

China Economy

Inflation is too low as demand remains weak

China faced deflation pressure as the CPI growth dropped to 0.1% while the PPI further declined 3.6% YoY in April. China's economic recovery was uneven as service consumption rapidly rebounded while housing sales and durable consumption remained weak. Pork prices continued to decline amid the de-capacity cycle, while commodity prices also corrected after the recent turmoil of small & medium banks in the US. Looking forward, the CPI may moderately pick up from May while the PPI growth should gradually rebound in 2H23. We cut our forecast for 2023 CPI and PPI growth rates from 2.2% and -0.5% to 1.4% and -1.6%. The deflation pressure is bad for China's economic recovery as it increases debt burden and encourages saving instead of consumption. The deflation pressure increases the possibility of additional monetary policy easing in future.

- CPI growth dropped to the lowest since March 2021 as food & energy prices retreated and consumption remained weak.** CPI rose merely 0.1% YoY in April after rising 0.7% YoY in March. Core CPI rose 0.7% YoY in April, the same as in March. Food inflation dropped from 2.4% in March to 0.4% in April, while fuel price further declined 10.4% YoY in April after dropping 6.4% YoY in March. As service consumption recovered rapidly, service price picked up 1% YoY in April. Prices of air tickets, hotel accommodation, tourism and transportation rental fees jumped sharply. Meanwhile, education and home service prices respectively rose 1.1% and 1.9%. However, housing rent inflation declined from 0.5% in March to 0.3% in April as employment condition among the youth remained weak. Home appliances, vehicles and telecom equipment remained in deflation condition with weak demand and over capacity as their prices respectively declined 1.2%, 4.0% and 2.3% YoY in April. From the MoM perspective, CPI dropped 0.1% in April after declining 0.3% in March. Food prices dropped 1% MoM while tourism price jumped 4.6% MoM in April. Prices in transportation rentals fees, air tickets and accommodation increased noticeably.
- PPI further declined as capex demand was weak and commodity prices retreated after the recent bank turmoil in US.** PPI declined 3.6% YoY in April after dropping 2.5% YoY in March. Domestic capex and durable consumption remained weak, while overseas demand faced downside pressure as the recent bank turmoil in US caused credit supply tightening. PPI in coal mining, oil & gas mining, ferrous metal and non-ferrous metal respectively dropped 9.3%, 16.3%, 13.6% and 8.6% YoY in April after dropping 3.2%, 15.7%, 11% and 8% YoY in March. Meanwhile, prices of general equipment, auto and computer & telecom equipment respectively decreased 0.1%, 1% and 0.7% YoY in April. From the MoM perspective, PPI declined 0.5% in April after staying flat in March. Prices of crude oil & gas, non-ferrous metals and textile apparel rose 0.5%, 0.2% and 0.1% MoM in April. However, prices of coal, petroleum product and paper products declined by 4%, 2.3% and 1.2% MoM in April.
- We cut our forecast for CPI and PPI growth rates for 2023 from 2.2% and -0.5% to 1.4% and -1.6%.** The CPI and PPI growth rates were far below our expectations in 1Q23, indicating a slow recovery in housing starts, durable consumption and business capex. Looking forward, the CPI should moderately pick up from May into the next four quarters. The CPI growth is

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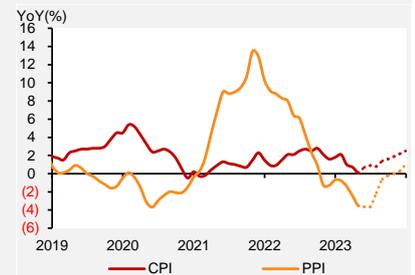
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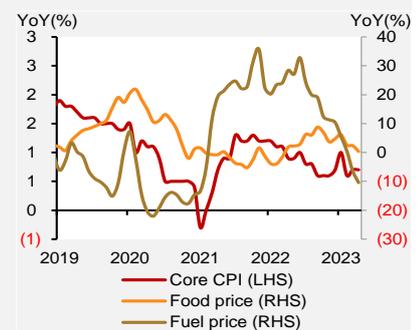
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Forecast numbers from May 2023
Source: Wind, CMBIGM

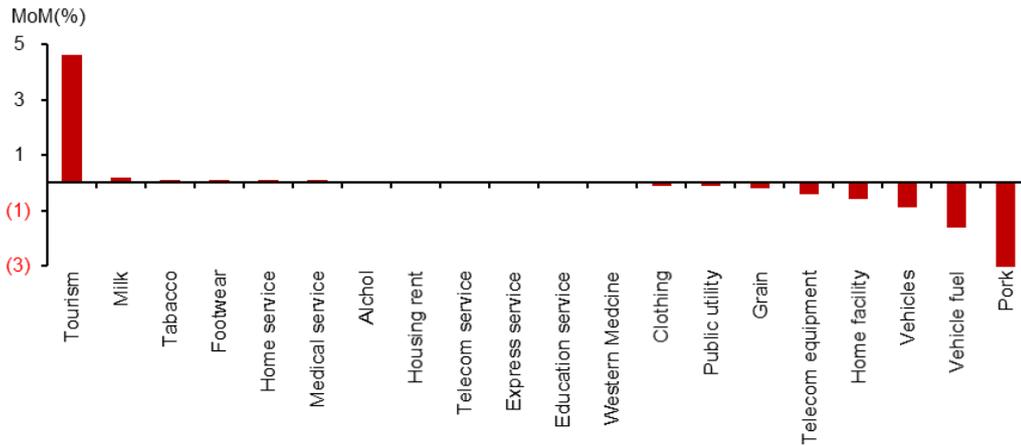


Source: Wind, CMBIGM

expected to reach 1.4% in 2023 and 2.5% in 2024. The PPI may further decline in next two months before gradually rebounding in 2H23. We expect the PPI to drop 1.6% in 2023 before rising 1.8% in 2024.

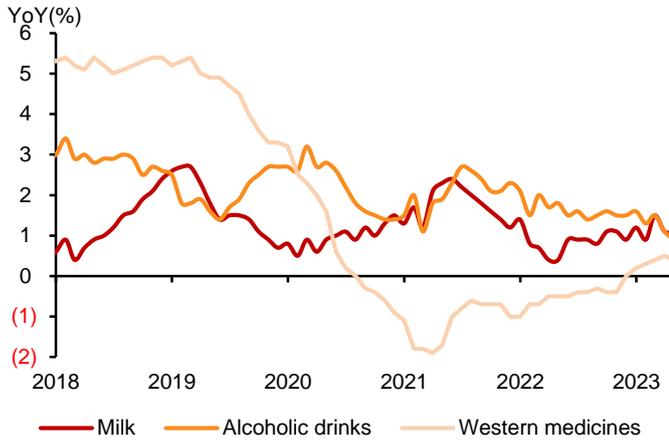
- **Deflation pressure will harm economic recovery, as China should consider additional monetary policy easing ahead.** The deflation pressure indicates demand remains weak while supply competition is tough in most sectors. The deflation will increase debt burden and lower households' incentive to consume. The Chinese policymakers should consider additional monetary policy easing to boost the demand growth.

Figure 1: MoM Changes of China CPI in April



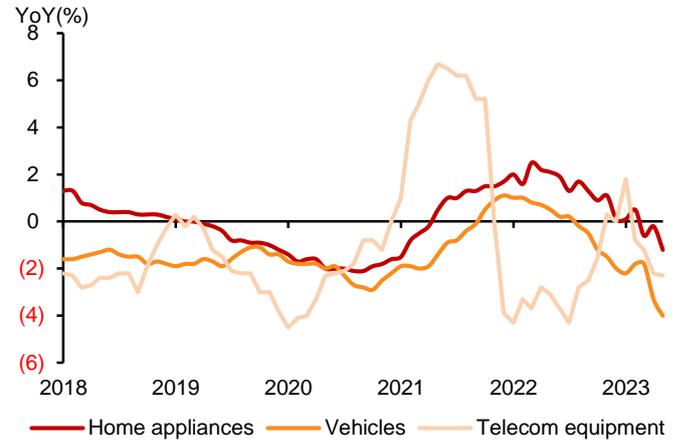
Source: Wind, CMBIGM estimates

Figure 2: China CPI Growth in Staples



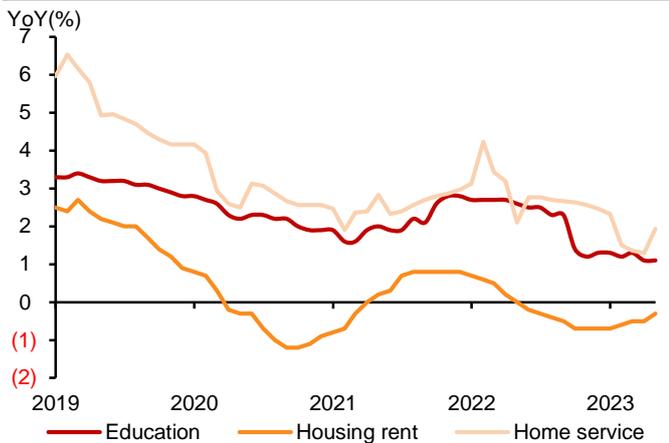
Source: Wind, CMBIGM

Figure 3: China CPI Growth in Durables



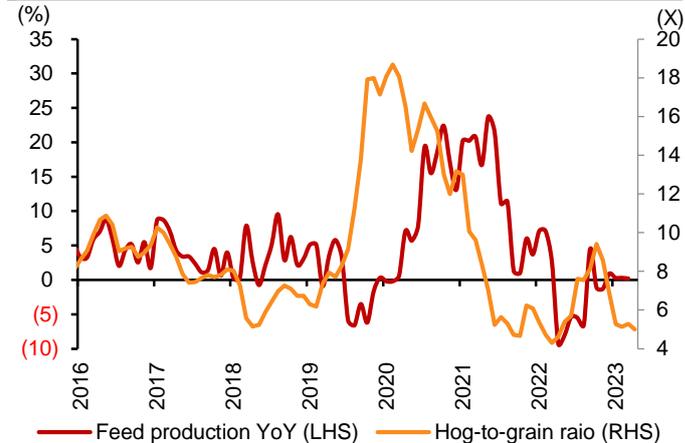
Source: Wind, CMBIGM

Figure 4: China CPI Growth in Services



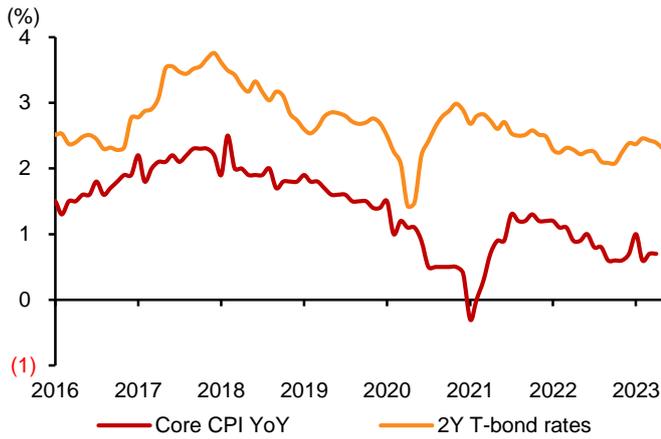
Source: Wind, CMBIGM

Figure 5: Hog-to-grain Ratio in China



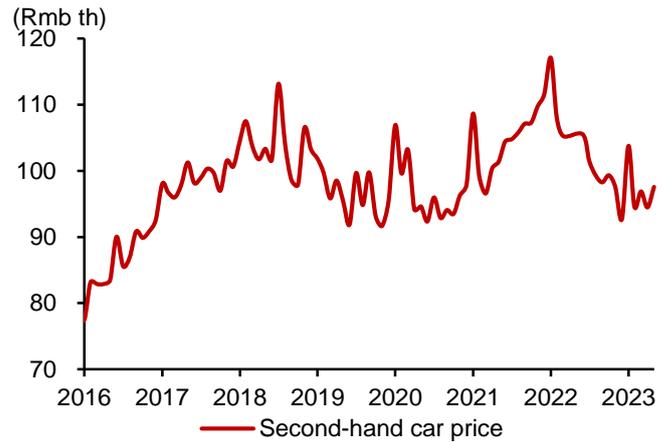
Source: Wind, CMBIGM

Figure 6: China Core CPI Growth & 2Y T-bond Rates



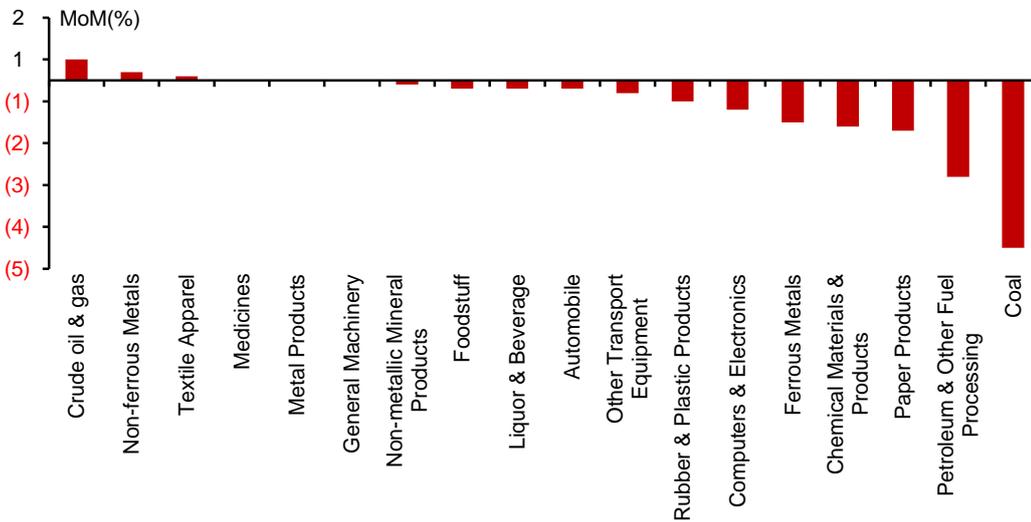
Source: Wind, CMBIGM

Figure 7: Second-hand Car Price in Shanghai



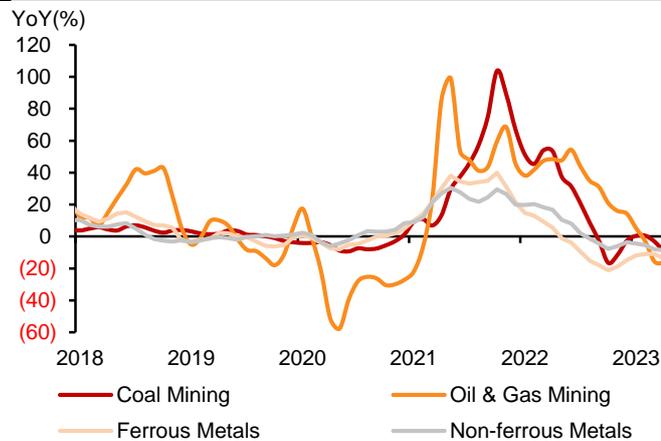
Source: Wind, CMBIGM

Figure 8: MoM Changes of China PPI in April



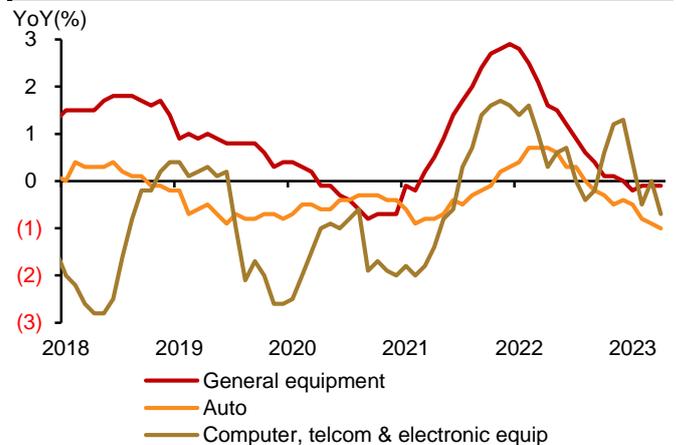
Source: Wind, CMBIGM estimates

Figure 9: China PPI in Energy & Metal



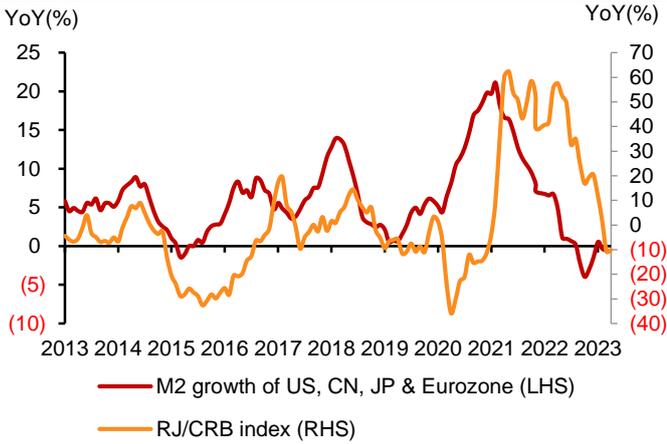
Source: Wind, CMBIGM

Figure 10: China PPI in Equipment



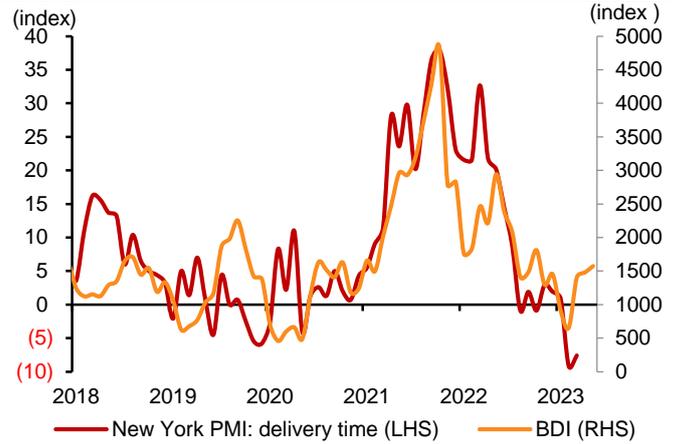
Source: Wind, CMBIGM

Figure 11: Global M2 Growth & Commodity Inflation



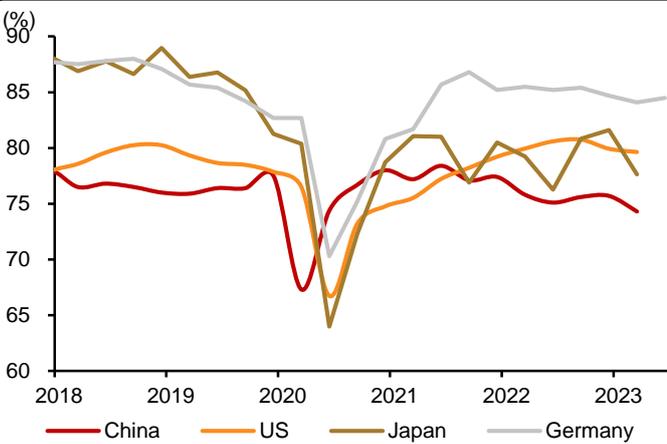
Source: Wind, CMBIGM

Figure 12: Global Supply Chain Pressure



Source: Wind, CMBIGM

Figure 13: Manufacturing Capacity Utilisation Ratio



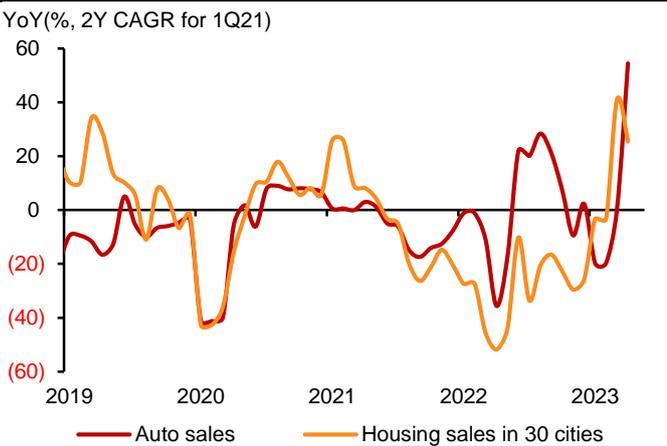
Source: Wind, CMBIGM

Figure 14: Copper-to-gold Ratio



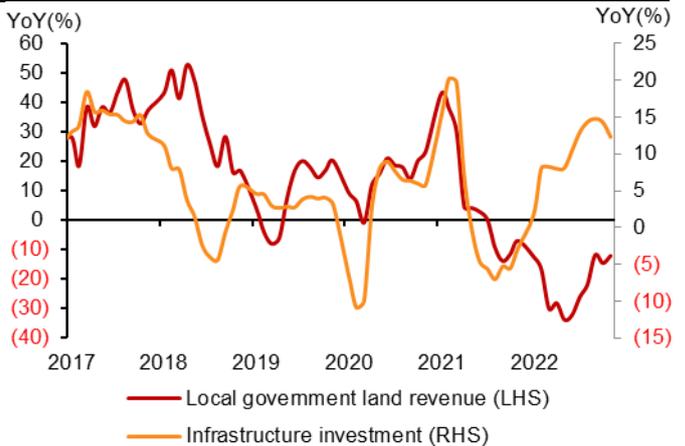
Source: Bloomberg, CMBIGM

Figure 15: China Auto & Housing Sales



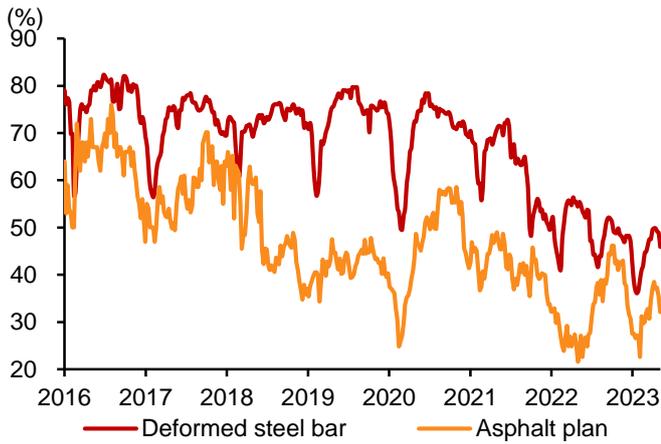
Source: Bloomberg, CMBIGM

Figure 16: Infrastructure Investment in China



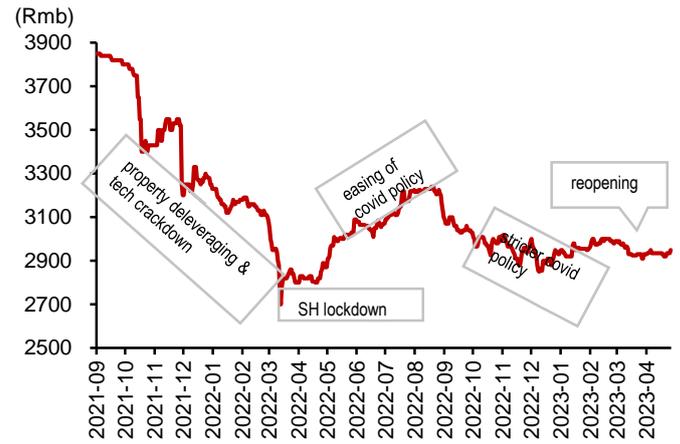
Source: Wind, CMBIGM

Figure 17: Operation Rate in China



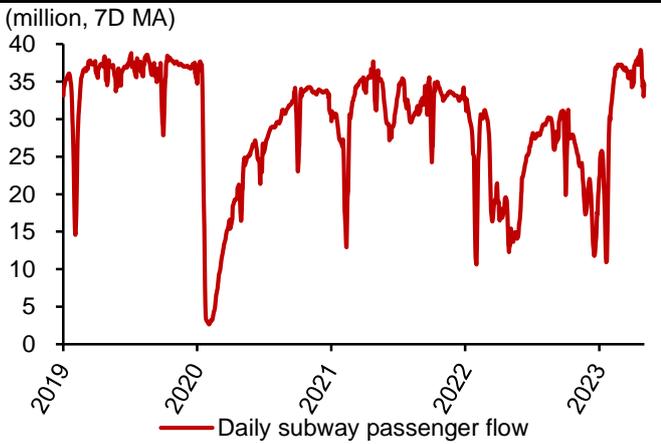
Source: Bloomberg, CMBIGM

Figure 18: MOUTAI Wholesale Reference Price



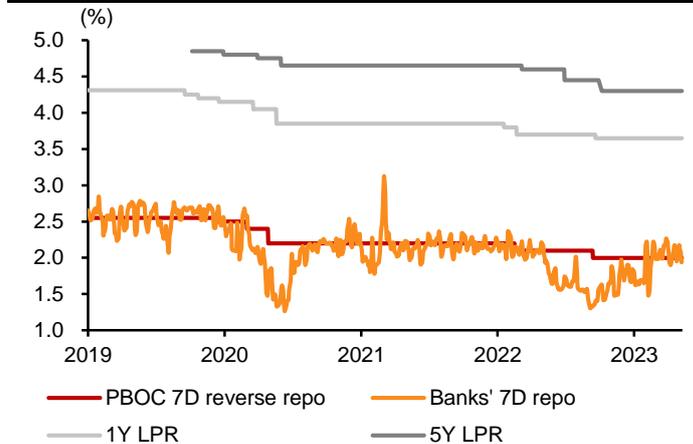
Source: Wind, CMBIGM

Figure 19: Mobility Indicators in China's Tier-1 Cities



Source: Bloomberg, CMBIGM

Figure 20: PBOC Policy Rates & Liquidity Condition



Source: Wind, CMBIGM

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