

China Economy

Deflation lingers with bumpy recovery in consumption

China's CPI growth dropped sharply in March as the boost effect from Chinese New Year holiday faded. The weak consumer price indicates a bumpy road for consumer demand to recover. PPI stayed flat amid elevated commodity price as the final demand remained subdued. As most prices are weaker than our expected, we revise down our forecast for CPI and PPI growth in 2024 from 0.7% and -0.3% to 0.5% and -0.7%. The retreat of China's consumer price contrasts with the stronger inflation in the US, which may expand the US-Sino interest rate gap and add downside pressure on renminbi. China's lingering deflation pressure calls for a shift of policy stimulus from supply side to demand side as the fiscal policy continues to focus on infrastructure investments and industrial development. But such shift is not easy as this requires a change of policy philosophy from pro-central-planner to pro-market. As real-term interest rates remained high and credit demand was still weak, the PBOC may guide banks to further lower deposit rates in 2Q24 before additional moderate cuts in loan rates in 2H24. We expect additional 10bps cut in LPR and 25bps cut targeted specifically at mortgage rates for the first-home and second-home buyers in the remainder of this year.

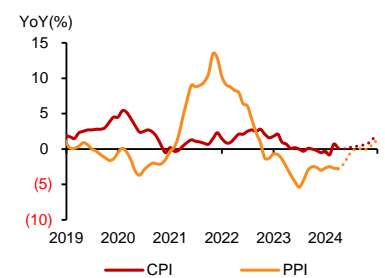
- CPI dropped below expectations.** CPI YoY growth declined to 0.1% in Mar from 0.7% in Feb, lower than the market expectation of 0.4%. The decline of food price accelerated from -0.9% to -2.7%, while core CPI slowed down to 0.6% from 1.2%. In sequential terms, CPI dropped 1% after rising 1% in Feb, below Mar average of -0.6% in history. Specifically, food CPI dropped 3.2% MoM after rising 3.3% during the CNY month. Pork price declined 6.7% MoM after a sharp rebound of 7.2% in Feb, with its YoY growth retracted to modest contraction again. As live hog farms started to cut capacity or go bankruptcy, pork price may gradually stabilize in the coming months. Energy price extended its rally with vehicle fuel price up by 1.1% MoM and by 2.2% YoY.
- Core CPI dipped after the boost from CNY faded.** Core CPI plummeted by 0.6% MoM in Mar after a historic rise of 0.5% in Feb as its YoY growth moderated to 0.6%. The boost effect of CNY holiday faded as we have witnessed a new consumer pattern with more concentrated consumption during holiday and bigger swing in the following month. Tourism price, for instance, dropped 14.2% MoM in Mar after notably rising 13.1% MoM in Feb with a record-breaking number of travellers during CNY holiday. Other services came in stronger than historic trend while rent remained lethargic as a sign of weak employment condition. Durable goods continued to endure headwinds from income deterioration, real estate contraction and fierce producer competition, as home equipment, telecom equipment and vehicles dropped 0.3%, 0.3% and 0.7% MoM. Looking forward, CPI growth may mildly rise as household consumption slowly recovers.
- PPI was in-line with expectation as energy price rebounded, yet final demand remained weak.** PPI stayed flat on 2.7% YoY decline in Mar, contracting for the 18th consecutive month. The MoM decline of PPI narrowed to -0.1% from -0.2% in Feb amid resurgence of commodities prices. For mining industries, PPI in oil & gas mining and non-ferrous metals increased to 6.3% and 0.6% YoY from 4.2% and -0.2% in Feb thanks to the rally of crude oil and copper prices, while coal mining and ferrous metals remained lethargic, dropping 15% and 7.2%. For mid-and-downstream industries, PPI in durables and capital goods remained tepid with over

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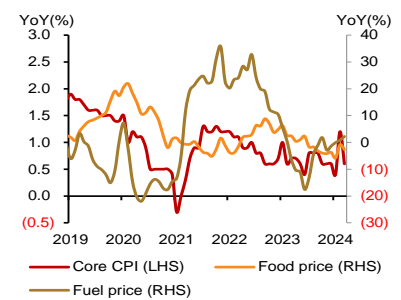
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Forecast numbers from Mar 2024
Source: Wind, CMBIGM



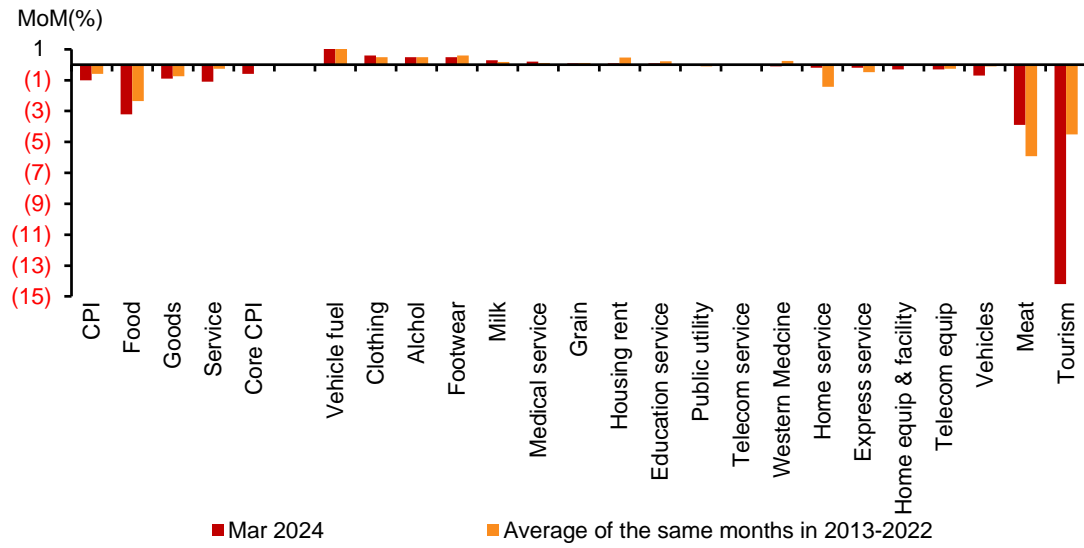
Source: Wind, CMBIGM

supply capacity pressure. Looking forward, PPI may modestly recover amid elevated commodities prices and improving exports.

■ **Lingering deflation pressure calls for demand-side policy stimulus.**

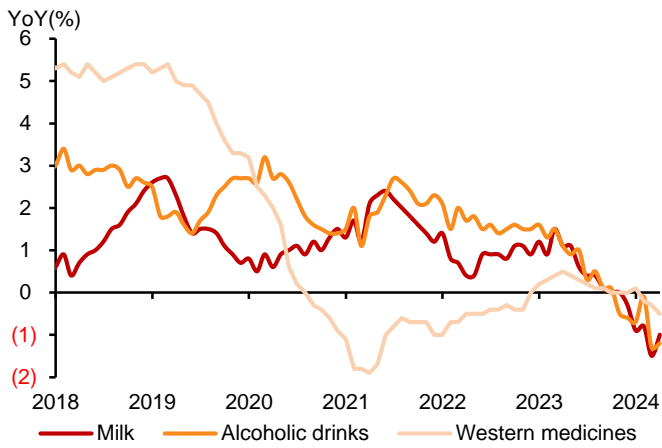
The weakness of consumer and producer prices in March indicates the pick-up of retail sales and core CPI in 2M24 may be mainly due to the holiday momentum. The lingering deflation pressure calls for a shift of policy stimulus from the producer side to consumer side. But such shift is not easy as this requires a change of policy philosophy from pro-central-planner to pro-market. Investors will wait and see whether actual progress could be made in the policy shift. As real-term interest rates remained high and credit demand was still weak, the PBOC may guide banks to further lower deposit rates in 2Q24 before additional moderate cuts in loan rates in 2H24. We expect additional 10bps cut in LPR and 25bps cut targeted specifically at mortgage rates for the first-home and second-home buyers in the remainder of this year.

Figure 1: MoM Changes of China CPI in Mar



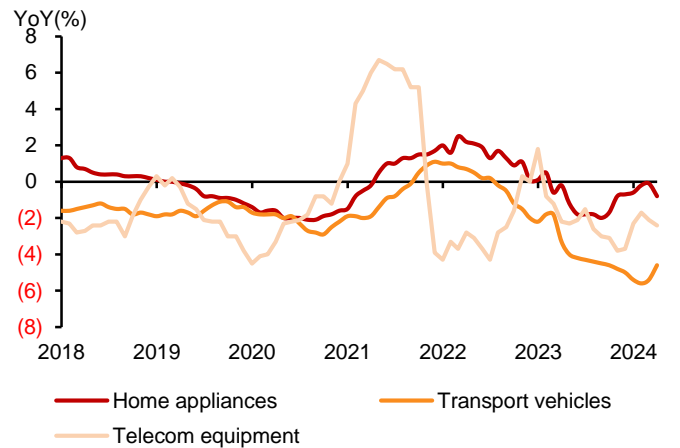
Source: Wind, CMBIGM

Figure 2: China CPI Growth in Staples



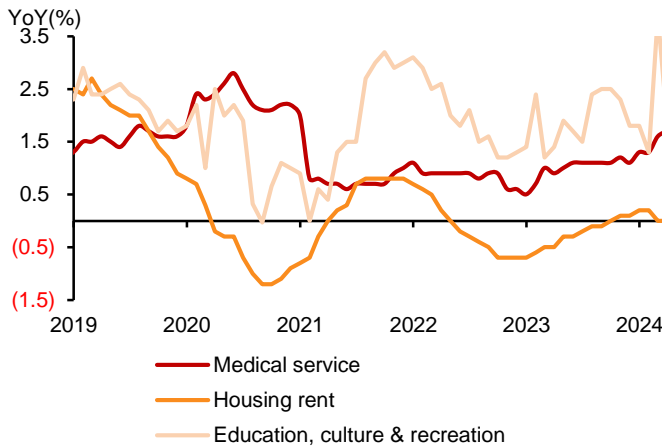
Source: Wind, CMBIGM

Figure 3: China CPI Growth in Durables



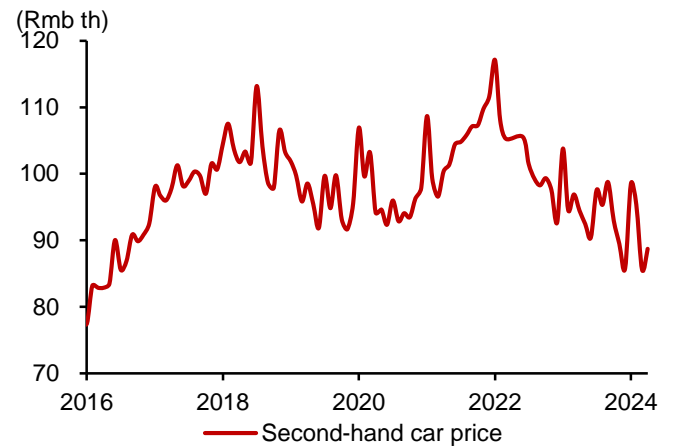
Source: Wind, CMBIGM

Figure 4: China CPI Growth in Services



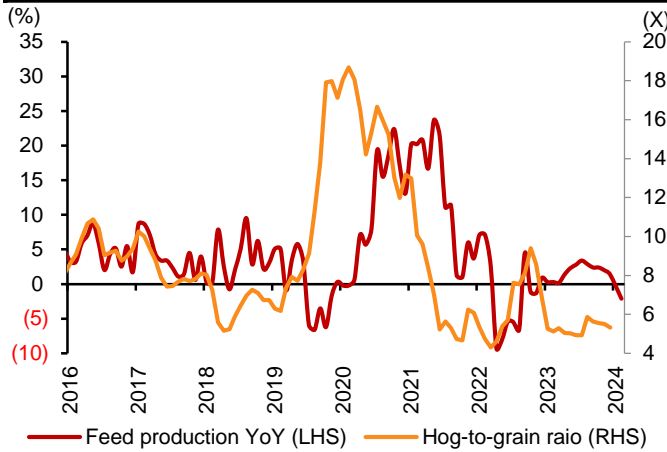
Source: Wind, CMBIGM

Figure 5: Second-hand Car Price in Shanghai



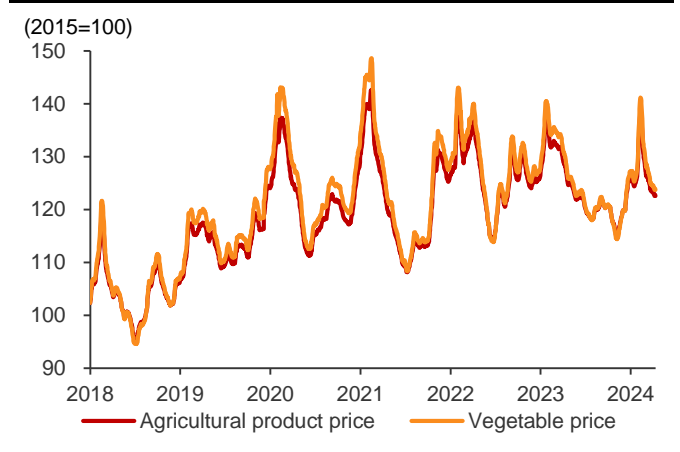
Source: Wind, CMBIGM

Figure 6: Feed Production & Hog-to-Grain Ratio



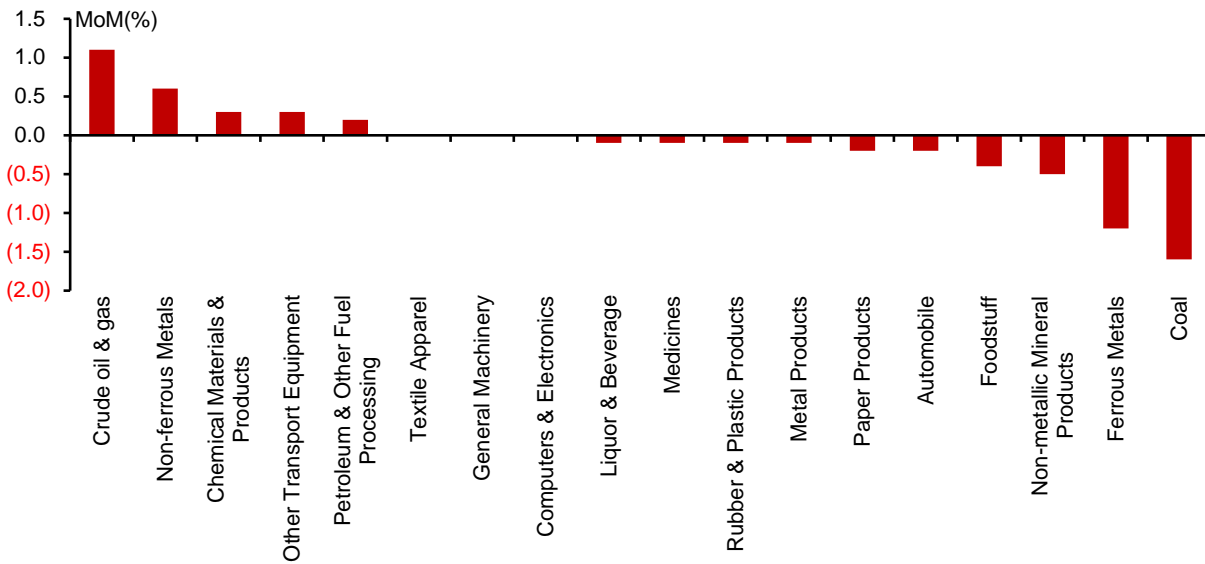
Source: Wind, CMBIGM

Figure 7: Agricultural and Vegetable Price



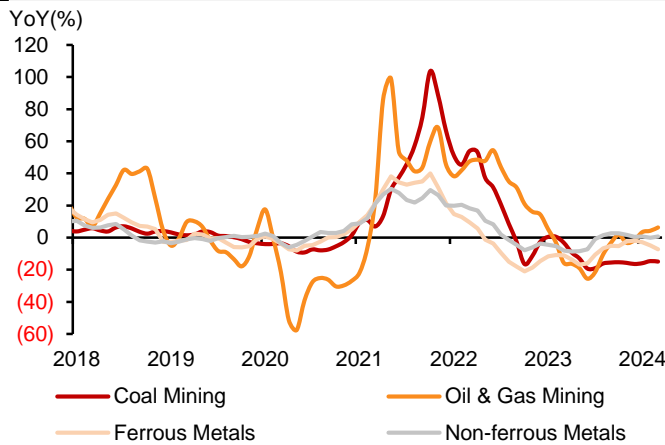
Source: Wind, CMBIGM

Figure 8: MoM Changes of China PPI in Mar



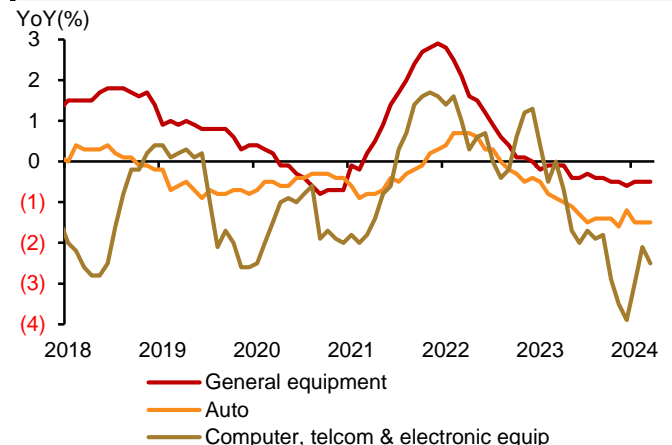
Source: Wind, CMBIGM

Figure 9: China PPI in Energy & Metals



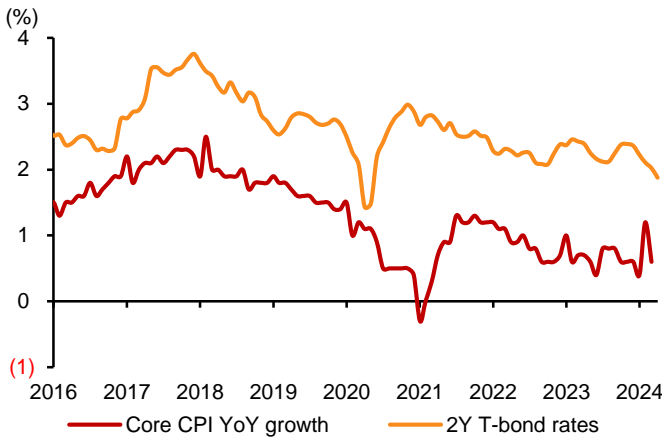
Source: Wind, CMBIGM

Figure 10: China PPI in Equipment



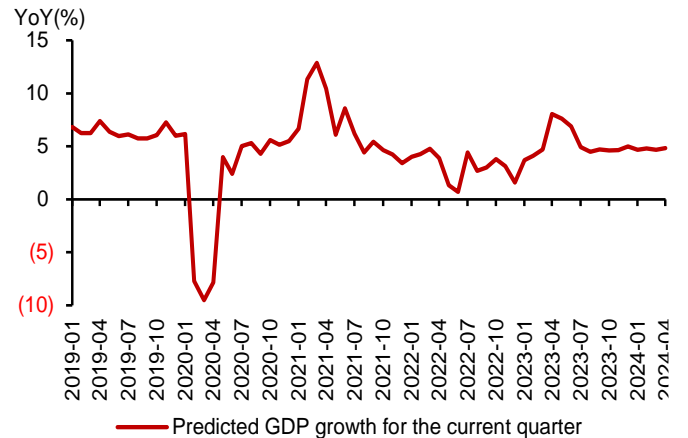
Source: Wind, CMBIGM

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



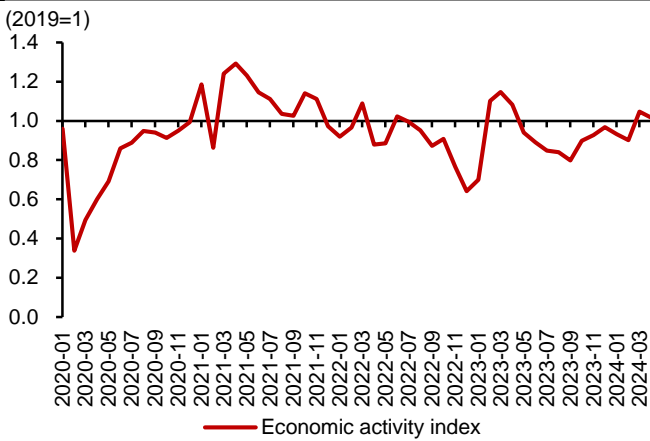
Source: Wind, CMBIGM

Figure 12: China Predicted GDP Growth



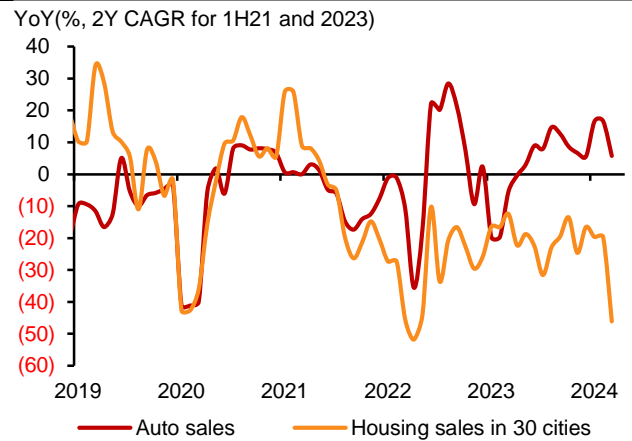
Source: Wind, CMBIGM estimates

Figure 13: China Economic Activity Index



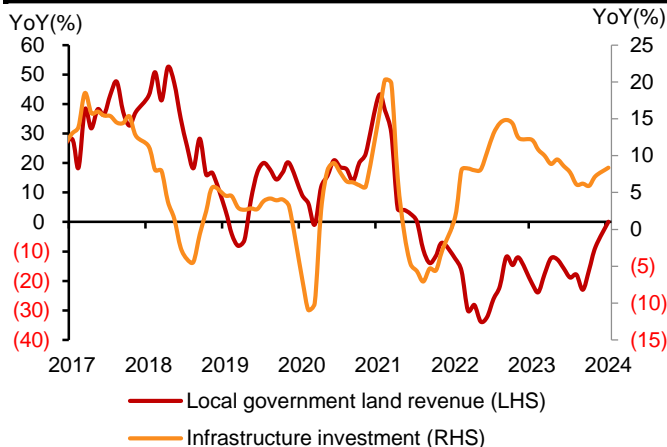
Source: Wind, CMBIGM

Figure 14: China Auto & Housing Sales



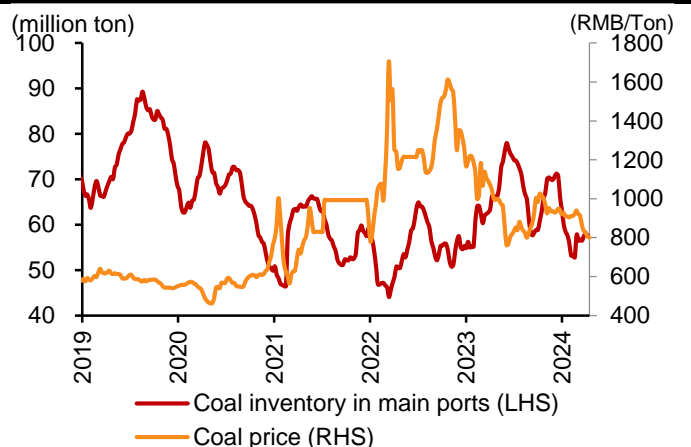
Source: Bloomberg, CMBIGM

Figure 15: Infrastructure Investment in China



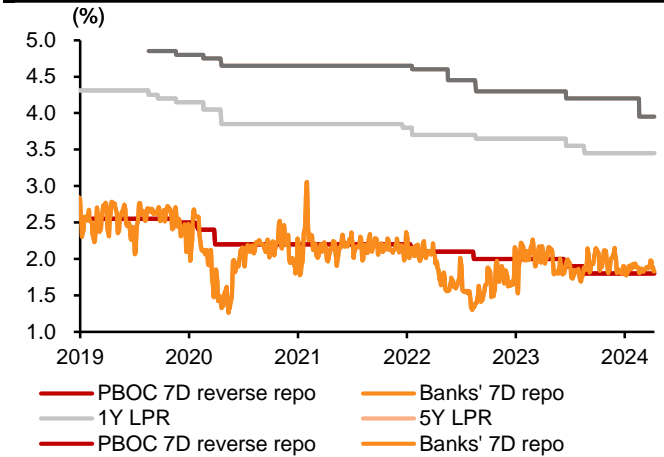
Source: Bloomberg, CMBIGM

Figure 16: China Coal Inventory & Price



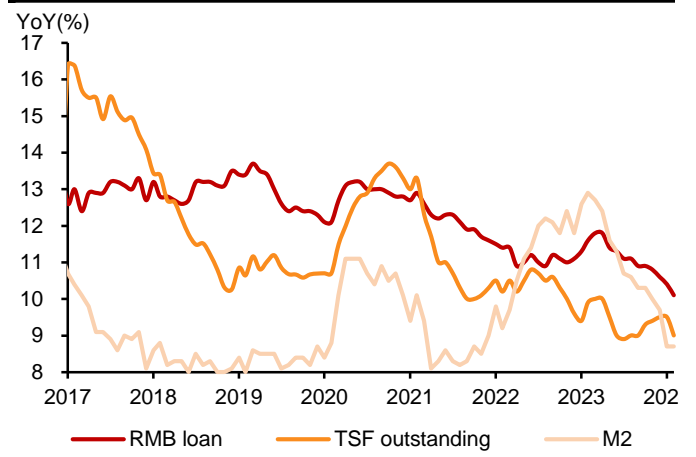
Source: Wind, CMBIGM

Figure 17: PBOC Policy Rates & Liquidity Condition



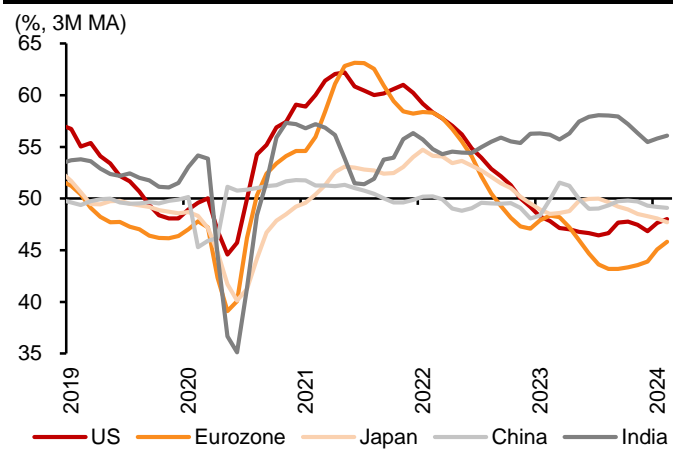
Source: Bloomberg, CMBIGM

Figure 18: China Credit Growth



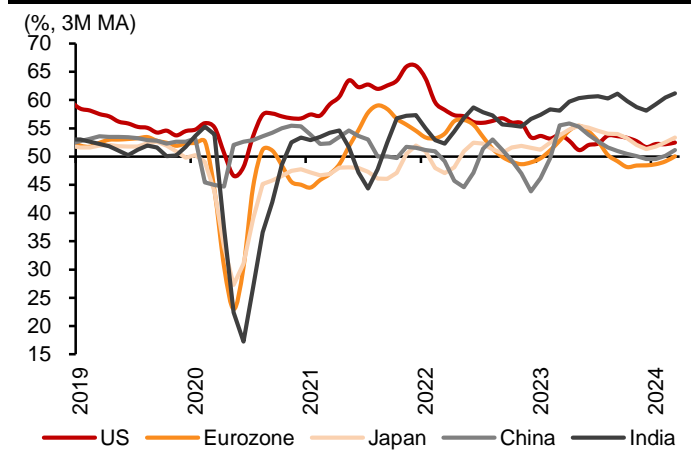
Source: Wind, CMBIGM

Figure 19: Manufacturing PMI of Major Economies



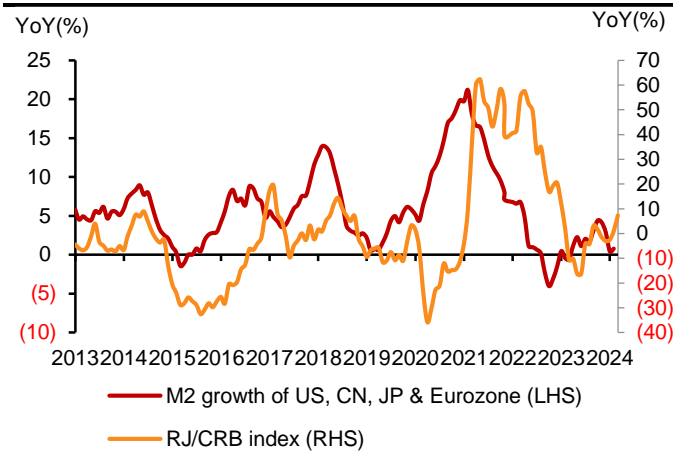
Source: Bloomberg, CMBIGM

Figure 20: Service PMI of Major Economies



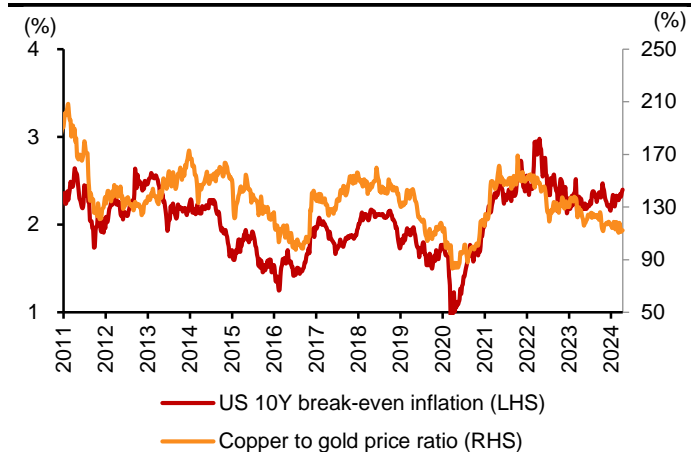
Source: Wind, CMBIGM

Figure 21: M2 Growth & Commodity Inflation



Source: Bloomberg, CMBIGM

Figure 22: Copper-to-gold Ratio



Source: Wind, CMBIGM

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