

China Economy

Inflation declines as aggregate demand remains weak

China's CPI growth was far below expectations in February as consumer demand remained weak and the fluctuation of pork supply caused its price collapse. Durable prices continued to decline, while housing rent and service cost mildly improved. PPI further declined as global demand for goods remained weak while strong service inflation caused stronger Fed tightening. We expect China's inflation may further decline in next 2-3 months and then pick up in 2H23-2024 as the economy continues to recover. The reflation should be mild for China as domestic demand recovery is in a gradual manner and overseas economy may see a recession. The weak reflation indicates that China continues to have negative output gap this year. The country has to maintain easing credit policy to support the growth.

- CPI growth dropped to the lowest since last February.** CPI increased 1.0% YoY in February, down from 2.1% in January. Meanwhile, the YoY growth of core CPI declined from 1% to 0.6%, indicating consumer demand remained weak. By item, inflation in staples like milk, alcoholic drinks and medicines mildly climbed as demand increased. However, prices in durables like home appliances, vehicles and telecom equipment continued to decline from the YoY perspective as the demand remained weak. Inflation in education & home service remained low while housing rent continued to decline as labor market was not strong. From the MoM perspective, CPI declined 0.5% in February after rising 0.8% in January. Specifically, pork and tourism prices declined significantly, while the price in vehicle fuel, milk and alcohol drinks rose MoM.
- PPI further declined as commodities prices retreated with expectations of stronger Fed tightening and higher recession risk.** PPI dropped 1.4% YoY in February after decreasing 0.8% in January. From the MoM perspective, PPI held flat in February compared to a decline of 0.4% in January. Global commodities prices continued to decline as investors expected stronger Fed tightening and higher recession risk ahead. In February, non-metal mineral products, rubber & plastic products and general equipment dropped 0.7%, 0.3% and 0.2% MoM, respectively. As the reopening improved traffic mobility and demand for energy, PPI in crude oil & natural gas rose 1.7% MoM, while petroleum & coal processing price increased 0.6% MoM. However, coal prices dropped by 2.2% MoM in February as China expanded coal imports to lower energy costs.
- We maintain forecast for CPI growth at 2.2% and that for PPI growth at -0.5% in 2023.** The CPI growth may remain low in March and April and then gradually climb as the economy continues to resume. We expect the CPI growth to reach 2.2% in 2023 and 2.5% in 2024. The PPI may further decline in the next two months before gradually improving in 2H23. We expect the PPI to drop 0.5% in 2023 and rise 1.6% in 2024.
- China has to maintain easing credit policy to boost growth.** China's weak reflation indicates its growth remains far below potential this year. The country has to maintain easing credit policy to boost growth. The policymakers may face the pressure to ease policy again after a few months as the domestic recovery pace may slow and overseas economy braces for a recession.

Bingnan YE, Ph.D

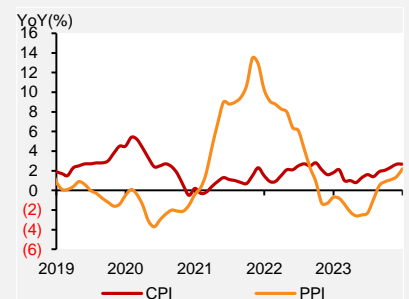
(852) 6989 5170

yebingnan@cmbi.com.hk

Kevin Zhang

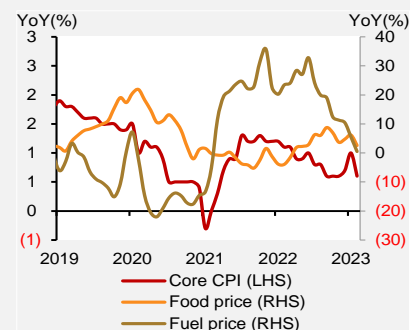
(852) 5336 4682

kevinzhang@cmbi.com.hk



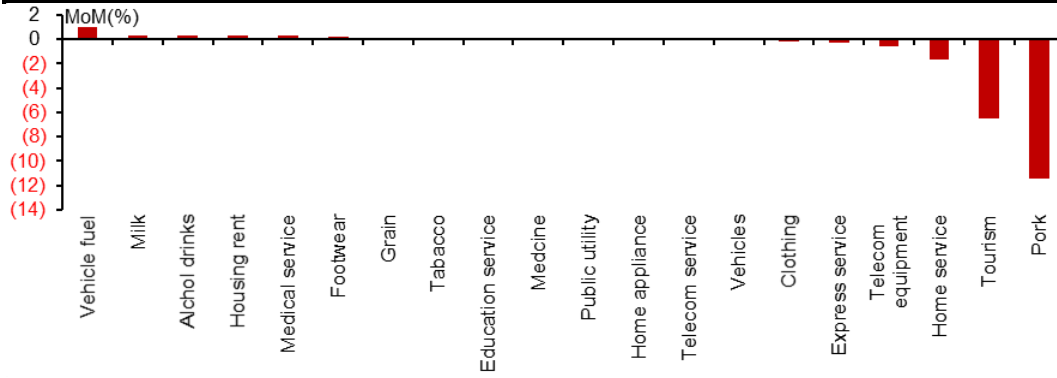
Forecast numbers from March 2023

Source: Wind, CMBIGM



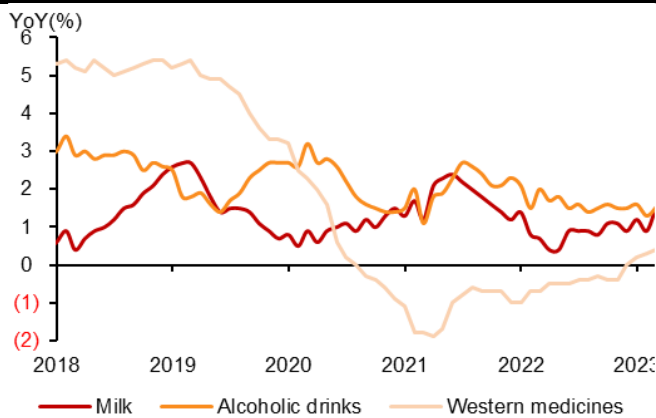
Source: Wind, CMBIGM

Figure 1: MoM Changes of China CPI in February



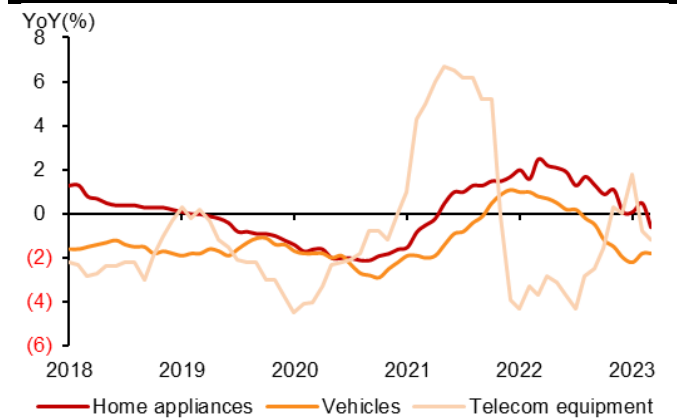
Source: Wind, CMBIGM estimates

Figure 2: China CPI Growth in Staples



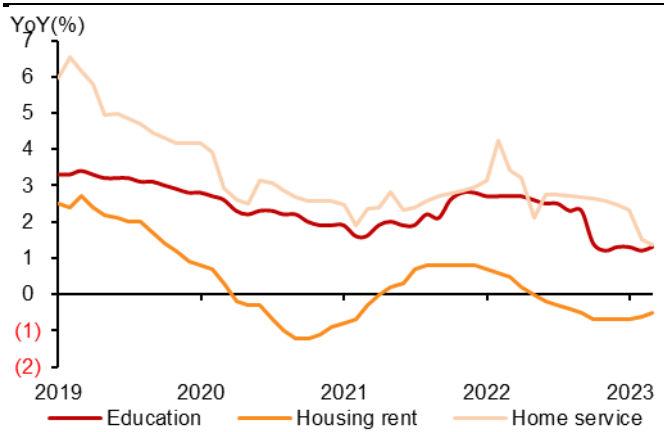
Source: Wind, CMBIGM

Figure 3: China CPI Growth in Durables



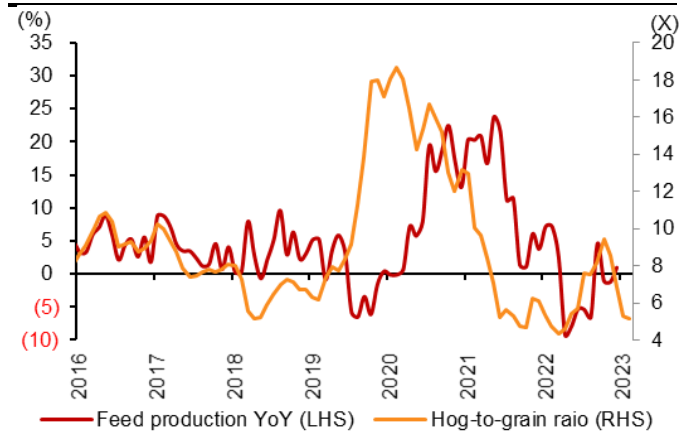
Source: Wind, CMBIGM

Figure 4: China CPI Growth in Services



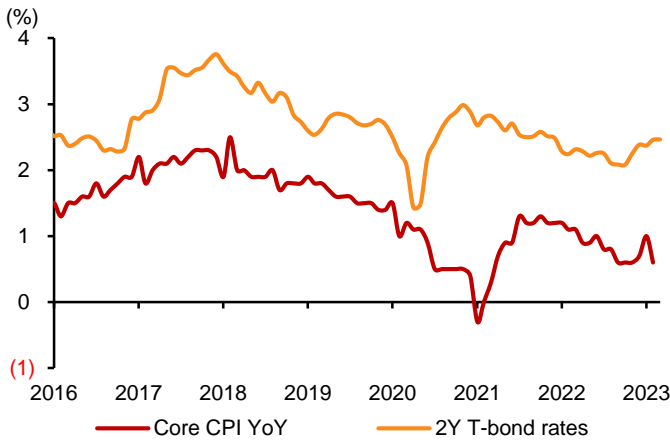
Source: Wind, CMBIGM

Figure 5: Hog-to-grain Ratio in China



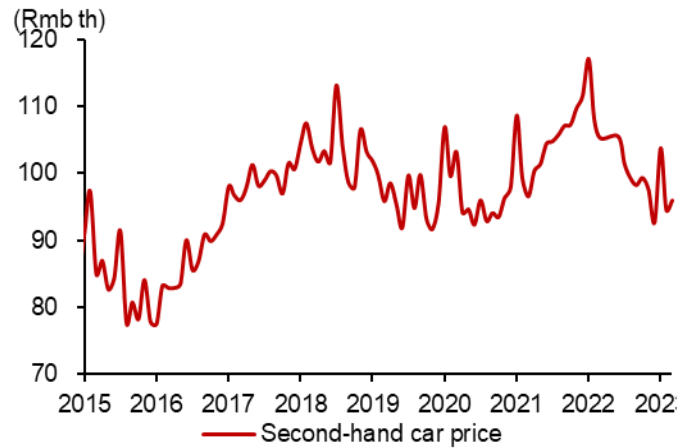
Source: Wind, CMBIGM

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



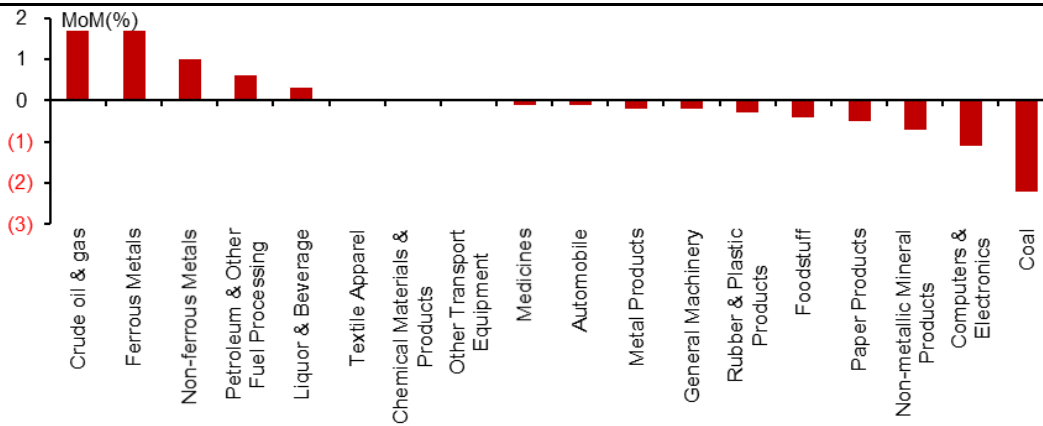
Source: Wind, CMBIGM

Figure 7: China Second-hand Car Price



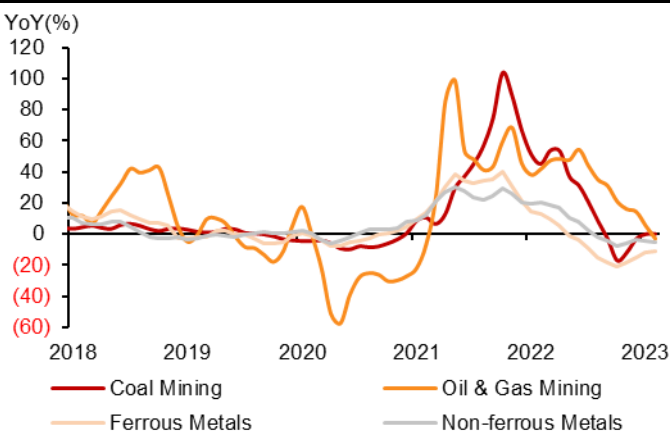
Source: Wind, CMBIGM

Figure 8: MoM Changes of China PPI in February



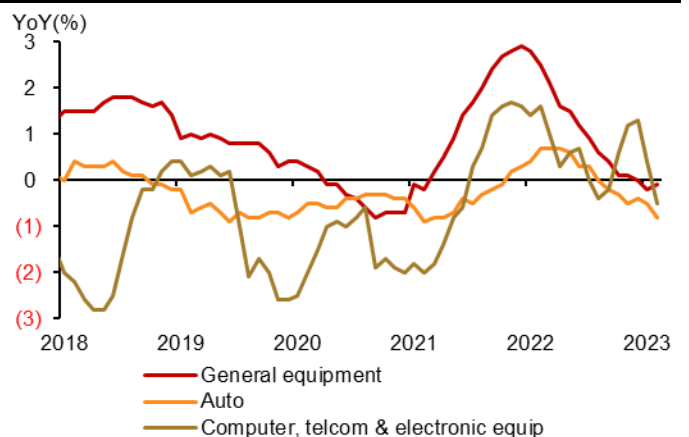
Source: Wind, CMBIGM estimates

Figure 9: China PPI in Energy & Metal



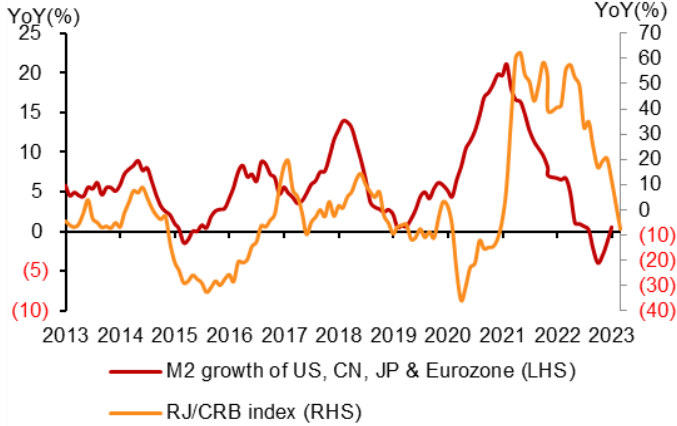
Source: Wind, CMBIGM

Figure 10: China PPI in Equipment



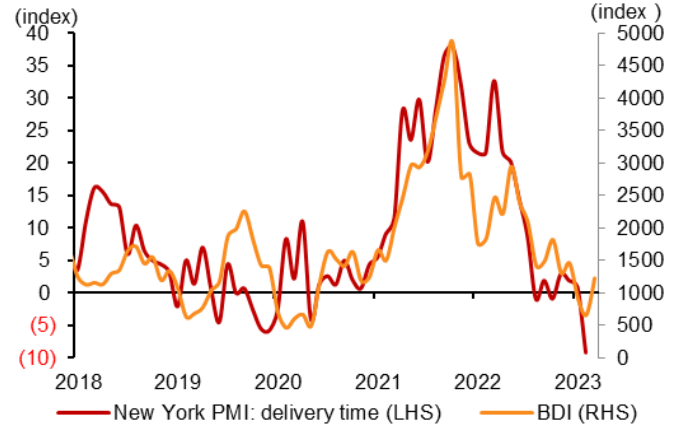
Source: Wind, CMBIGM

Figure 11: Global M2 Growth & Commodity Inflation



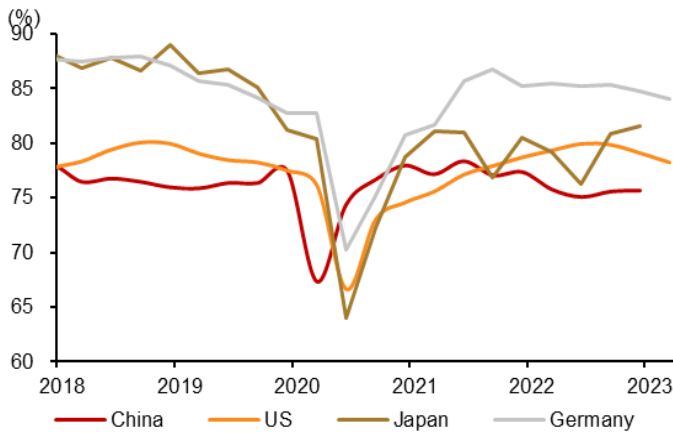
Source: Wind, CMBIGM

Figure 12: Global Supply Chain Pressure



Source: Wind, CMBIGM

Figure 13: Manufacturing Capacity Utilisation Ratio



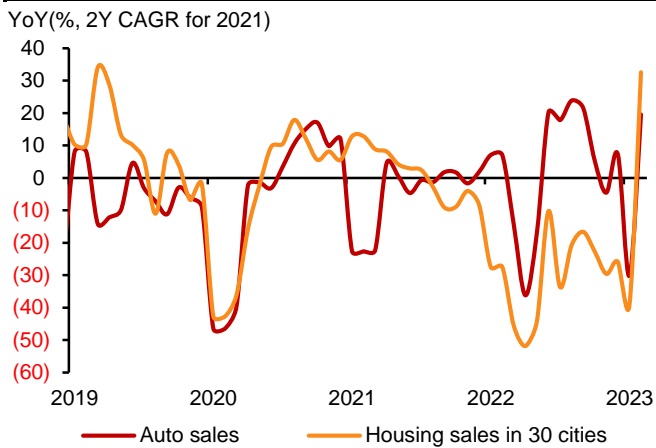
Source: Wind, CMBIGM

Figure 14: Copper-to-gold Ratio



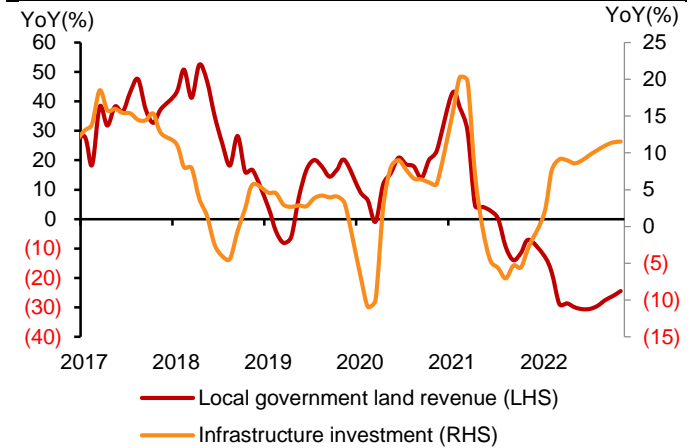
Source: Bloomberg, CMBIGM

Figure 15: China Auto & Housing Sales



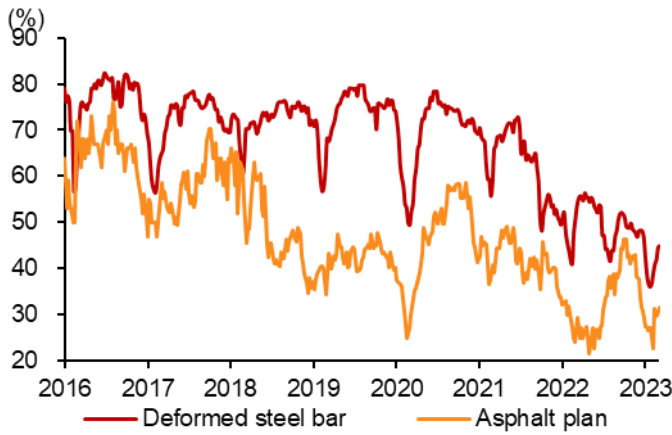
Source: Bloomberg, CMBIGM

Figure 16: Infrastructure Investment in China



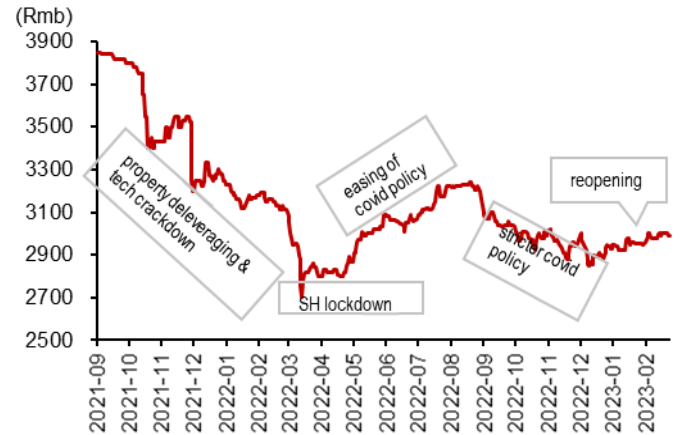
Source: Wind, CMBIGM

Figure 17: Operation Rate in China



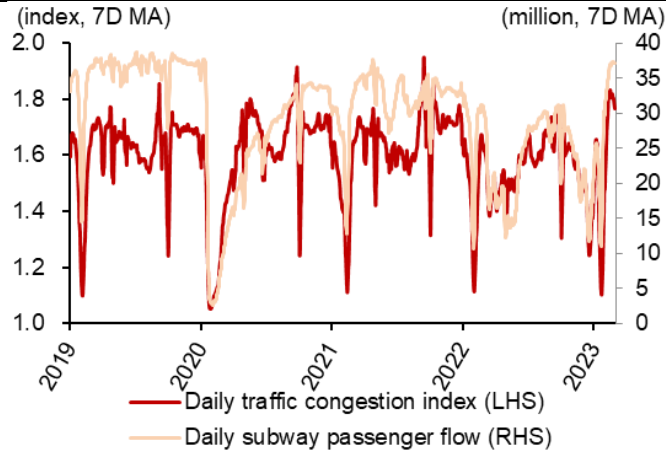
Source: Bloomberg, CMBIGM

Figure 18: MOUTAI Wholesale Reference Price



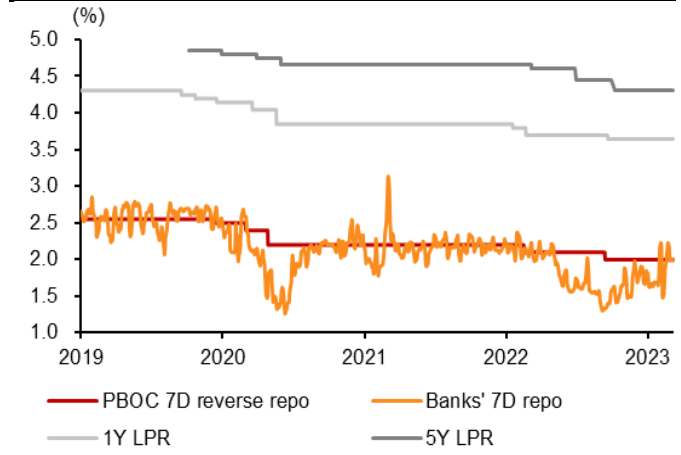
Source: Wind, CMBIGM

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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CMB International Global Markets Limited

Address: 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

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