

# China Economy

## China braces for mild reflation with credit

China's CPI growth returned to positive at 0.1% from contraction as we expected. The rebound of CPI was mainly caused by the resurgence of services and energy prices. The demand in durables was still worryingly weak as CPI growth in durables further deteriorated. Core CPI remained unchanged. China's PPI narrowed its YoY declines thanks to rallying raw material prices especially in mining and energy sector. Looking forward, we see a mild reflation in both CPI and PPI with continuous credit loosening, gradual demand improvement and alleviation of the de-stocking. 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 gradual improvement of industrial earnings ahead. But the low consumer inflation with continuous deflation in the industry indicates most sectors will still face tough competition with over-capacity pressure.

- CPI growth rebounded back to positive as services and energy prices rallied.** CPI picked up 0.1% YoY in August after dropping 0.3% in July. The positive CPI growth is mainly driven by the services and energy sector. Services CPI growth accelerated to 1.3% in August from 1.2% in July although its MoM growth slowed. Energy price rebounded as vehicle fuel narrowed its YoY decline from 13.2% to 4.5% and public utility price returned to positive at 0.3% after dropping 0.1%. The YoY growth of food CPI remained unchanged in August while its MoM growth rose to 0.5% from -1% in July as pork price notably increased 11.4% MoM. Core CPI growth remained unchanged at 0.8%. Demand in durables, which had the greatest impact on production output, was still alarmingly fragile as CPI in transport vehicles, home appliances and telecom equipment further declined. But CPI growth in travel continued to grow at historic high during the first summer holiday following the pandemic came to an end. Employment condition remained challenging with slight improvement as housing rent slightly declined. Medicines, medical service, home service, recreational services and apparel kept the reflation trend as demand in these sectors continued to recover.
- PPI narrowed its decline due to the rebound of commodity prices.** PPI declined 3% YoY in August after dropping 4.4% YoY in July, which has been in contraction for 11 months. The decline of PPI in coal mining, oil & gas mining, ferrous metal respectively narrowed to 16.2%, 10.6% and 6.6% after dropping 19.1%, 21.5% and 10.6% in July while non-ferrous metal rebounded to positive growth at 1.4% from -1% YoY growth to 1.4%. From the MoM perspective, PPI returned to positive growth at 0.2% in August after dipping 0.2% in July. Prices of crude oil & gas and petroleum significantly increased 5.6% and 5.4% MoM in August. However, prices of non-metal mineral products, coal, paper products and computers & electronics declined by 1.2%, 0.8%, 0.7% and 0.4% MoM in August. The moving trend of PPI growth is highly related to the inventory cycle as the shrinkage of PPI decline indicates an alleviation of de-stocking in most industries.
- We see a mild reflation in CPI and PPI with continuous credit loosening, gradual demand improvement and slowdown of de-stocking effect ahead.** The recent policy moves indicate a more pro-growth policy stance. We see additional monetary policy loosening, credit supply boost and property

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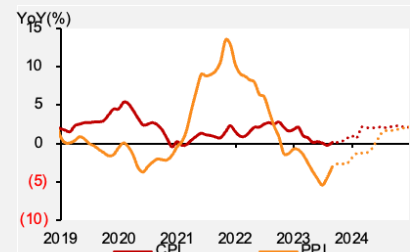
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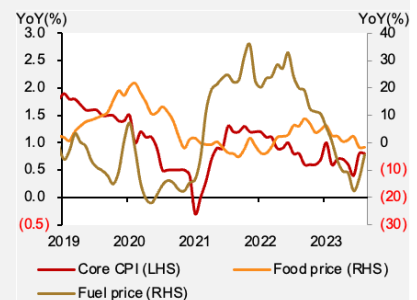
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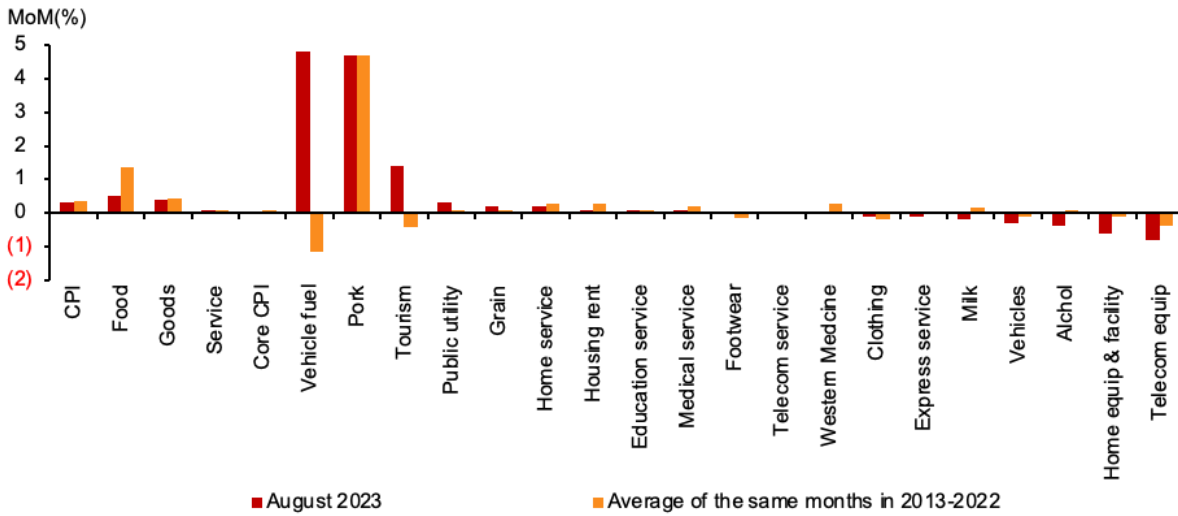
Forecast numbers from Aug 2023  
Source: Wind, CMBIGM



Source: Wind, CMBIGM

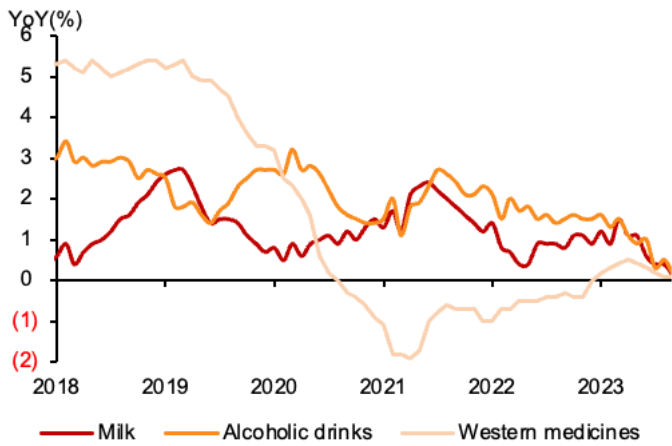
policy stimulus in future. Domestic demand may gradually stabilize with mild improvement. The de-stocking effect may gradually alleviate with demand improvement and commodity price rebound. China will brace for mild deflation with a moderate rise in CPI growth and gradual shrinkage of PPI decline in next 2-3 quarters. 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 August**



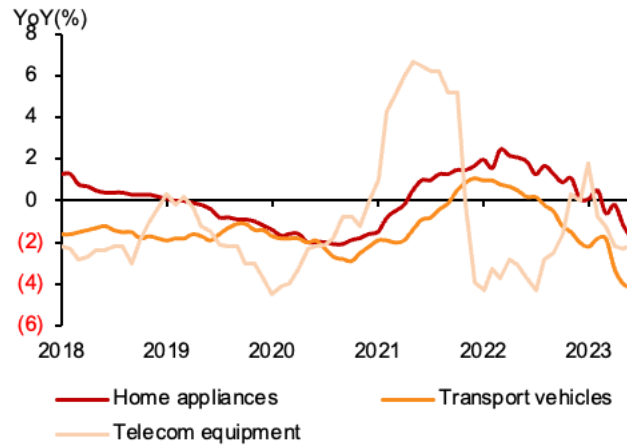
Source: Wind, CMBIGM estimates

**Figure 2: China CPI Growth in Staples**



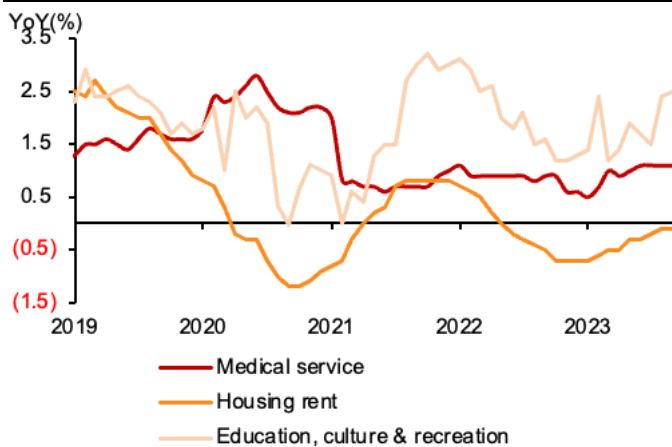
Source: Wind, CMBIGM

**Figure 3: China CPI Growth in Durables**



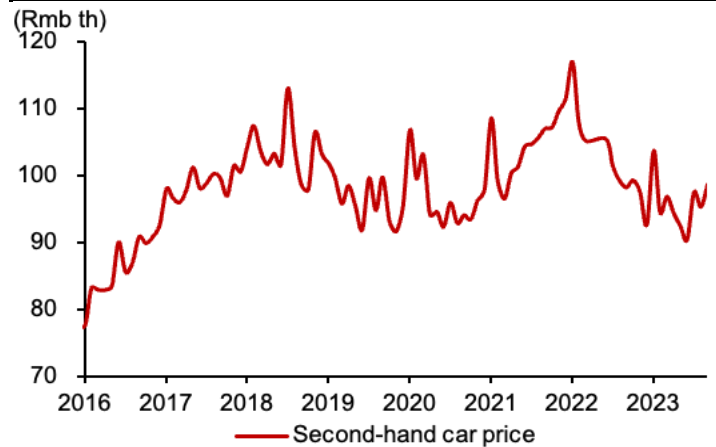
Source: Wind, CMBIGM

**Figure 4: China CPI Growth in Services**



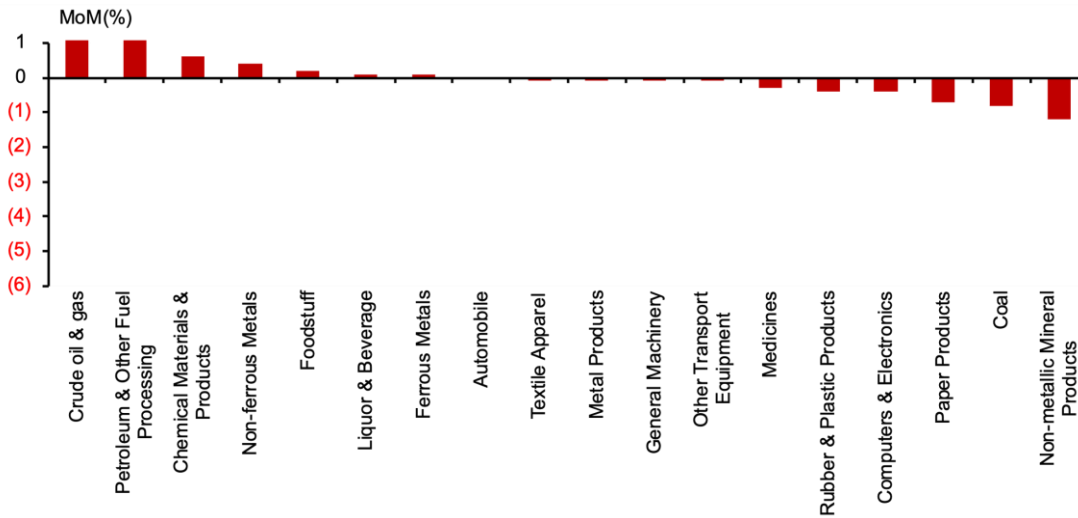
Source: Wind, CMBIGM

**Figure 5: Second-hand Car Price in Shanghai**



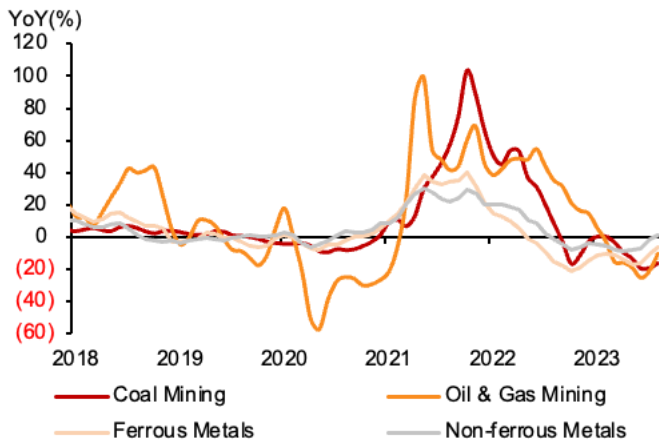
Source: Wind, CMBIGM

**Figure 6: MoM Changes of China PPI in August**



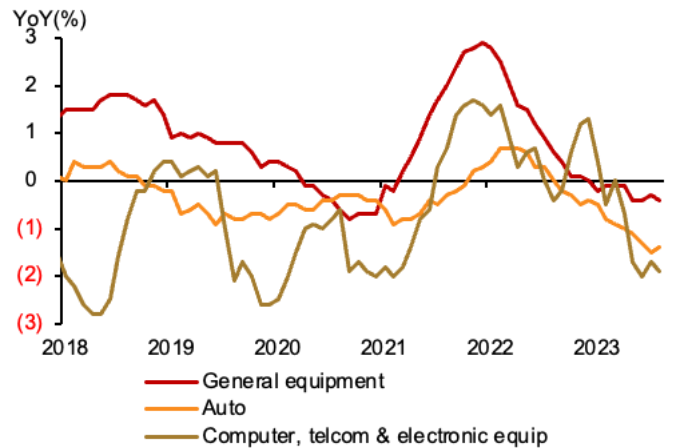
Source: Wind, CMBIGM estimates

**Figure 7: China PPI in Energy & Metal**



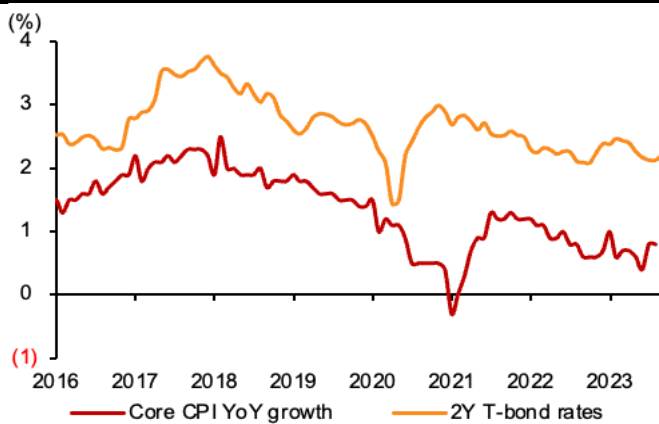
Source: Wind, CMBIGM

**Figure 8: China PPI in Equipment**



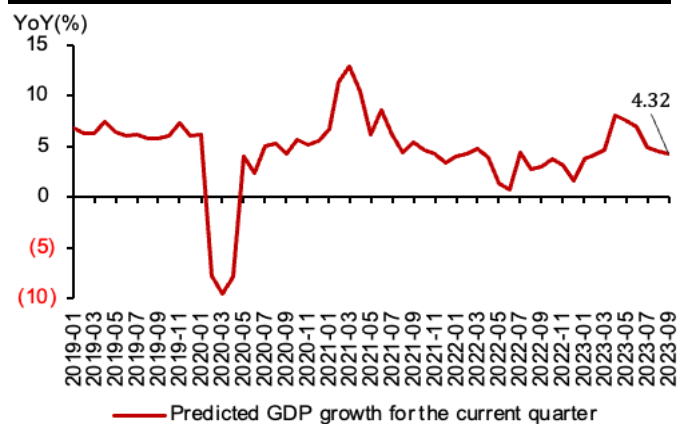
Source: Wind, CMBIGM

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



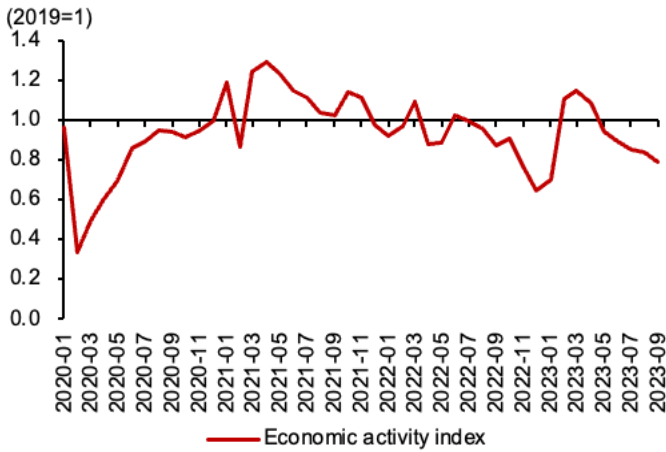
Source: Wind, CMBIGM

**Figure 10: China Predicted GDP Growth**



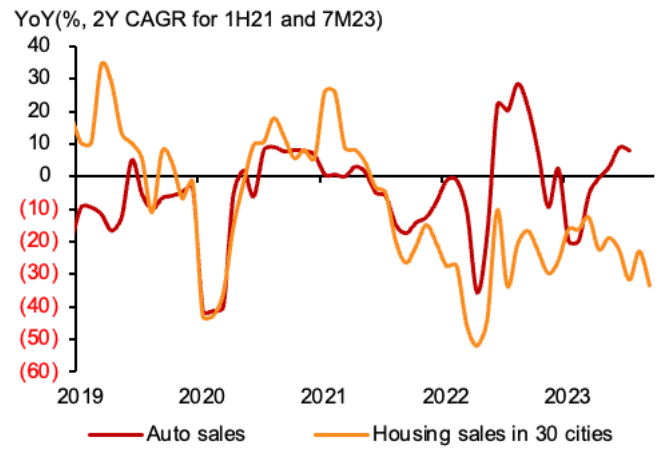
Source: Wind, CMBIGM

**Figure 11: China Economic Activity Index**



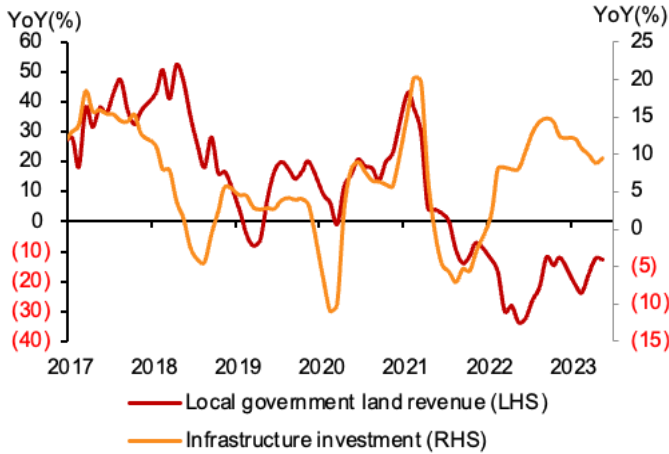
Source: Wind, CMBIGM

**Figure 12: China Auto & Housing Sales**



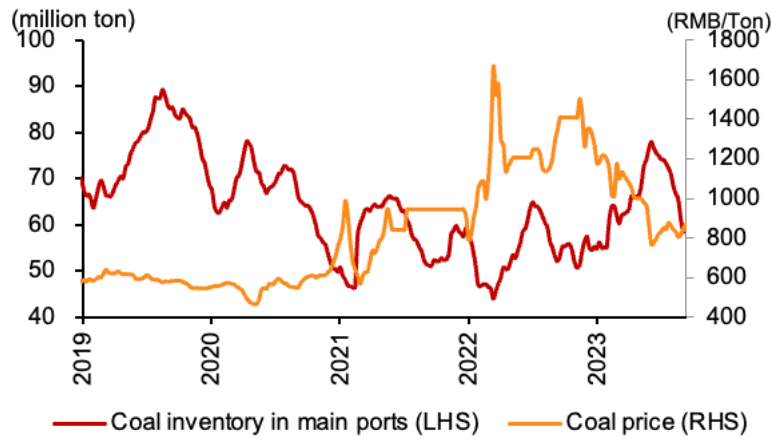
Source: Bloomberg, CMBIGM

**Figure 13: Infrastructure Investment in China**



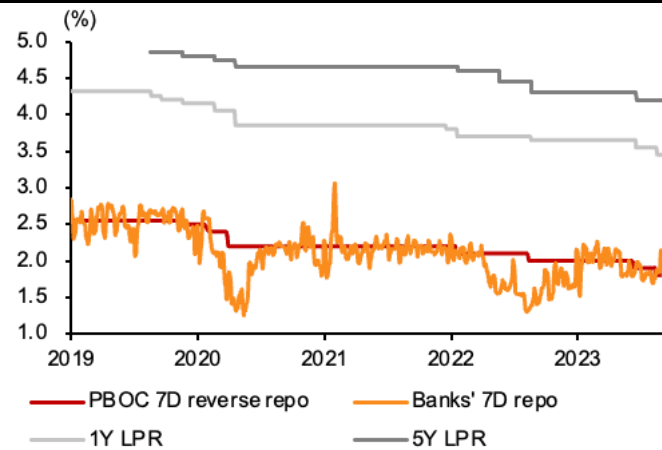
Source: Bloomberg, CMBIGM

**Figure 14: China Coal Inventory & Price**



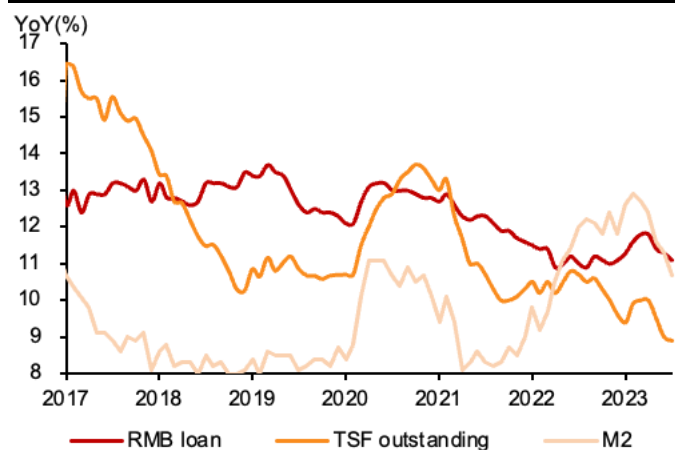
Source: Wind, CMBIGM

**Figure 15: PBOC Policy Rates & Liquidity Condition**



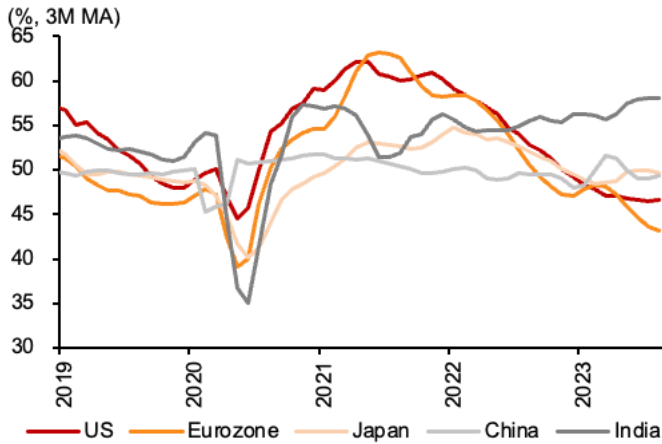
Source: Bloomberg, CMBIGM

**Figure 16: China Credit Growth**



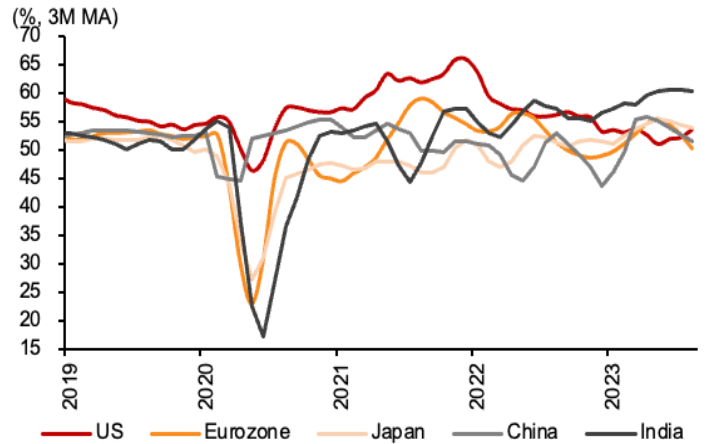
Source: Wind, CMBIGM

**Figure 17: Manufacturing PMI of Major Economies**



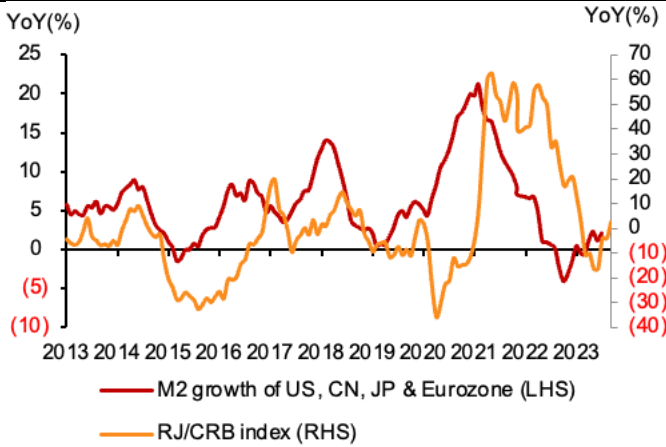
Source: Bloomberg, CMBIGM

**Figure 18: Service PMI of Major Economies**



Source: Wind, CMBIGM

**Figure 19: M2 Growth & Commodity Inflation**



Source: Bloomberg, CMBIGM

**Figure 20: Copper-to-gold Ratio**



Source: Wind, CMBIGM

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