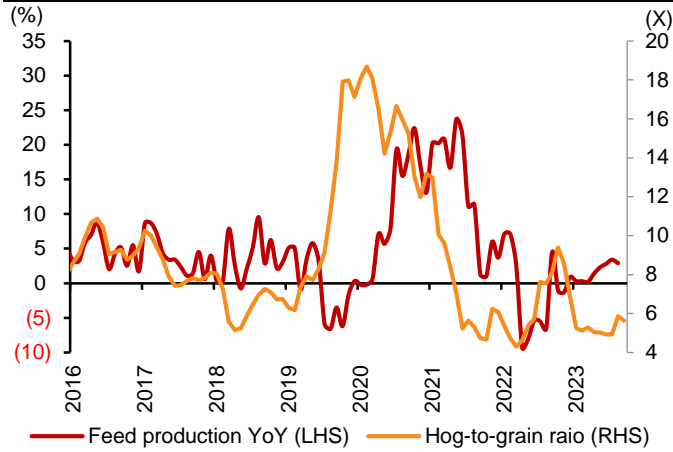
Source: Wind, CMBIGM

Figure 5: Second-hand Car Price in Shanghai



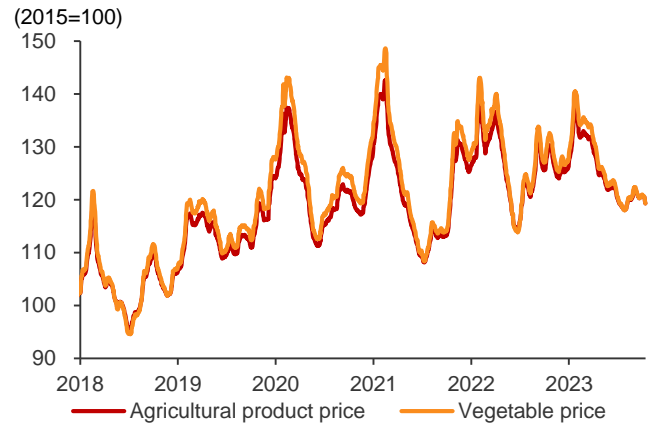
Source: Wind, CMBIGM

Figure 6: Feed production & Hog-to grain ratio



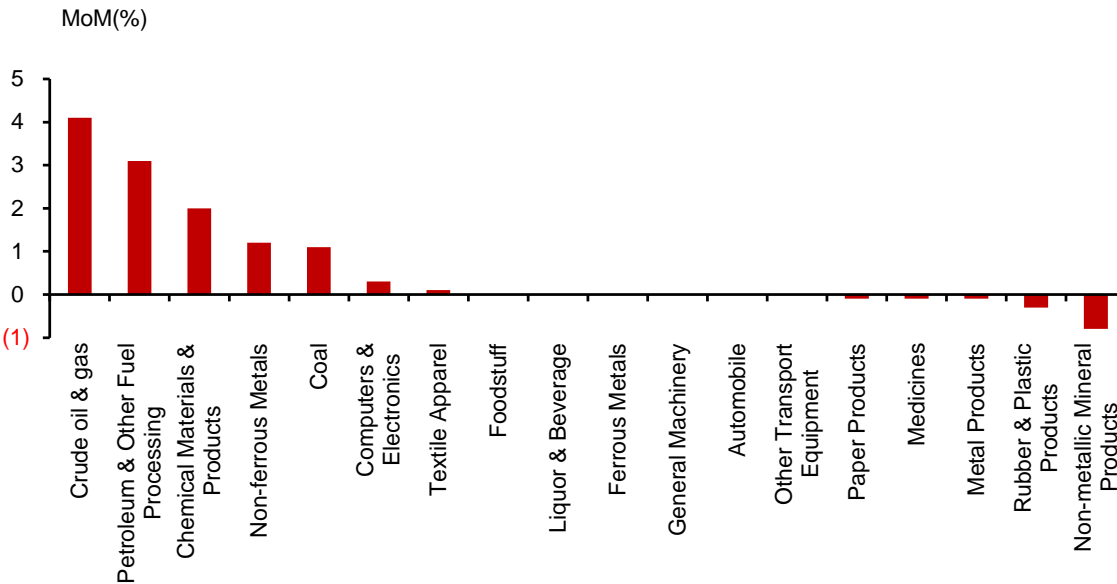
Source: Wind, CMBIGM

Figure 7: Agricultural and vegetable price



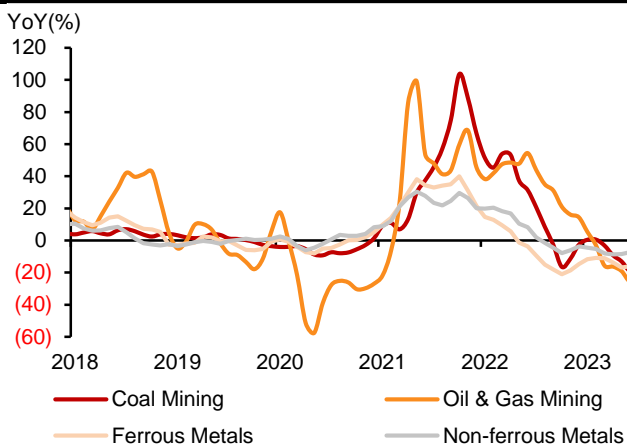
Source: Wind, CMBIGM

Figure 8: MoM Changes of China PPI in Sep



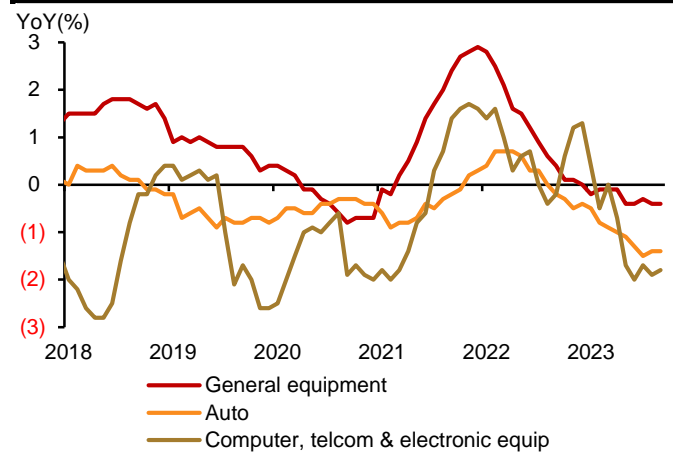
Source: Wind, CMBIGM estimates

Figure 9: China PPI in Energy & Metal



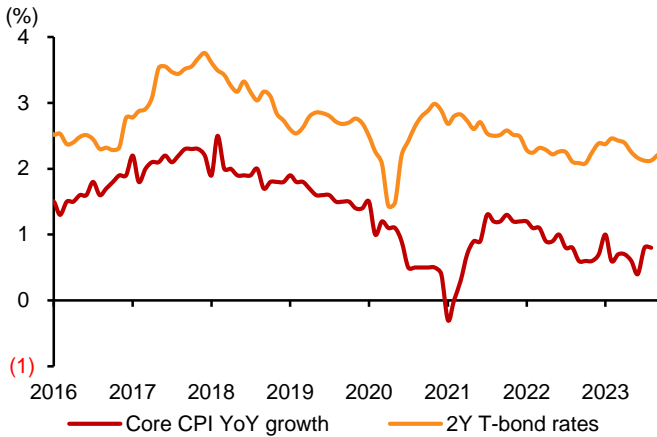
Source: Wind, CMBIGM

Figure 10: China PPI in Equipment



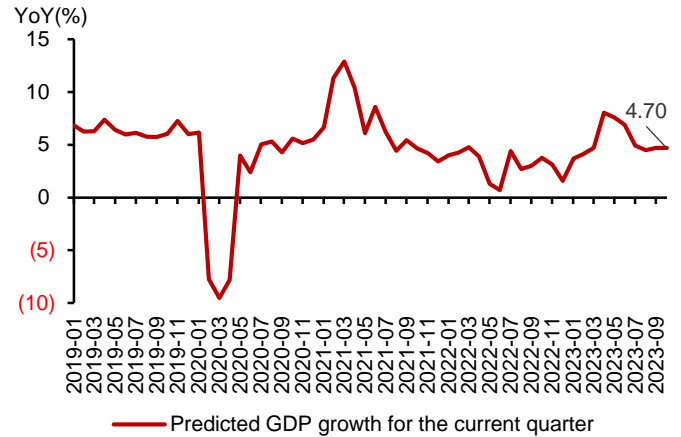
Source: Wind, CMBIGM

Figure 11: China Core CPI Growth & 2Y T-bond Rates



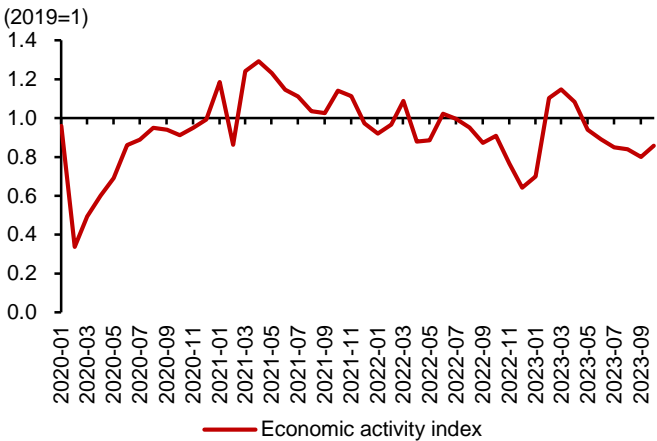
Source: Wind, CMBIGM

Figure 12: China Predicted GDP Growth



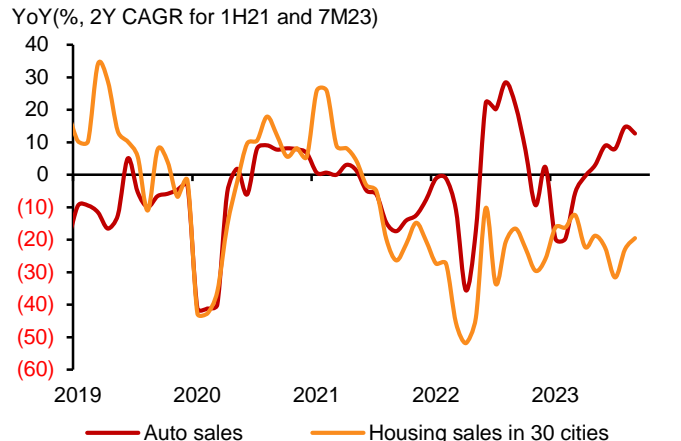
Source: Wind, CMBIGM

Figure 13: China Economic Activity Index



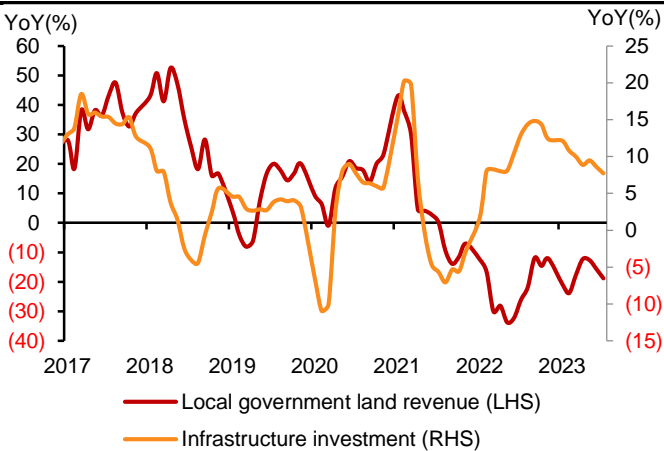
Source: Wind, CMBIGM

Figure 14: China Auto & Housing Sales



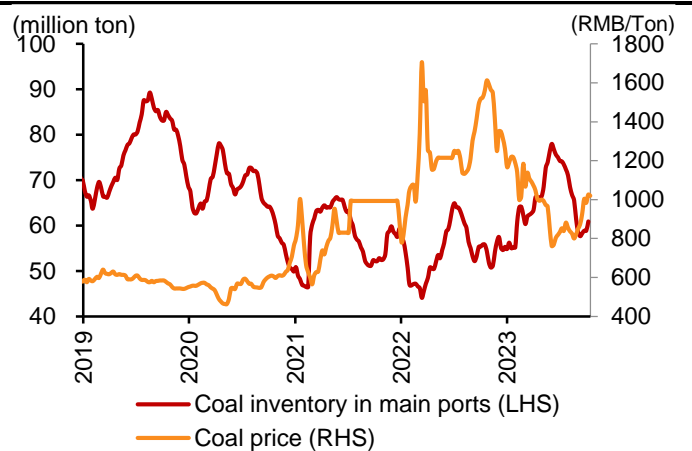
Source: Bloomberg, CMBIGM

Figure 15: Infrastructure Investment in China



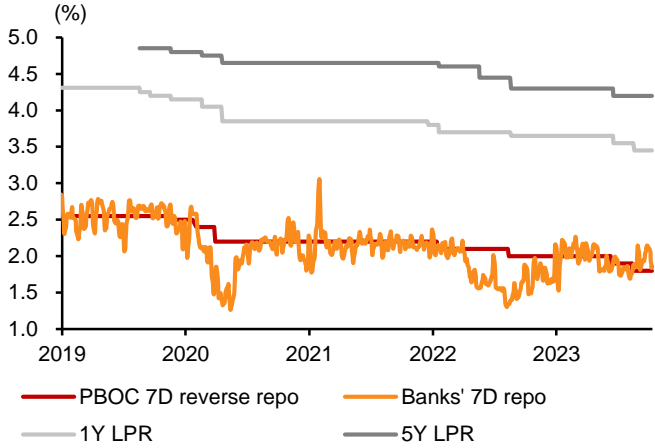
Source: Bloomberg, CMBIGM

Figure 16: China Coal Inventory & Price



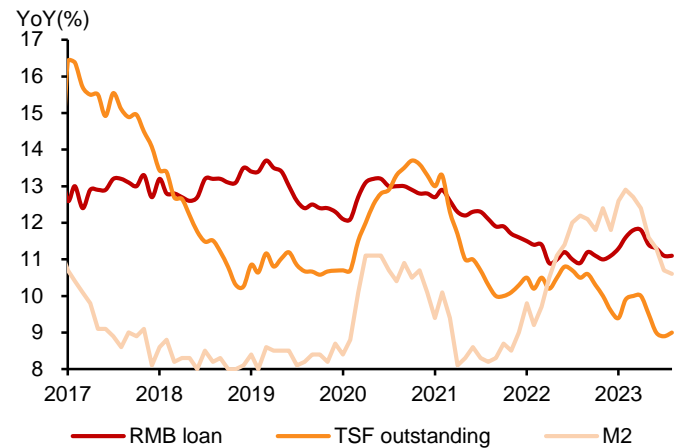
Source: Wind, CMBIGM

Figure 17: PBOC Policy Rates & Liquidity Condition



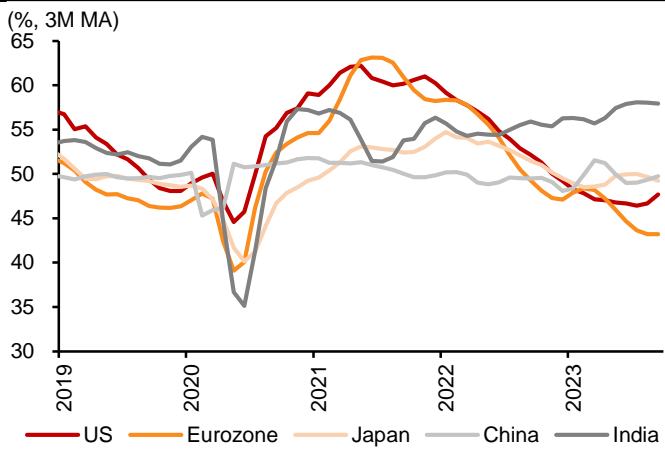
Source: Bloomberg, CMBIGM

Figure 18: China Credit Growth



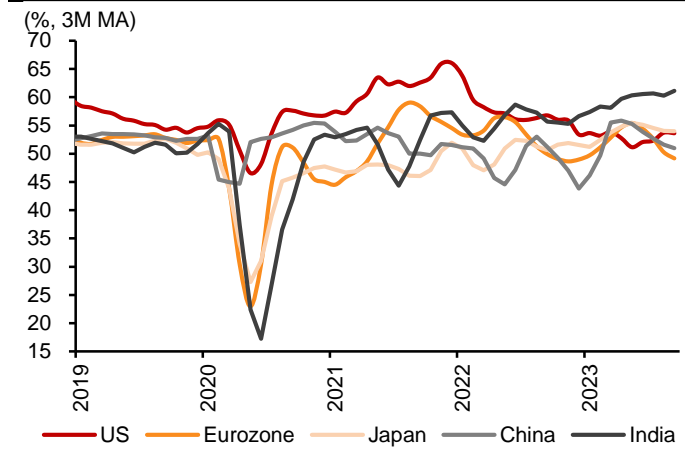
Source: Wind, CMBIGM

Figure 19: Manufacturing PMI of Major Economies



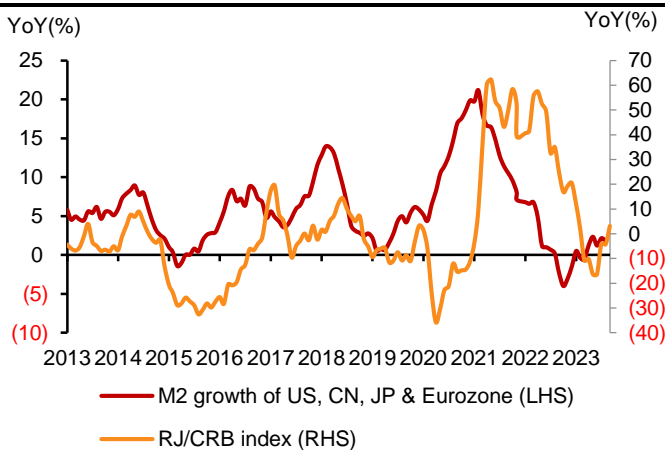
Source: Bloomberg, CMBIGM

Figure 20: Service PMI of Major Economies



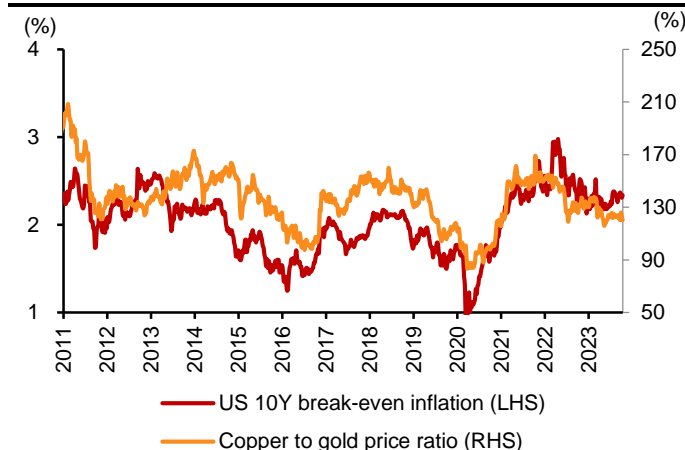
Source: Wind, CMBIGM

Figure 21: M2 Growth & Commodity Inflation



Source: Bloomberg, CMBIGM

Figure 22: Copper-to-gold Ratio



Source: Wind, CMBIGM

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