

China Economy

CPI picks up with possible fine-tuning in liquidity condition

China's CPI gradually picks up as pork price moves into a reflation cycle and service inflation mildly rises amid gradual reopening and resumption. The consumer inflation may peak at 3.3% in September and reach a new high at 3.6% in early 2023. But producer inflation should significantly decline thanks to base effect, supply resumption, China's property investment correction and overseas recession risk. The divergence of consumer and producer inflation is positive for consumer goods and service sector. As consumer inflation moderately rises and housing sales gradually improves in higher tier cities, the PBOC may fine-tune the liquidity condition with mild increase in money market rates. There will be no new stimulus or easing policies ahead. But monetary policy should remain relatively accommodative as the growth is still below potential growth and the resumption remains unbalanced by different regions and sectors. The central bank should maintain easing credit policy to support the economic resumption process.

■ Food price jumped, energy price declined while core CPI remained weak.

Consumer price index (CPI) picked up 2.7% YoY in July after rising 2.5% YoY in June, below expectations. From the MoM perspective, CPI rose 0.5% in July thanks to increases of pork, vegetables and some service items like air ticket, hotel charge, vehicle rental fee and tourism service price. But petroleum product price decreased as global oil prices slumped in July. Core CPI slightly rose 0.1% MoM in July, the same as June, as consumption remained weak.

■ **PPI further slowed amid divergence for different commodities.** The YoY growth of producer price index (PPI) slowed from 6.1% in June to 4.2% in July. From the MoM perspective, the PPI dropped 1.3% in July after seeing zero growth in June, as oil, non-ferrous metal, ferrous metal and coal prices declined. As global market was priced in gradual supply resumption and recession risk, both oil and non-ferrous metal prices experienced correction in July. Ferrous metal and construction material prices dropped as China's property development investment continued to shrink. Coal prices also declined as coal production continued to increase. Producer inflation in equipment sector remained tepid as business capex remained weak.

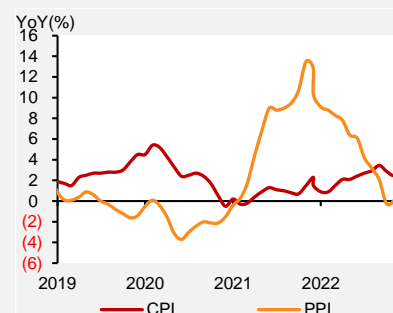
■ **Consumer inflation on an uptrend in 2H22-1Q23.** The YoY growth of CPI should rise to above 3% in September, decline in 4Q22 and increase again in 1Q23. We expect the CPI growth to reach 2.3% in 2022 and 2.7% in 2023. Firstly, food inflation will further rise as live hog sector sees a de-capacity and reflation cycle. Secondly, service inflation should mildly rise amid gradual resumption of service consumption. Thirdly, energy and grain inflation may experience some fluctuations with a gradual decline thanks to supply resumption and base effect.

■ **Producer inflation in a slowdown in 2H22-1H23.** The YoY growth of PPI will gradually decline in next 3-4 quarters due to decreases of commodity prices and the base effect. The PPI is expected to increase by 4.8% in 2022 before slightly dropping 1% in 2024. First, energy and metal prices should gradually decline as supply improves and demand softens. The supply improvement reflects global resumption progress from the pandemic shock and Russia-Ukraine war. The demand softening is because of Fed tightening,

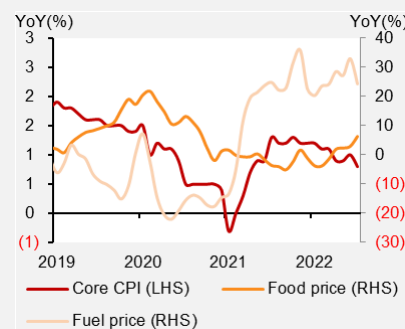
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Source: Wind, CMBIGM

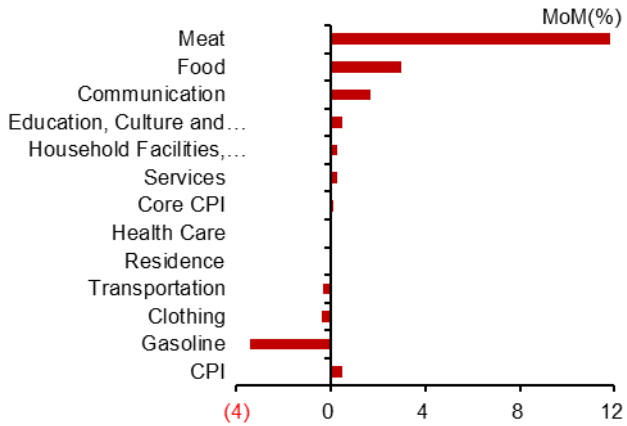


Source: Wind, CMBIGM

global recession risk and China property investment correction. Second, the base effect should cause a natural decline of the YoY growth rates of PPI.

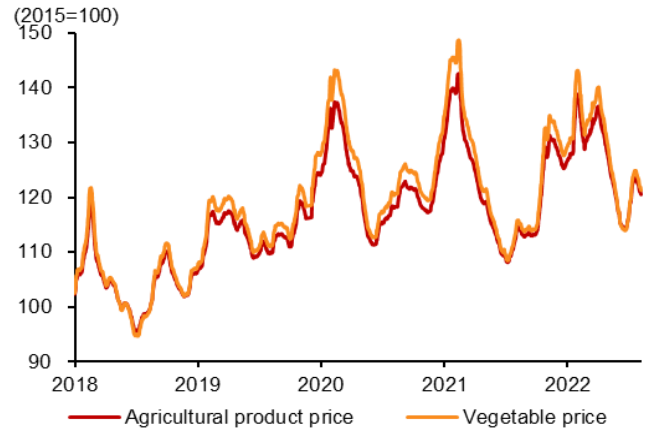
- **Policy implications.** The pick-up of CPI may cause some fine-tuning in the liquidity condition, but will not change monetary policy stance. After the recent threat of foreclosures from some homebuyers in the ceased housing projects, the central bank noticeably eased the liquidity condition. DR007 (banks' 7 day repo funding rate) further declined from above 1.5% in July to around 1.3% in August. As consumer inflation further climbs and housing sales may gradually improve in higher tier cities in next two months, the PBOC is likely to fine-tune the liquidity condition with possible mild increase of money market rates. Meanwhile, there will be no new stimulus or easing policies ahead. But monetary policy should remain prudent with easing bias, as the growth is still below potential growth and the resumption is unbalanced in different regions and various sectors.

Figure 1: MoM Changes of China Consumer Prices



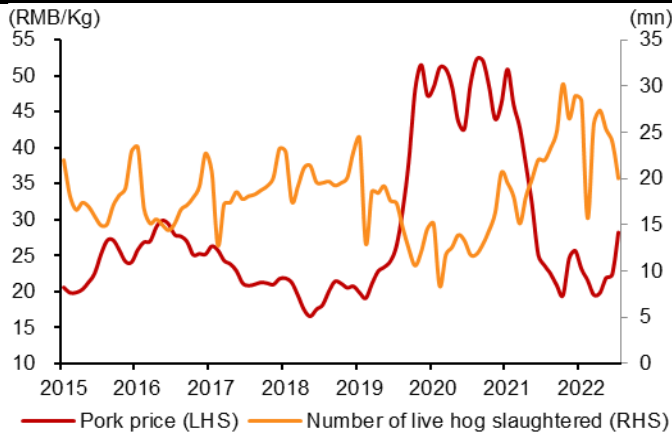
Source: Wind, CMBIGM

Figure 2: China Agricultural Product Price



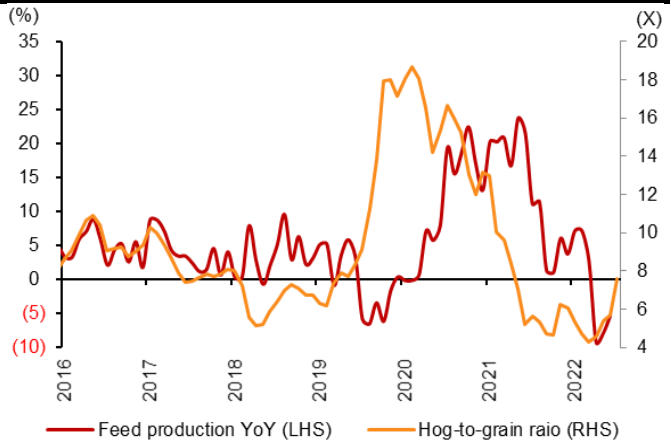
Source: Wind, CMBIGM

Figure 3: China Pork Price and Supply



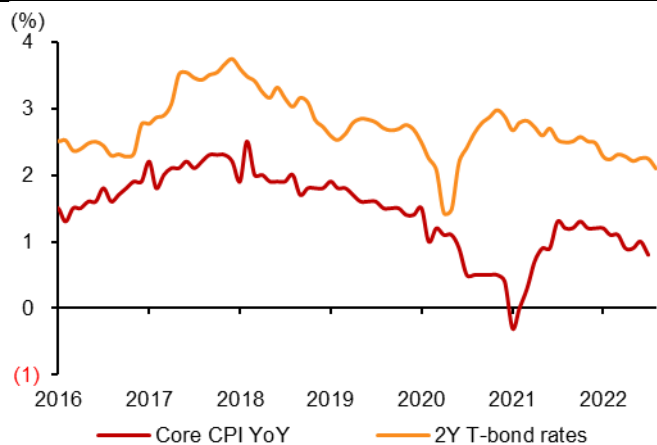
Source: Wind, CMBIGM

Figure 4: China Feed Production & Hog-to-grain Ratio



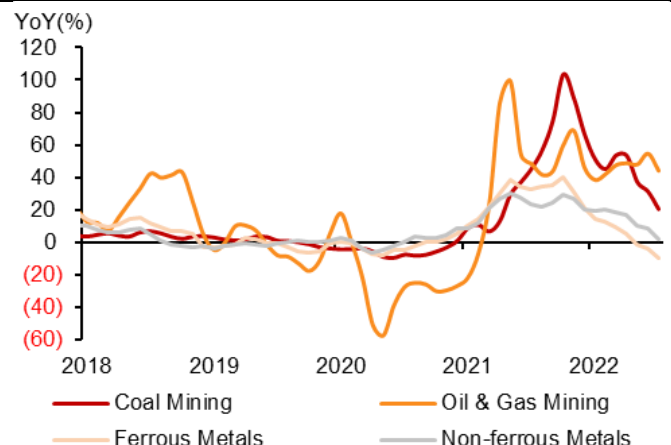
Source: Wind, CMBIGM

Figure 5: China Core CPI Growth & 2Y T-bond Rates



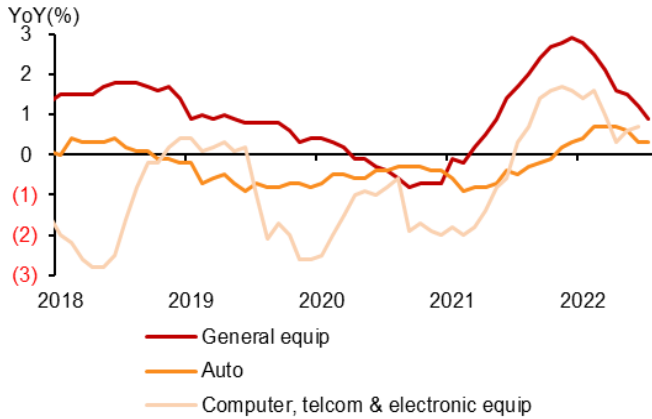
Source: Wind, CMBIGM

Figure 6: China Producer Price Growth in Commodity



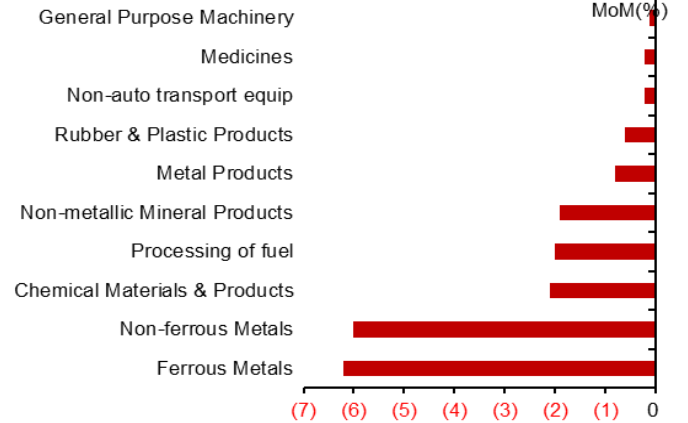
Source: Wind, CMBIGM

Figure 7: China Producer Price Growth in Equipment



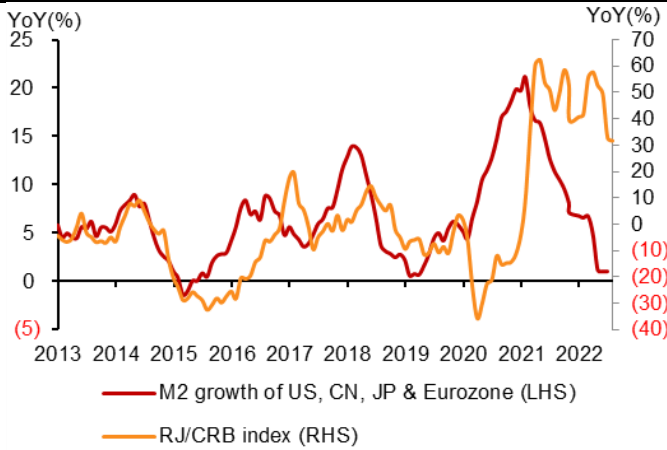
Source: Wind, CMBIGM

Figure 8: China's Producer Price



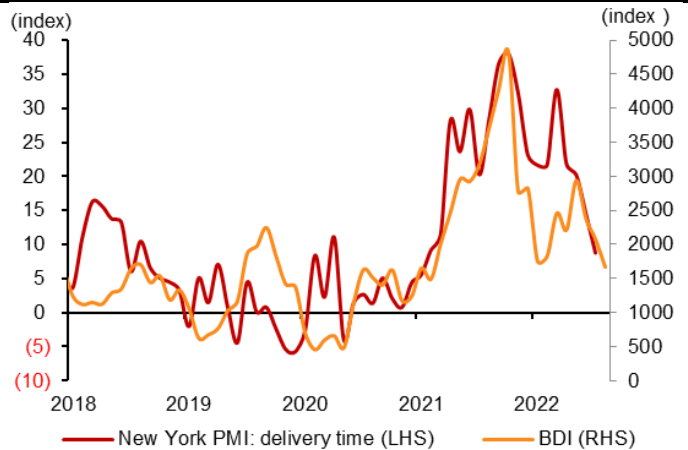
Source: Wind, CMBIGM

Figure 9: Global M2 Growth & Commodity Price



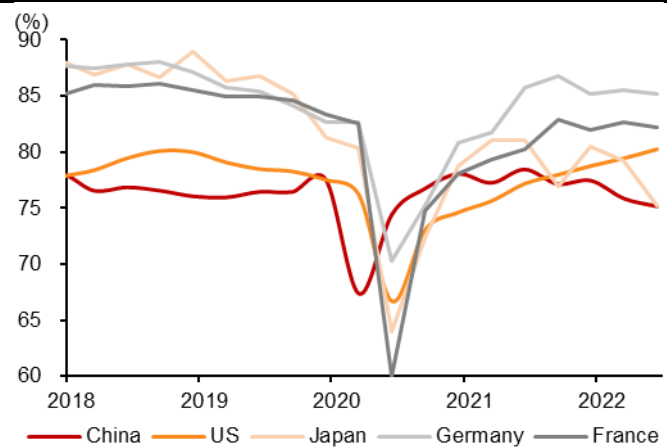
Source: Wind, CMBIGM

Figure 10: Global Supply Chain Pressure



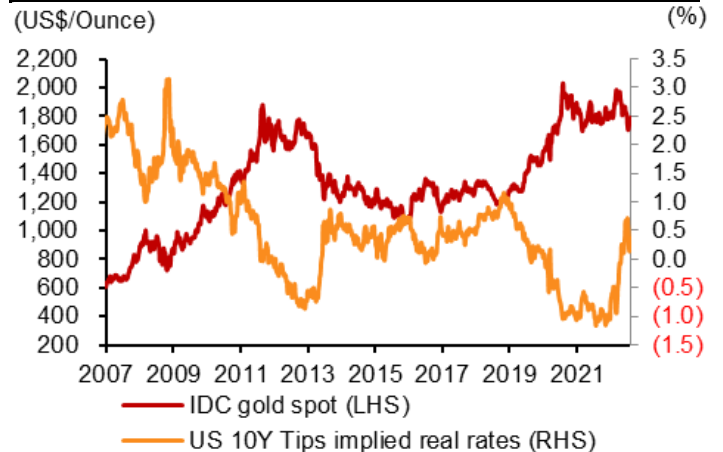
Source: Wind, CMBIGM

Figure 11: Manufacturing Capacity Utilisation Ratio



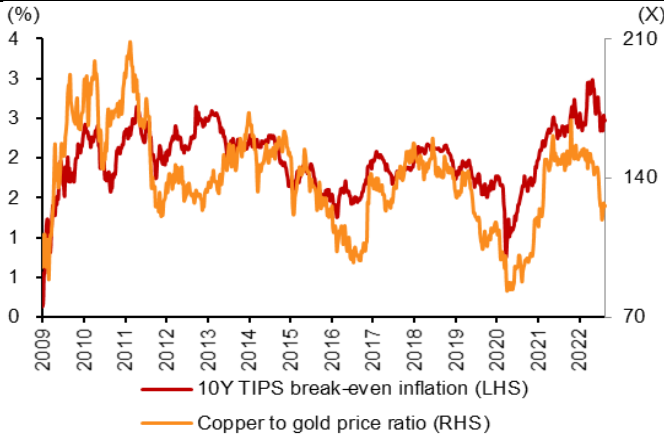
Source: Wind, CMBIGM

Figure 12: Gold Price and US\$ Real Interest Rates



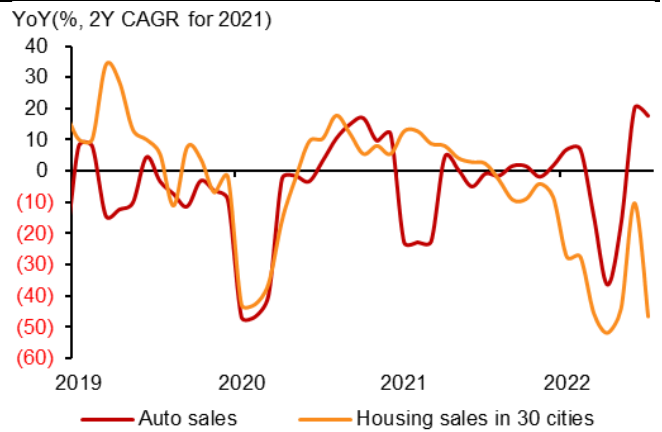
Source: Wind, CMBIGM

Figure 13: Copper-to-gold Ratio & Inflation Expectation



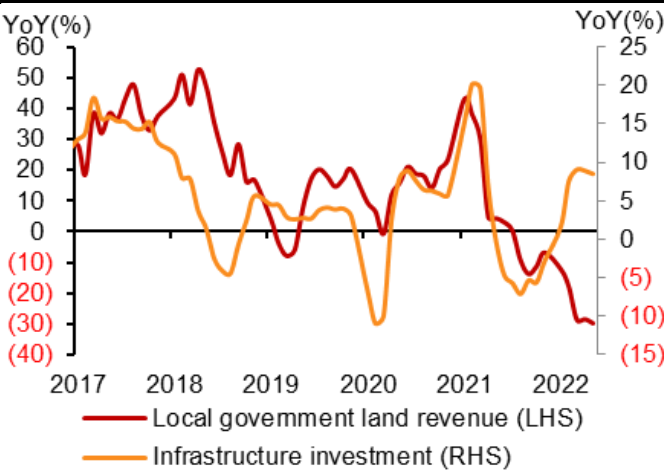
Source: Wind, CMBIGM

Figure 14: China Auto & Housing Sales Growth



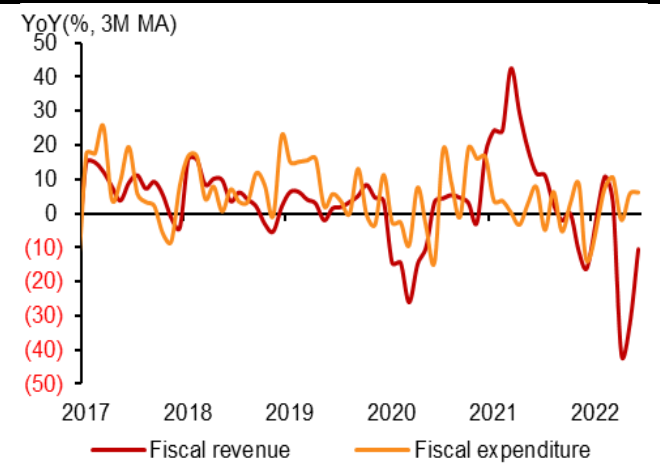
Source: Bloomberg, CMBIGM

Figure 15: Land Revenue & Infrastructure Investment



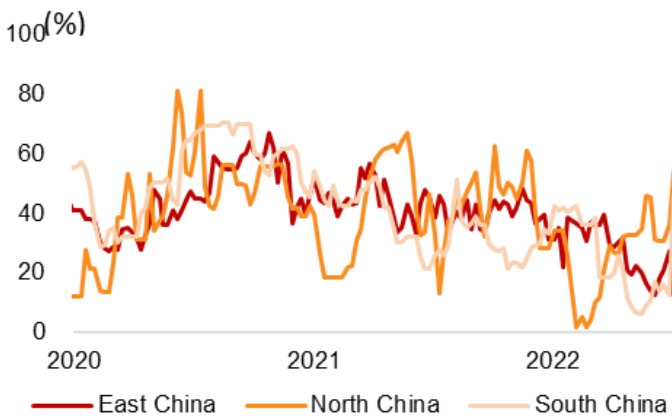
Source: Bloomberg, CMBIGM

Figure 16: China Fiscal Revenue & Expenditure



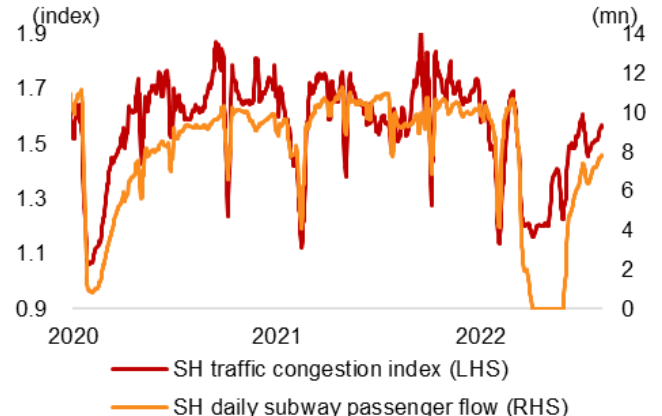
Source: Wind, CMBIGM

Figure 17: Operation of Asphalt Plant in China



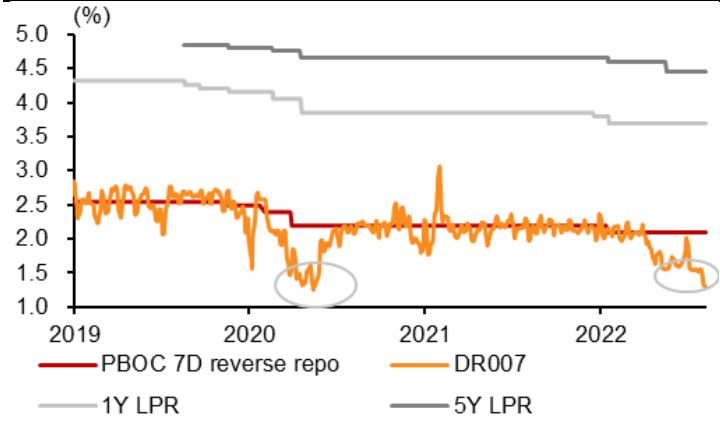
Source: Bloomberg, CMBIGM

Figure 18: Mobility Index in Shanghai



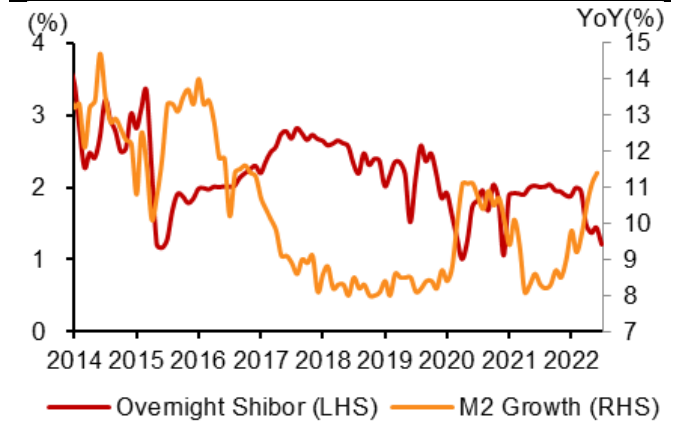
Source: Wind, CMBIGM

Figure 19: PBOC Policy Rates



Source: Bloomberg, CMBIGM

Figure 20: Liquidity Easing & M2 Expansion



Source: Wind, CMBIGM

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