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China Economy

Deflationary pressures set to ease but impulse remained weak

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China continues to experience mild reflation, primarily driven by food prices and lower base effect. Core CPI remained unchanged as the surge in gold prices, alongside a rebound in discretionary items such as footwear and apparel, constituted the primary drivers, while durable goods including vehicles, telecom equipment and home appliances remained subdued. PPI edged down on a higher base last year, though its MoM reading registered a second consecutive gain for the first time since 2023. Seasonal factors lifted prices in heat-related industries such as coal processing and heat production, while rebounds in international non-ferrous metals prices pushed up costs in associated sectors. We expect deflationary pressures to ease in 2026, but the momentum should remain weak. We believe the surging gold prices have masked the underlying fragility of the 2025 reflation trend, while muted durable-goods prices and consumer demand cast doubt on the sustainability of a supply-pull reflation. We expect the CPI and PPI to reflate from 0% and -2.7% in 2025 to 0.7% and -0.5% in 2026.

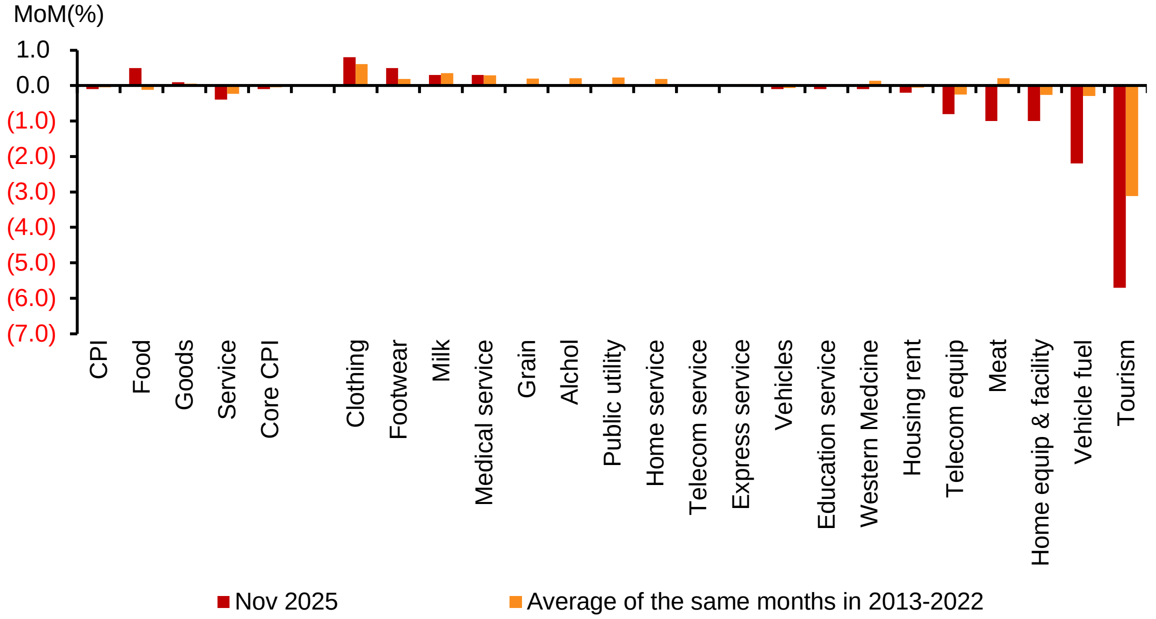
- **Food price drove the rebounding CPI.** China's CPI YoY rebounded to 0.7% in Nov from 0.2% in Oct, in line with market expectation, marking its strongest reading since early 2024. Nonetheless, CPI dipped to -0.1% in Nov from 0.2% in Oct in sequential terms. Food price was the key driver, climbing 0.5% MoM in Nov, with YoY momentum turning positive to 0.2% from -2.9%. Vegetable price notably rebounded by 7.2% MoM, boosting headline CPI by 0.17 ppt, while pork price saw another drop at -2.2% in Nov. Vehicle fuel price dropped 2.2% MoM due to falling crude oil price. We expect the CPI to recover to 0.8% YoY in Dec due to lower base last year and reflating food price especially vegetables, while high frequency data indicated the prices of pork and vehicle fuel remained subdued.

- **Core CPI stayed elevated.** Core inflation stayed flat at 1.2% YoY in Nov, but dropped 0.1% MoM. Price of durable goods remained subdued, as home equipment, telecom equipment and vehicles dropped 1%, 0.8% and 0.1% MoM respectively. Discretionary goods including clothing and footwear have been particularly strong recently, rising 0.8% and 0.5% MoM in Nov. According to the NBS, gold jewellery remarkably rose to 58.4% YoY in Nov from 50.3%, contributing at least 0.4pp to core inflation. Service price dropped to -0.4% MoM in Nov, as tourism price sharply declined by 5.7%. Other services were lethargic as education and rent dropped 0.1% and 0.2% MoM while express, telecom and home service remained flat. Medical service has been reflating since Apr, expanding 0.3% MoM in Nov, reflecting the impact of medical service price reforms.

- **PPI growth edged down YoY but continued to expand MoM.** YoY contraction of PPI edged down to -2.2% in Nov from -2.1% due to higher base last year, missing the market expectation at -2%. The MoM growth increased for a second month, rising 0.1%. PPI of mining industries was the major driver, rebounding 1.7% MoM in Nov, driven by the 4.1% and 2.6% growth of extraction of coal and non-ferrous metals, while the mining of crude oil and gas declined 2.4%. PPI of raw material sectors dropped 0.2% while processing sectors rose 0.1%. Price of paper manufacturing and non-ferrous metals processing rebounded by 1.4% and 2.1%. NBS officials pointed out that YoY price contraction has continued to narrow in major anti-involution sectors, including photovoltaic equipment, lithium batteries and NEVs. Downstream sectors remained subdued, as PPI of consumer goods stayed flat at 0% MoM. Non-durable goods rebounded, while durable goods further dropped 0.2% in Nov as auto declined by 0.1%.

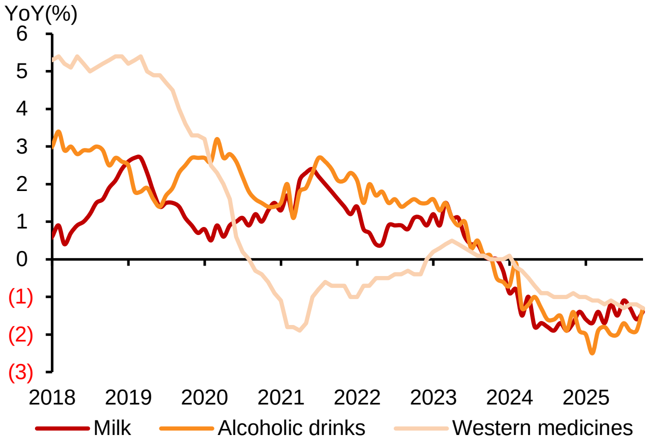
- **Deflation pressures are set to ease, but the reflation momentum remains weak.** We expect the CPI and PPI to reflate from 0% and -2.7% in 2025 to 0.7% and -0.5% in 2026. CPI will be driven by rebounding food price, narrowing decline of energy price and moderately recovering services price, while PPI will be driven by easing monetary cycle in the US and China, fiscal expansion in the EU and Japan, and continuous anti-involution efforts from China. However, the rise in gold prices may have masked the underlying fragility of the reflation trend in CPI, as CPI excluding the impact of gold price may have been close to negative. The subdued prices of durable goods also reflected soft consumer demand, casting doubt on the durability of a supply-pull reflation.

Figure 1: MoM Changes of China CPI in Nov



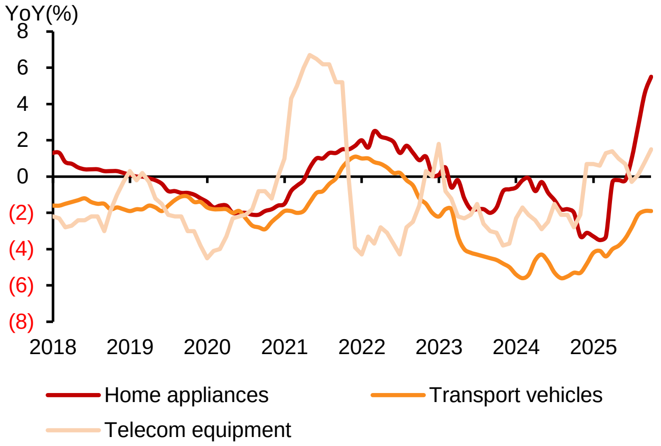
Source: Wind, CMBIGM

Figure 2: China CPI growth in staples



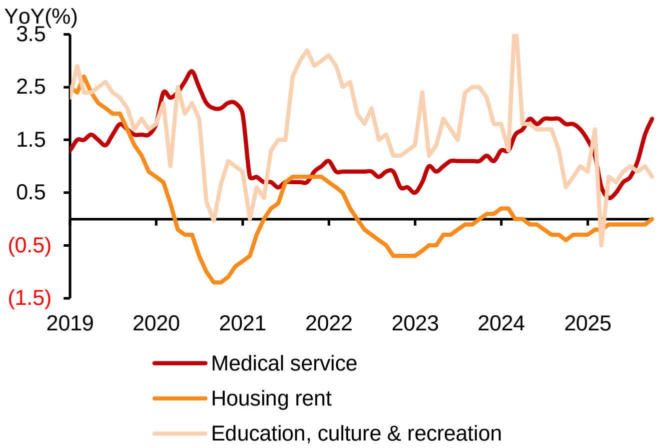
Source: Wind, CMBIGM

Figure 3: China CPI growth in durables



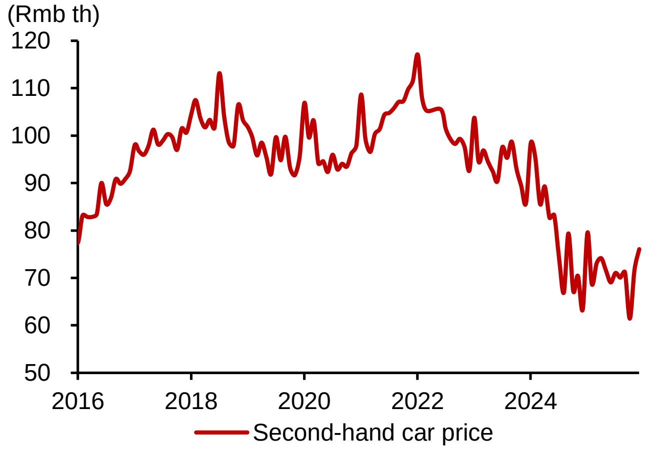
Source: Wind, CMBIGM

Figure 4: China CPI growth in services



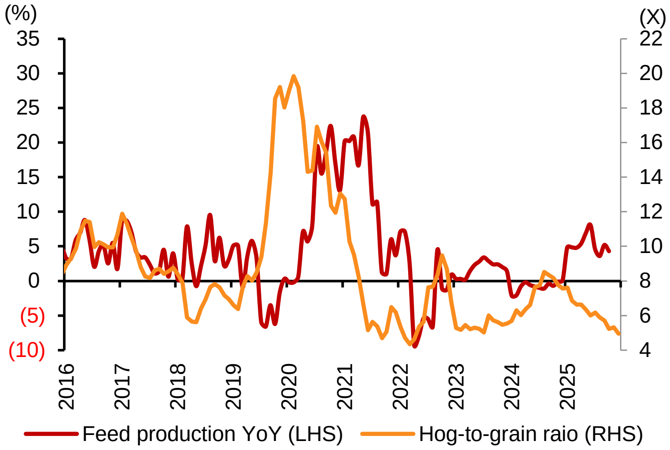
Source: Wind, CMBIGM

Figure 5: Second-hand car price in Shanghai



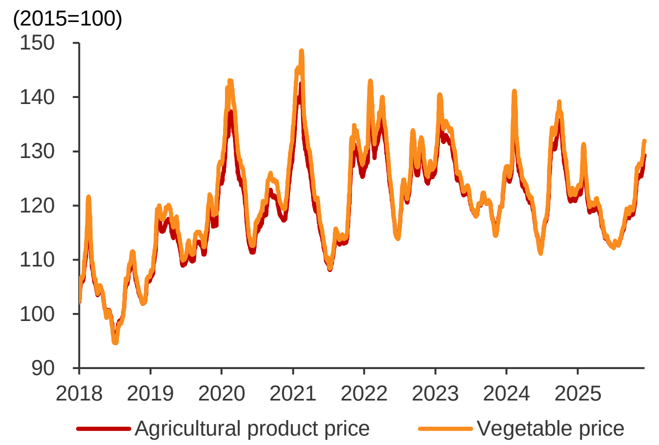
Source: Wind, CMBIGM

Figure 6: Feed production & hog-to-grain ratio



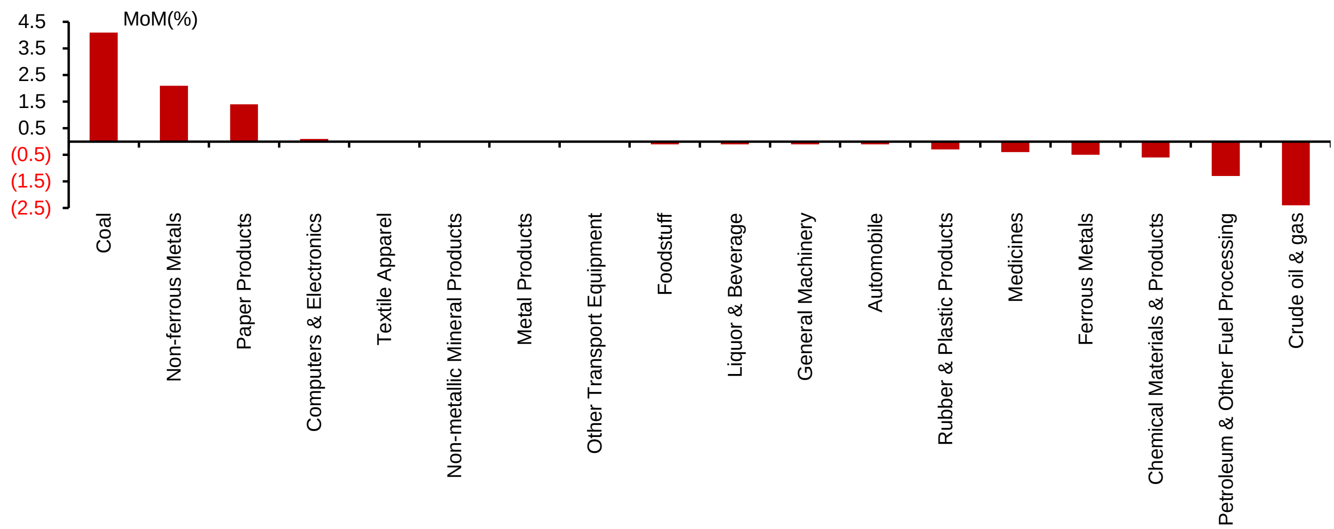
Source: Wind, CMBIGM

Figure 7: Agricultural and vegetable price



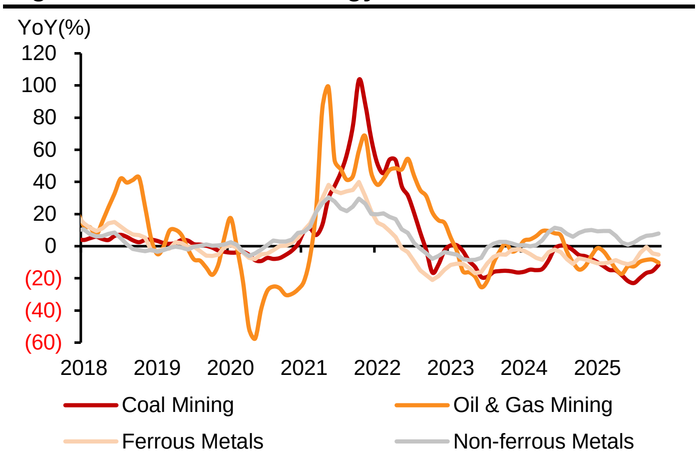
Source: Wind, CMBIGM

Figure 8: MoM changes of China PPI in Nov



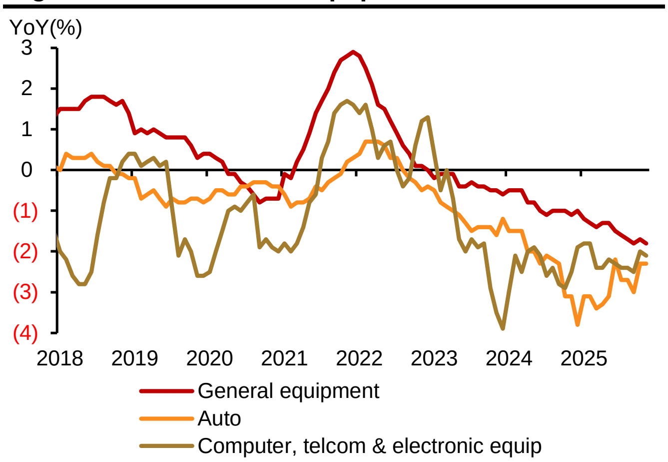
Source: Wind, CMBIGM

Figure 9: China PPI in energy & metals



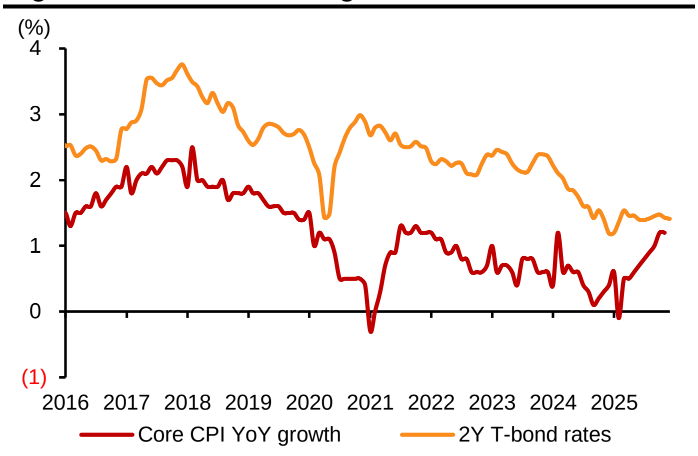
Source: Wind, CMBIGM

Figure 10: China PPI in equipment



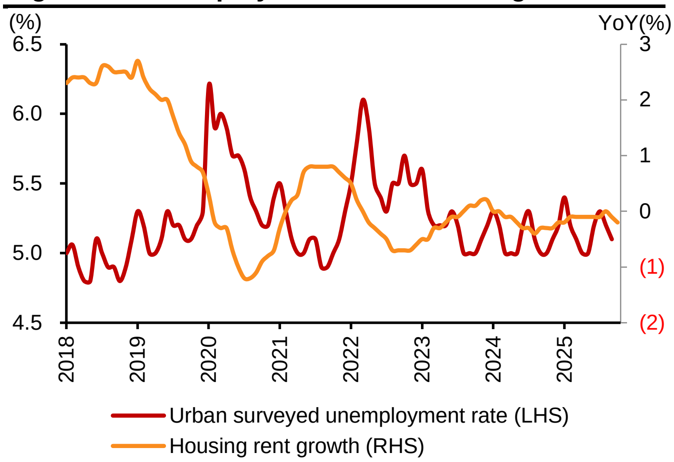
Source: Wind, CMBIGM

Figure 11: China core CPI growth & 2Y T-bond rates



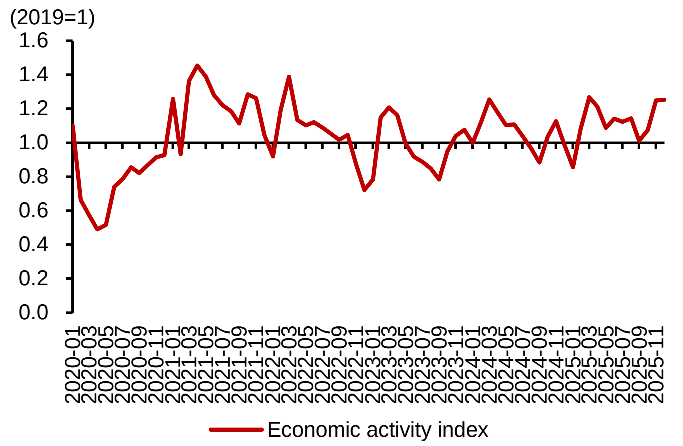
Source: Wind, CMBIGM

Figure 12: Unemployment rate and rent growth



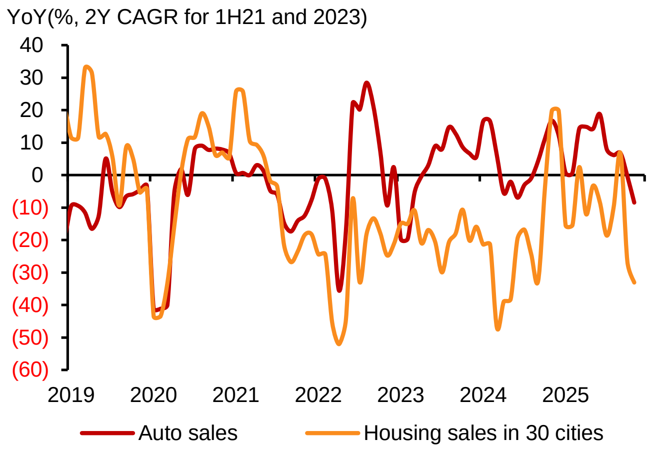
Source: Wind, CMBIGM estimates

Figure 13: China Economic Activity Index



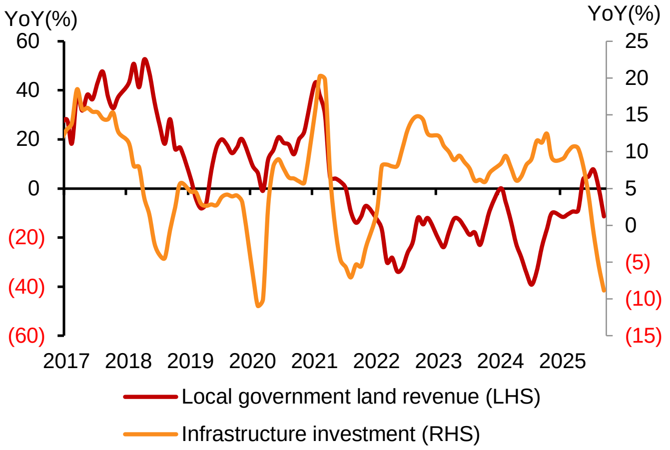
Source: Wind, CMBIGM

Figure 14: China auto & housing sales



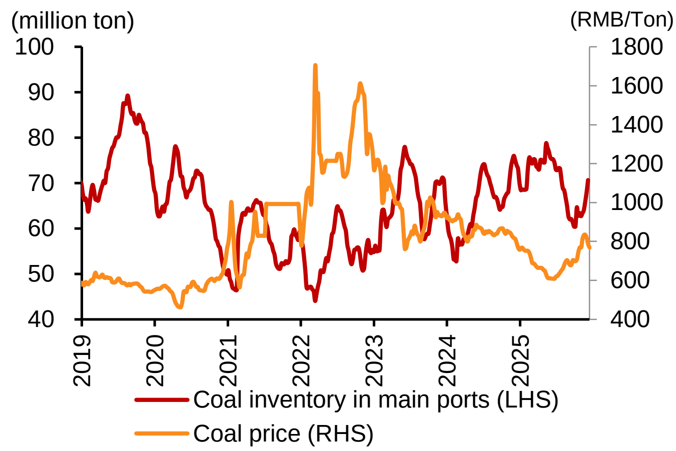
Source: Bloomberg, CMBIGM

Figure 15: Infrastructure investment in China



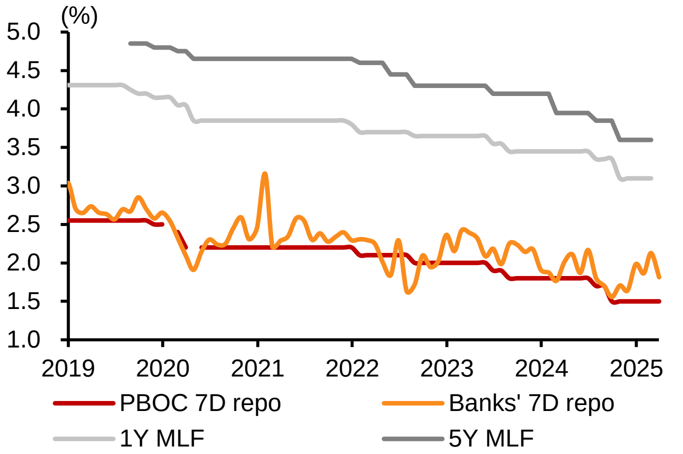
Source: Bloomberg, CMBIGM

Figure 16: China coal inventory & price



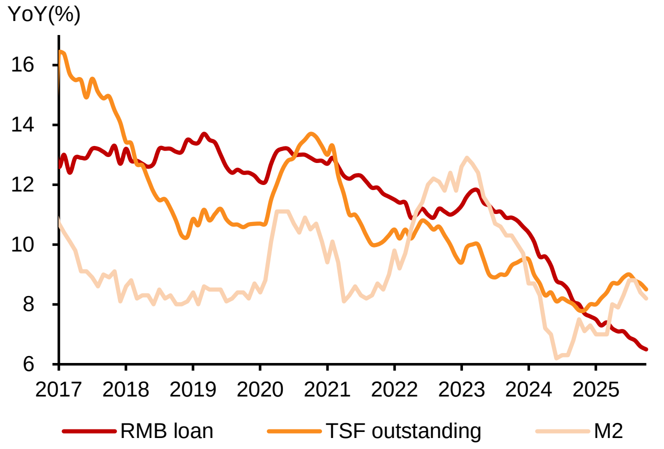
Source: Wind, CMBIGM

Figure 17: PBOC policy rates & liquidity condition



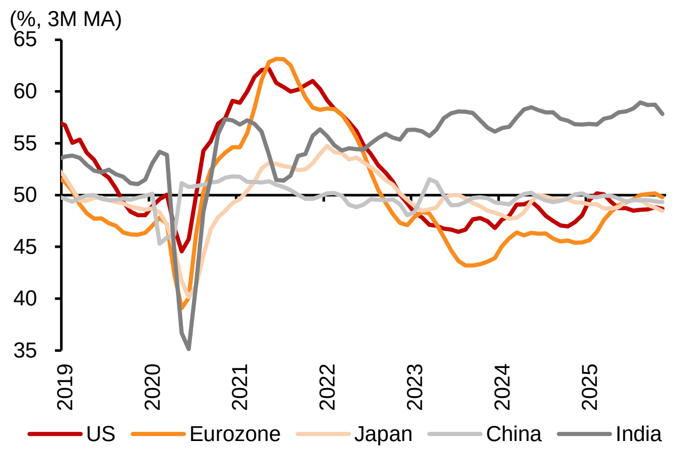
Source: Bloomberg, CMBIGM

Figure 18: China credit growth



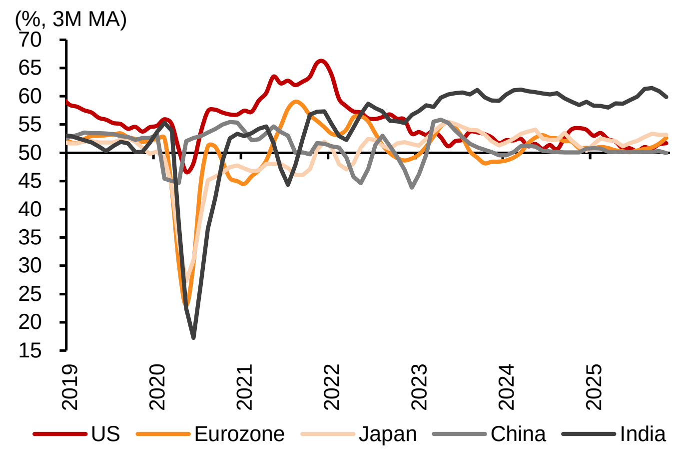
Source: Wind, CMBIGM

Figure 19: Manufacturing PMI of major economies



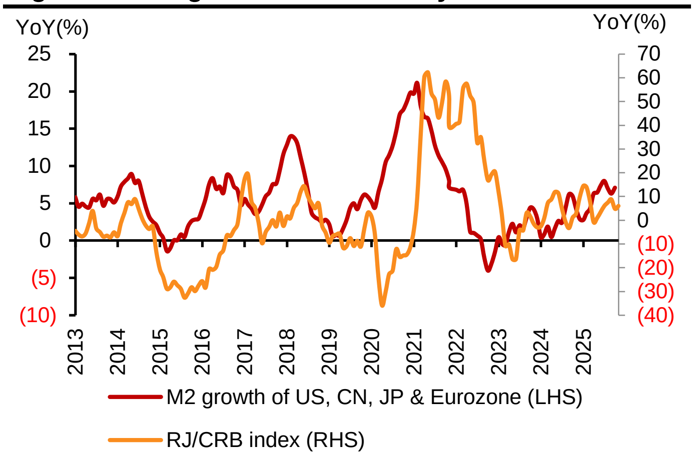
Source: Bloomberg, CMBIGM

Figure 20: Service PMI of major economies



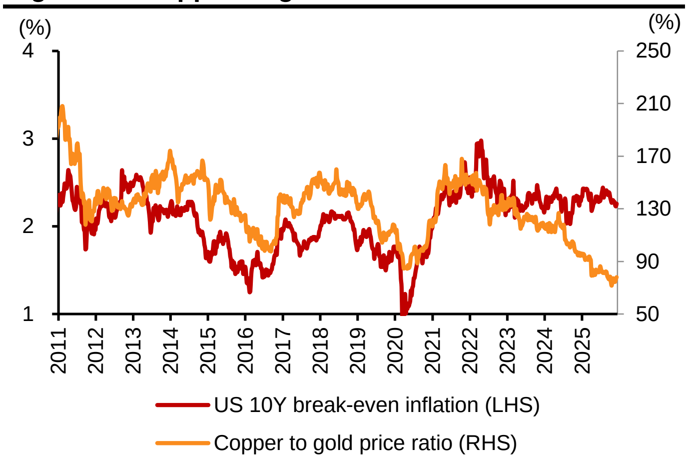
Source: Wind, CMBIGM

Figure 21: M2 growth & commodity inflation



Source: Bloomberg, CMBIGM

Figure 22: Copper-to-gold ratio



Source: Wind, CMBIGM

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