

China Economy

Deflation may last longer than expected

China's CPI in Jan dropped 0.8% YoY, the largest decline since the global financial crisis in 2009. The deterioration was due to the Lunar New Year (LNY) mismatch. Pork price remained anomalously lethargic, with signs of relief on the supply side. Core CPI exhibited one of the few bright spots with a robust MoM increase of 0.3%. PPI narrowed its YoY decline thanks to the base effect while continuing to decline in sequential terms due to weak downstream demand and overcapacity pressure. China may suffer a longer deflation cycle than we expected given headwinds from weak consumer demand and continued policy support to the supply side. We revise down our forecasts on China's CPI, PPI and nominal GDP growth rates in 2024 from 1%, 0.2% and 5.5% to 0.7%, -0.3% and 5.1%. The PBOC may further cut LPRs by 10 or 20 bps in Feb amid the deflation pressure. The central bank is also expected to commit RMB1-1.5trn PSL loans for "three major projects". The fiscal policy will be more expansionary with expected broad fiscal deficit ratio at over 7.1% in 2024 from 6.4% in 2023.

■ **CPI further deteriorated due to the LNY mismatch while pork price remained lethargic.** CPI widened its YoY decline from -0.3% in Dec to -0.8% in Jan, worse than the market expectation of -0.5%. The YoY CPI decline was mainly due to a higher base caused by the LNY in Jan 2023, especially for food price, which dropped 5.9% in Jan from -3.7% in Dec 2023. In sequential terms, CPI recovered to 0.3% growth after rising 0.1%. Specifically, food CPI eased to 0.4% MoM from 0.9%, showing much weaker seasonality compared to an average 2.4% MoM in Jan from 2013 to 2022. Pork price dropped 0.2% MoM after decreasing 1% in Dec, with its YoY decline contracting to -17.3% from -26.1%, pointing to a very weak demand when pork price typically exhibited strong seasonality approaching the LNY. Pork price may remain a headwind of reflation in 1H24 as the de-capacity process on the supply side may take longer than we expected. However, we see positive signs including the mild drops in feed production and the number of live hogs and breeding sows.

■ **Core CPI growth dropped to 0.4% YoY, one of the lowest since Mar 2021, while its MoM growth was robust, at 0.3% from 0.1%.** CPI in tourism and home service respectively picked up 4.2% and 2.7% MoM in Jan, in line with its seasonality. Home equipment stayed flat at 0.6% MoM, while vehicles and telecom equipment dropped 0.1% and 0.3% MoM, showing an overall weak demand in durable goods. CPI MoM growth in other services remained subdued including telecom, postal and education services. Rent has been dropping since Sep, with a 0.1% MoM decline in Jan, indicating a deteriorating employment situation. Overall the MoM growth of headline CPI showed much weaker seasonality dragged by food price, albeit solid core CPI growth. In 2013, 2016 and 2021 with similar LNY dates, the Jan MoM growth rates of CPI, core CPI and pork on average were 0.8%, 0.1% and 4.4%, compared to 0.3%, 0.3% and -0.2% respectively in Jan 2024.

■ **PPI narrowed its YoY decline while continuing to drop in sequential terms.** PPI declined 2.5% YoY in Jan after decreasing 2.7% YoY in Dec, contracting for the 16th consecutive month. The slightly-above-expectation PPI was mainly driven by a smaller base last year. The MoM growth of PPI edged up to -0.2% from -0.3% in Dec, showing a still sluggish demand considering a moderate rebound in crude oil price. PPI in oil & gas mining recovered to 3.1% YoY growth while non-ferrous metals picked up 0.6% from 0.4%. Coal mining and ferrous metals remained in contraction at -16% and -2.9% from -16.5% and -1.9%. From the MoM perspective, ferrous and non-ferrous metals saw the biggest growth of 0.4% and 0.3% in Jan from 0.8% and -0.3%. The declines of crude oil & gas and

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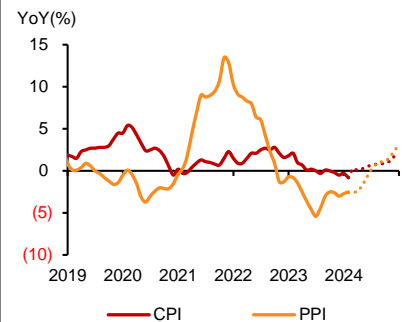
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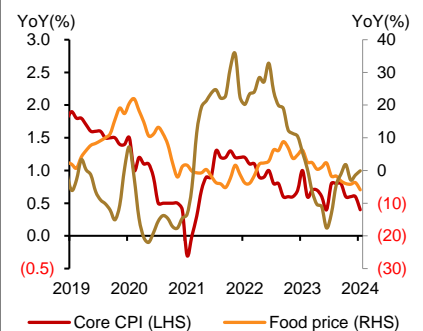
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Forecast numbers from Aug 2023
Source: Wind, CMBIGM

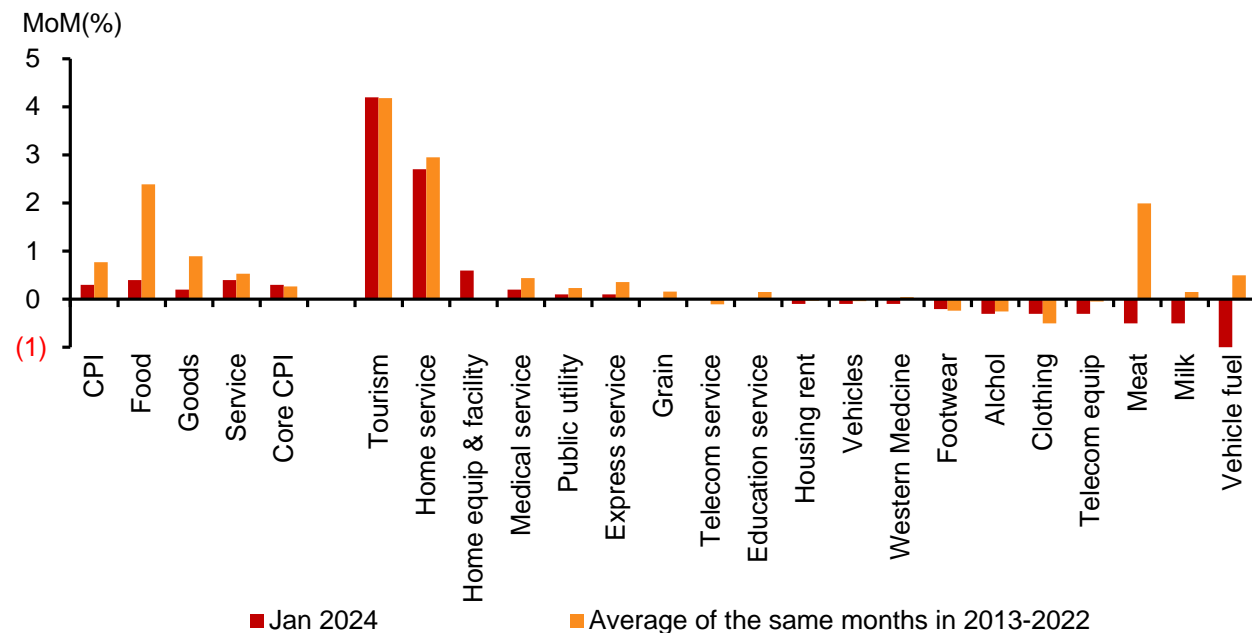


Source: Wind, CMBIGM

petroleum moderated to -0.8% and -1.7% from -6.6% and -3%. PPI in durables and capital goods remained weak with enduring deflation.

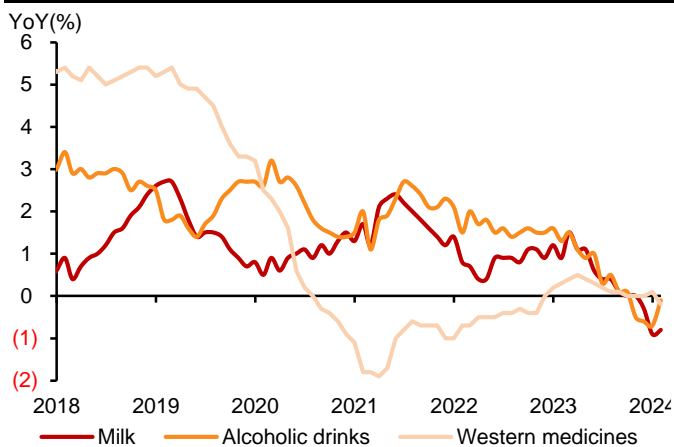
- **PBOC is expected to lower LPRs in Feb amid deflation pressure.** China may suffer a longer deflation cycle than we expected as the pork price and weak consumer demand continue to weigh on CPI. Deflation itself and the accompanied expectation may lead the economy into the dangerous “deflation-spiral” as it would increase debt burden, restrain capex and durable consumption, and hurt business earnings. Considering Japan’s experience in the two lost decades, a preliminary and maybe aggressive monetary policy is vital to address the deflation pressure, and the time is ticking. The PBOC will maintain accommodative liquidity and credit policy with possible 10 or 20 bps of LPR cuts in Feb. We expect additional cuts in RRR, deposit rates and LPRs in 2H24. The central bank is also expected to commit RMB1-1.5trn PSL loans for “three major projects”. The fiscal policy will be more expansionary with expected broad fiscal deficit ratio at over 7.1% in 2024 from 6.4% in 2023.

Figure 1: MoM Changes of China CPI in Jan



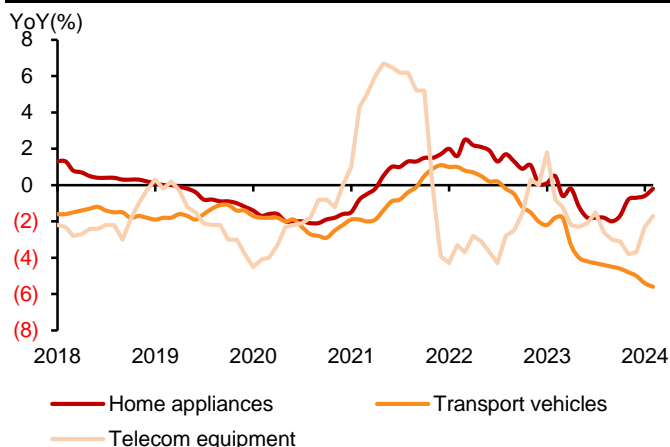
Source: Wind, CMBIGM

Figure 2: China CPI Growth in Staples



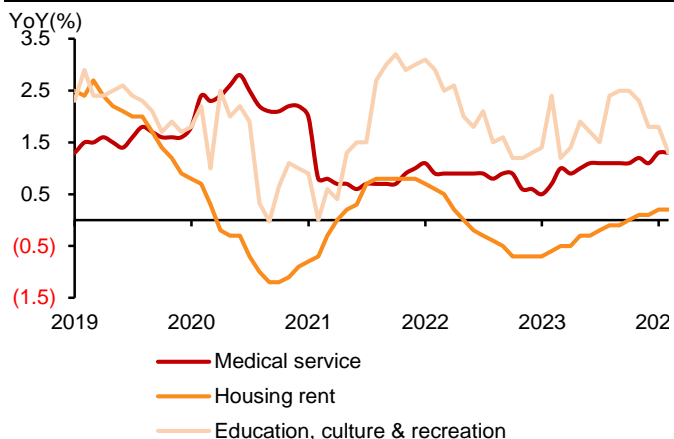
Source: Wind, CMBIGM

Figure 3: China CPI Growth in Durables



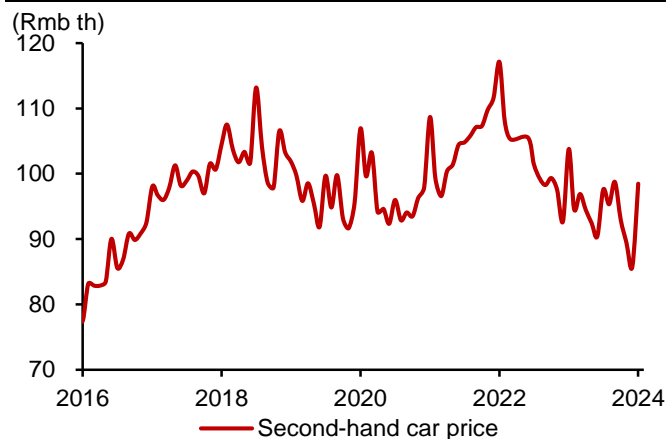
Source: Wind, CMBIGM

Figure 4: China CPI Growth in Services



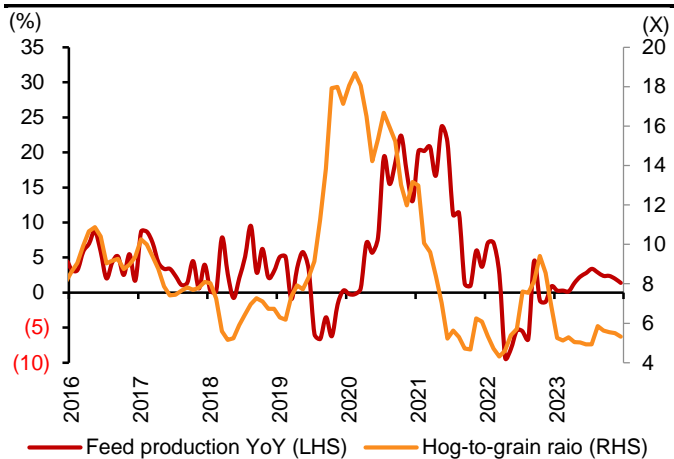
Source: Wind, CMBIGM

Figure 5: Second-hand Car Price in Shanghai



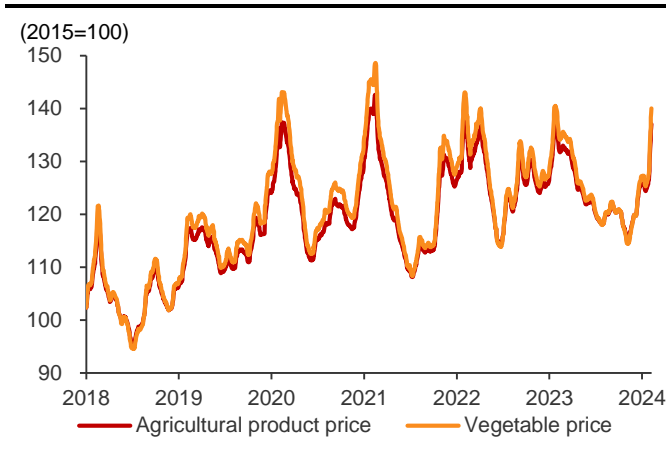
Source: Wind, CMBIGM

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



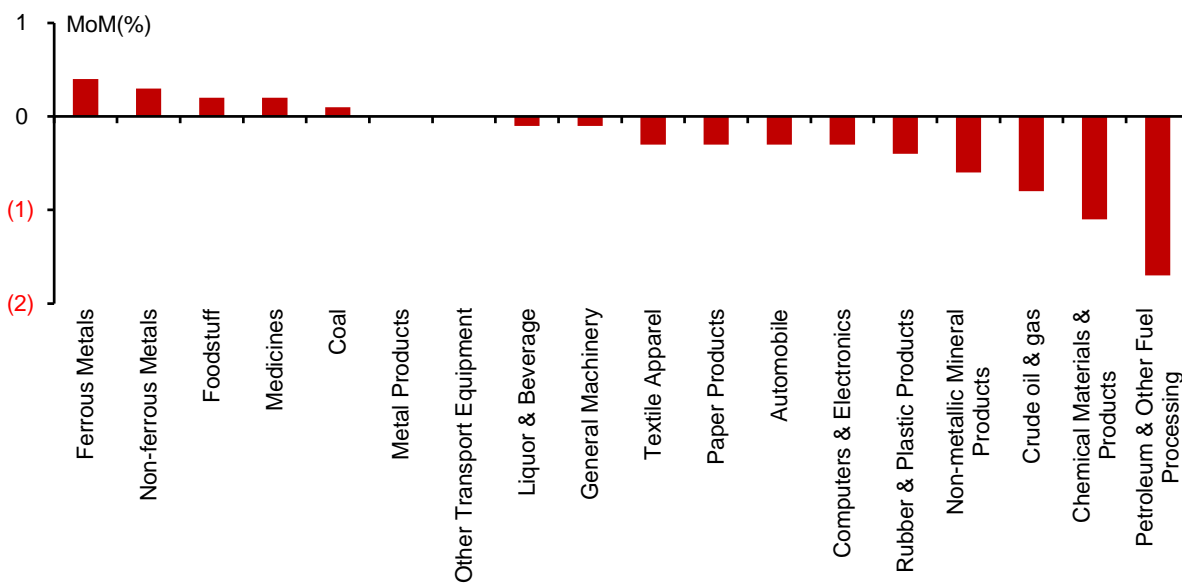
Source: Wind, CMBIGM

Figure 7: Agricultural and Vegetable Price



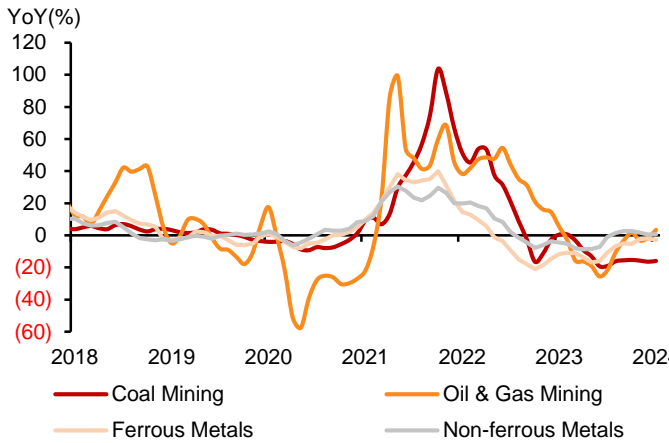
Source: Wind, CMBIGM

Figure 8: MoM Changes of China PPI in Jan



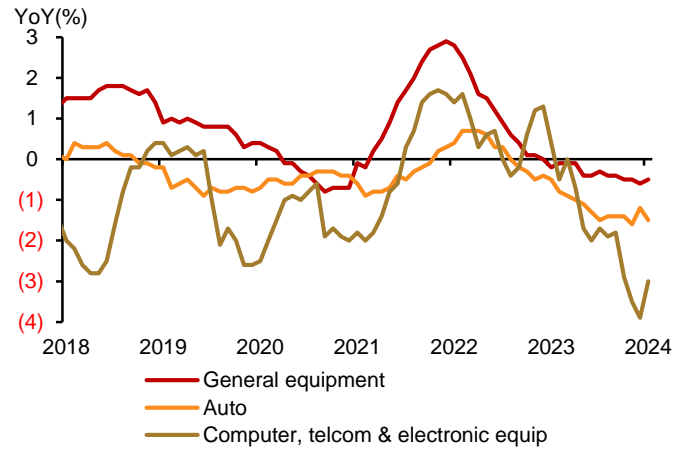
Source: Wind, CMBIGM

Figure 9: China PPI in Energy & Metals



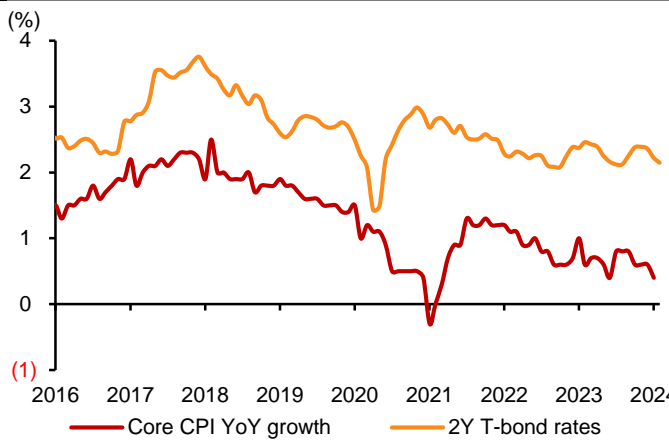
Source: Wind, CMBIGM

Figure 10: China PPI in Equipment



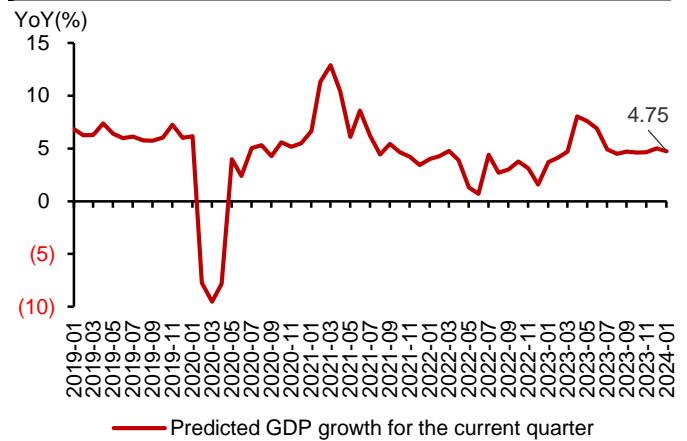
Source: Wind, CMBIGM

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



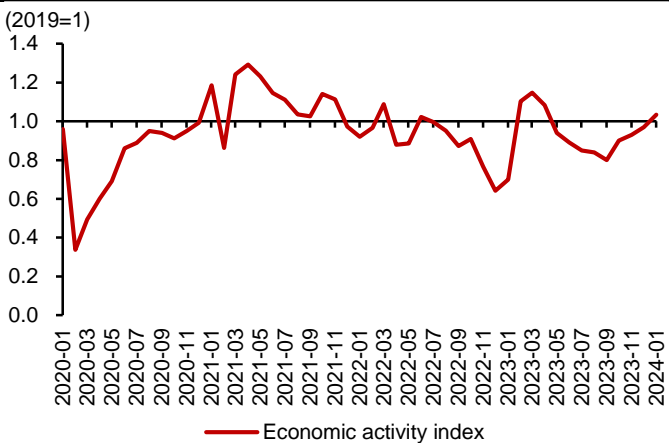
Source: Wind, CMBIGM

Figure 12: China Predicted GDP Growth



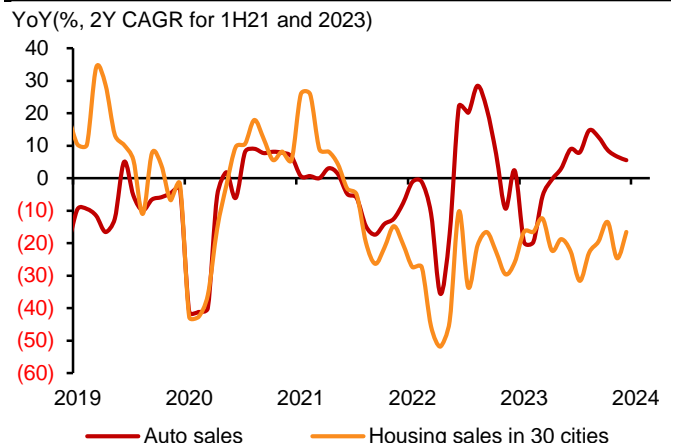
Source: Wind, CMBIGM estimates

Figure 13: China Economic Activity Index



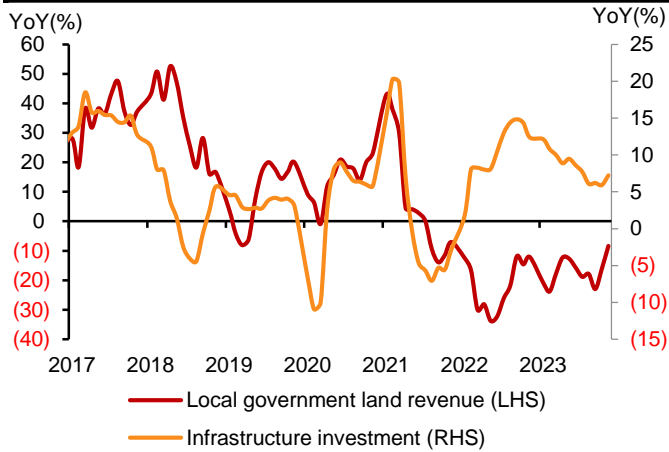
Source: Wind, CMBIGM

Figure 14: China Auto & Housing Sales



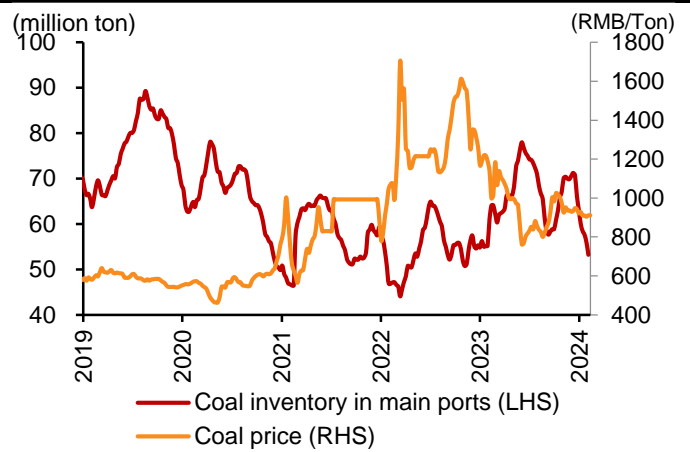
Source: Bloomberg, CMBIGM

Figure 15: Infrastructure Investment in China



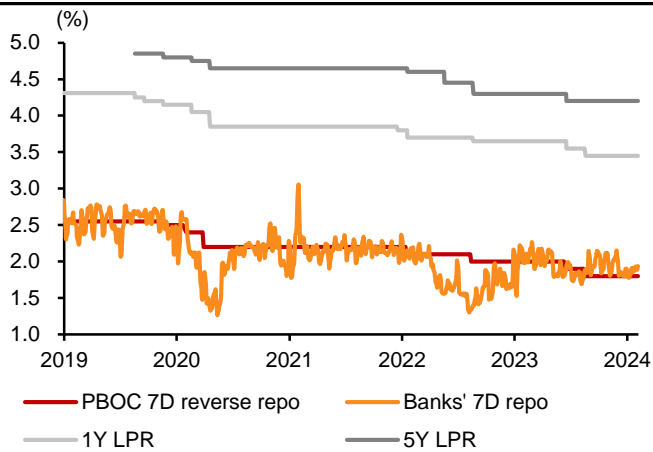
Source: Bloomberg, CMBIGM

Figure 16: China Coal Inventory & Price



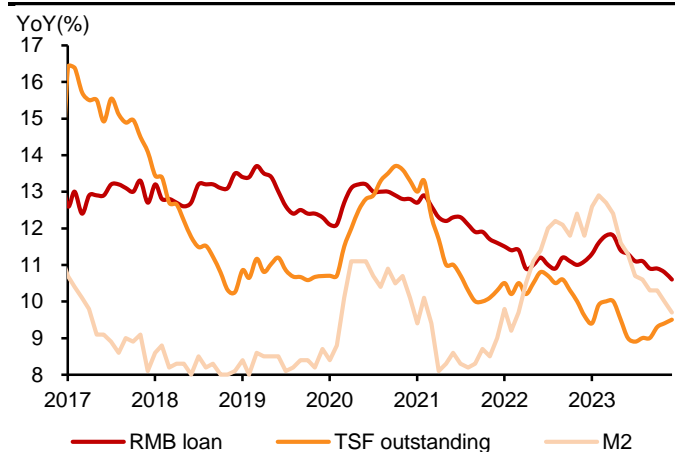
Source: Wind, CMBIGM

Figure 17: PBOC Policy Rates & Liquidity Condition



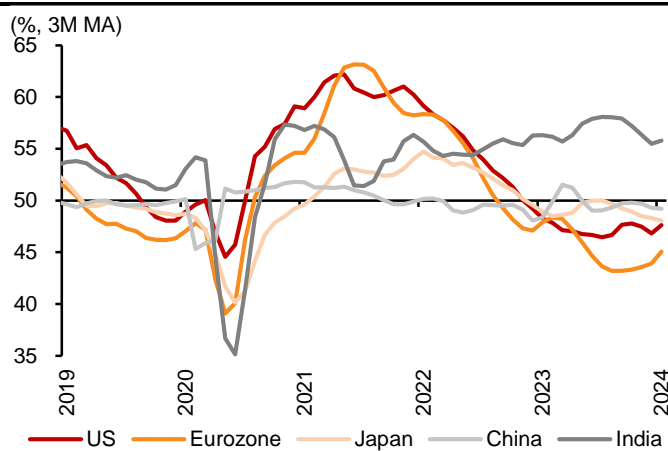
Source: Bloomberg, CMBIGM

Figure 18: China Credit Growth



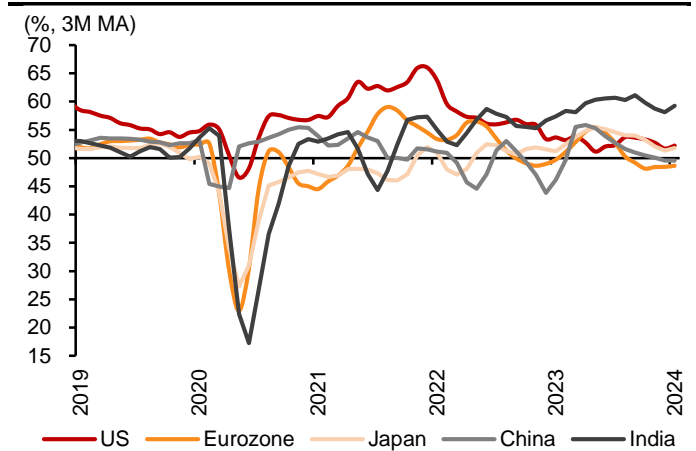
Source: Wind, CMBIGM

Figure 19: Manufacturing PMI of Major Economies



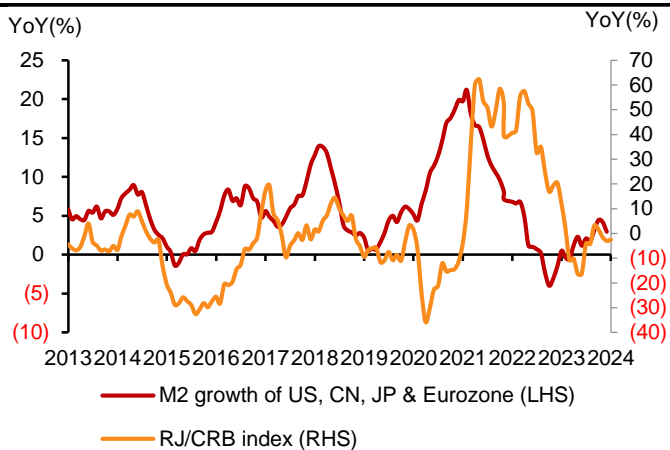
Source: Bloomberg, CMBIGM

Figure 20: Service PMI of Major Economies



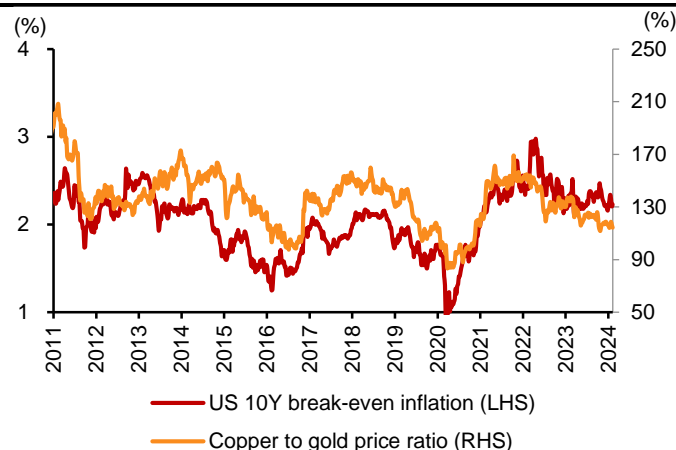
Source: Wind, CMBIGM

Figure 21: M2 Growth & Commodity Inflation



Source: Bloomberg, CMBIGM

Figure 22: Copper-to-gold Ratio



Source: Wind, CMBIGM

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