

China Economy

Persistent deflationary pressure

China's YoY CPI bounced back to positive territory in June while its MoM growth remained negative. Energy prices rebounded while food, durable goods and services remained lethargic. PPI slumped to the two-year trough albeit with rising energy prices. Industries with a high export share faced higher deflationary pressure, while fierce supply-side competition remained in most sectors. Deflation pressure may continue to accumulate due to weak consumer demand and softening global trade, despite policymakers' recent efforts to curb disorderly competition from the supply side. China economy may face further headwinds in 2H25 given the intensifying deflation, softening property sector and payback effect from the trade-in scheme, in our view. China may gradually shift its policy framework towards economic rebalancing with consumption stimulus and capacity reduction after the country could reach a trade deal with the US. We expect a further 10bps LPR cut and 50bps RRR cut in 4Q25 to boost the property sector and consumption. We estimate that CPI and PPI may rise from 0.2% and -2.2% in 2024 to 0.3% and -2% in 2025.

■ **CPI returned to positive amid rebounding energy prices.** China's CPI YoY edged up to 0.1% in June from -0.1% in May, better than market expectation at 0%. In sequential terms, CPI remained negative at -0.1% in June compared to -0.2% in May. Food price further dropped 0.4% MoM in June as pork price dipped 1.2% MoM. High-frequency data indicated continued declines in vegetable prices by 0.5% MoM in early July, while pork ex-factory price rebounded. Vehicle fuel price rebounded by 0.3% MoM as global crude oil price surged in early June. We expect CPI to continue its recovery in July due to the rising gas and food prices, although a higher base may pull its YoY growth down to -0.1%.

■ **Core CPI remained subdued due to falling durable goods and tourism prices.** Core inflation edged up to 0.7% YoY in June from 0.6% in May, while its MoM growth stayed flat at 0%. Durable goods including telecom equipment and vehicles dropped 0.2% and 0.4% respectively while home appliances stayed unchanged at 0%, amid intensifying price competition. It's worth noting that the discounts from the trade-in scheme are excluded from CPI calculations. Discretionary goods also saw price declines as footwear and clothing both dropped by 0.1% in June. Service price stayed flat at 0% MoM in June, as tourism price dropped 0.8% in June while medical service and housing rent rose by 0.3% and 0.1%. Other services remained subdued, with no price change recorded in categories such as education, express, telecommunications and home services.

■ **PPI slumped further albeit with rising crude oil price.** YoY contraction of PPI further widened to -3.6% in June from -3.3% in May, marking its lowest level since July 2023 and missing the market expectation at -3.2%. The MoM growth remained flat at -0.4% for the fourth consecutive month, further weighing on the profit margin of the manufacturing sector. PPI of mining industries rebounded to -1.2% in June from -2.5%. Extraction of crude oil & gas rebounded to 2.6% MoM in June from -5.6%, while coal dipped 3.4%. Non-ferrous metals rose 1.3% MoM thanks to robust AI-related demand while ferrous metals dropped 2% MoM, indicating that domestic construction activities remained soft. Final consumption goods dropped 0.1% in June, as food and durable goods dipped 0.3% and 0.1% respectively. Industries with a high export share are facing price pressure, as computers & electronics, electrical equipment and textile dropped 0.4%, 0.2% and 0.2% respectively. Fierce supply-side competition mildly eased as the YoY decline of electric vehicles, photovoltaic equipment and lithium batteries narrowed by 0.4%, 1.2% and 0.2%. We expect the subdued PPI should persist due to the drag

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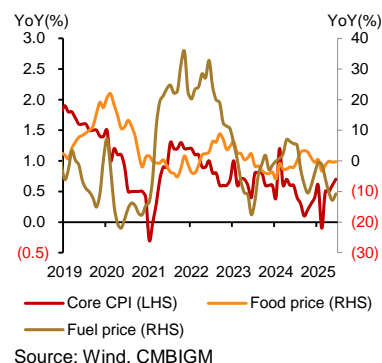
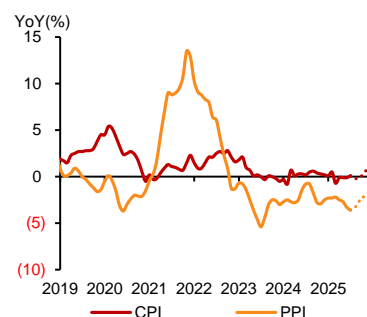
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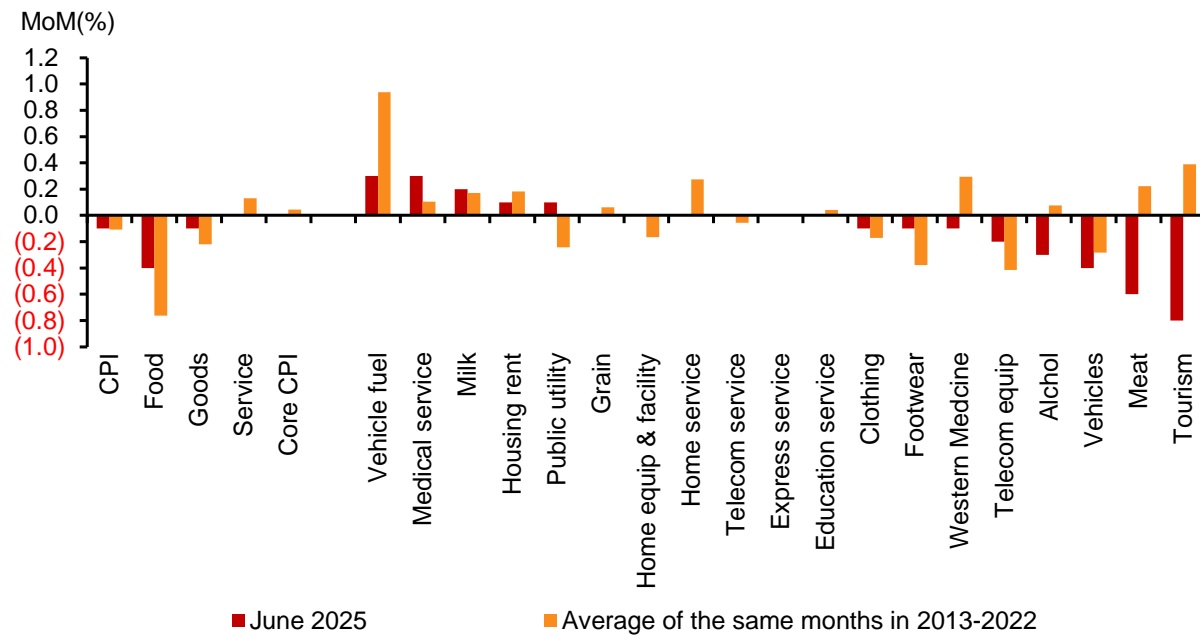
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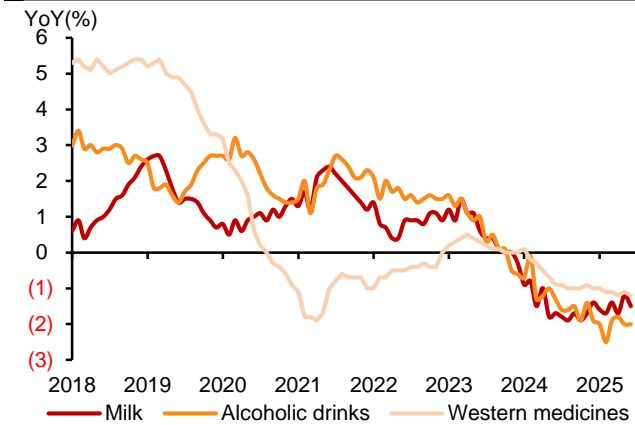


from the trade war and fierce price competition among manufacturers, which should further weigh on overall corporate earnings.

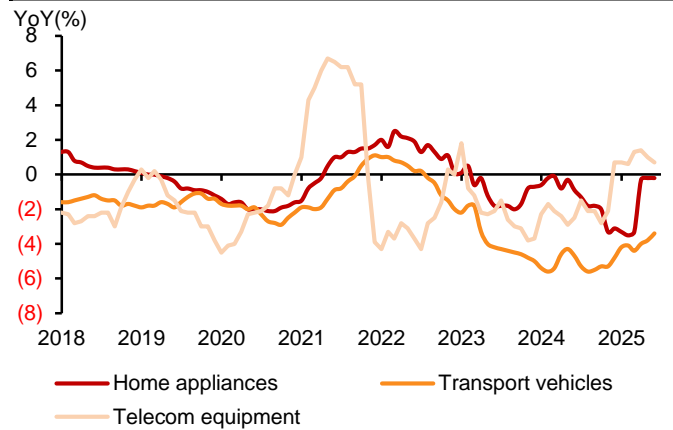
- **Deflation pressure might push China to gradually shift its policy framework towards economic rebalancing.** The policymakers have acknowledged the disruptive impact of fierce supply-side price competition, as the top leadership just vowed to curb disorderly low-price competition among enterprises. However, deflation pressure may continue to accumulate due to the softening global trade and subdued domestic demand, aside from the supply side. China economy may face further headwinds in 2H25 given the intensifying deflation, softening property sector and payback effect from the trade-in scheme. China may gradually shift its policy framework towards economic rebalancing with consumption stimulus and capacity reduction in future after the country could reach a trade deal with the US. We expect a further 10bps LPR cut and 50bps RRR cut in 4Q25 to boost the property sector and consumption.

Figure 1: MoM Changes of China CPI in June

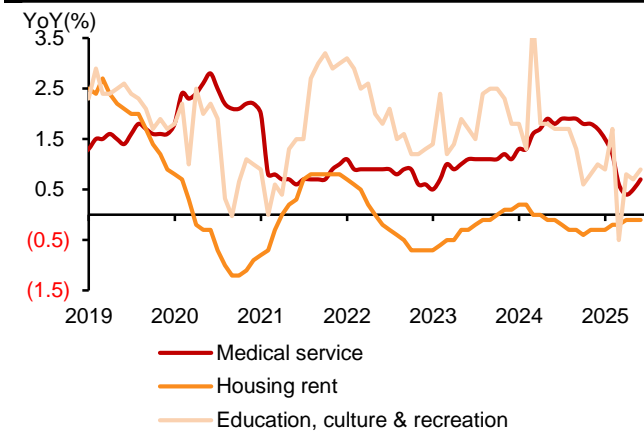
Source: Wind, CMBIGM

Figure 2: China CPI growth in staples

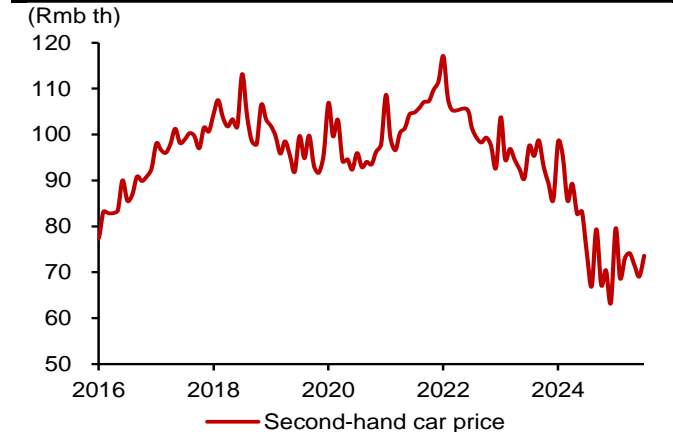
Source: Wind, CMBIGM

Figure 3: China CPI growth in durables

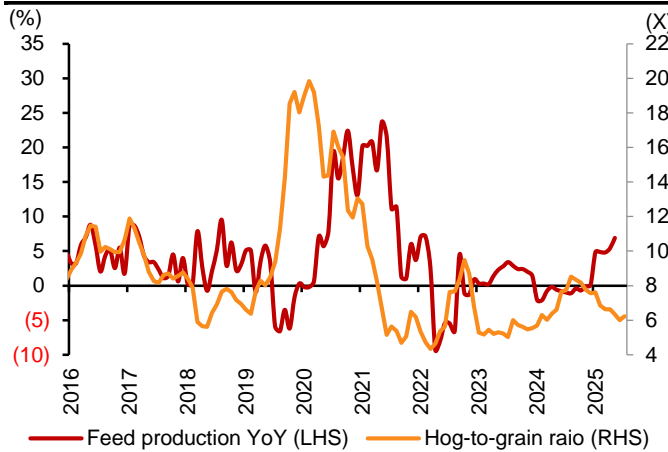
Source: Wind, CMBIGM

Figure 4: China CPI growth in services

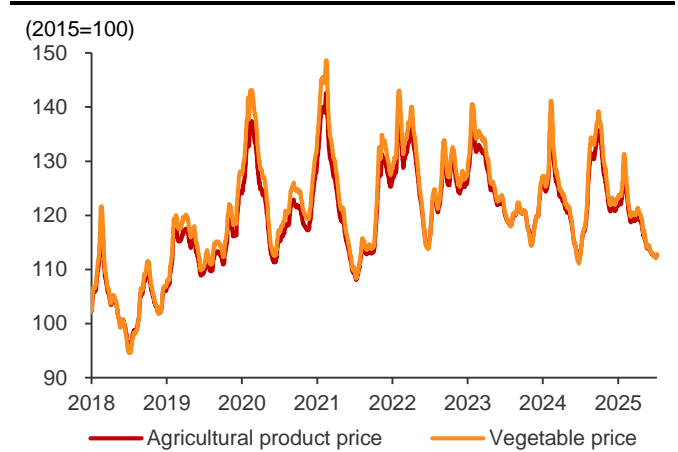
Source: Wind, CMBIGM

Figure 5: Second-hand car price in Shanghai

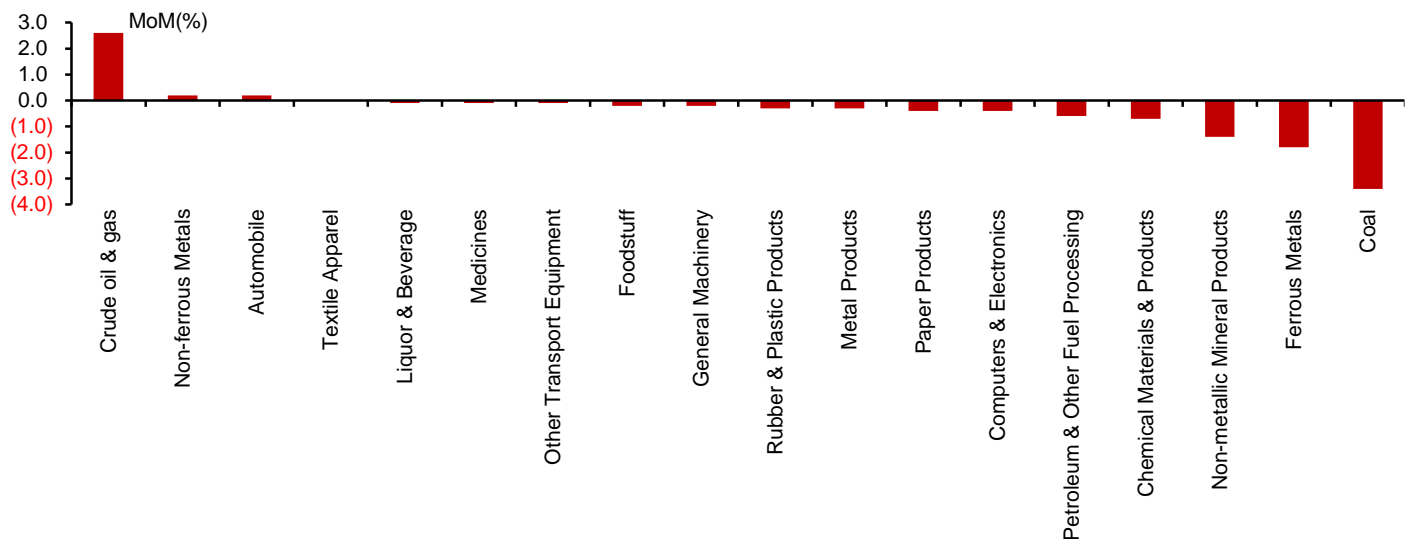
Source: Wind, CMBIGM

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

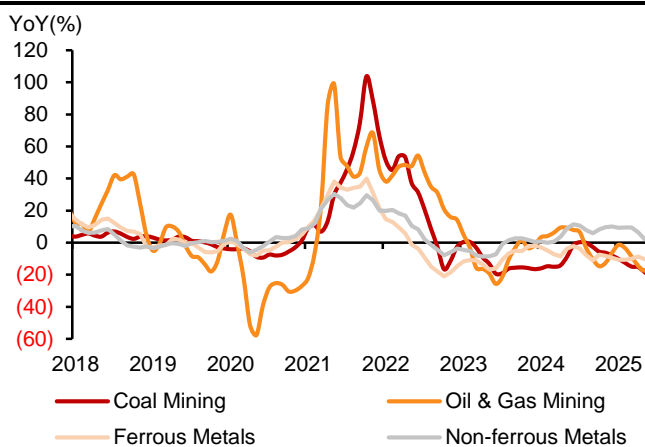
Source: Wind, CMBIGM

Figure 7: Agricultural and vegetable prices

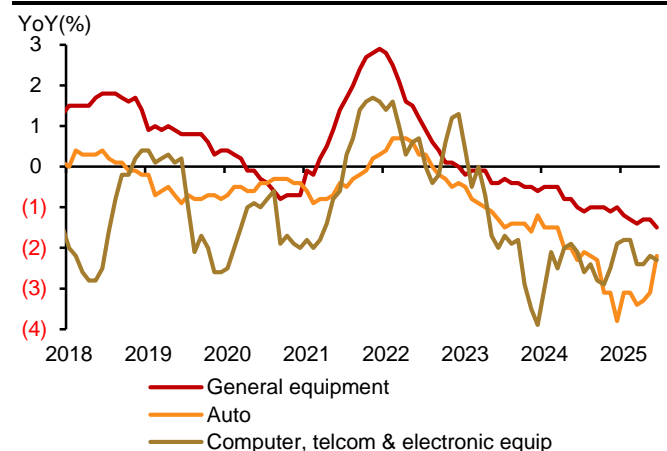
Source: Wind, CMBIGM

Figure 8: MoM changes of China PPI in June

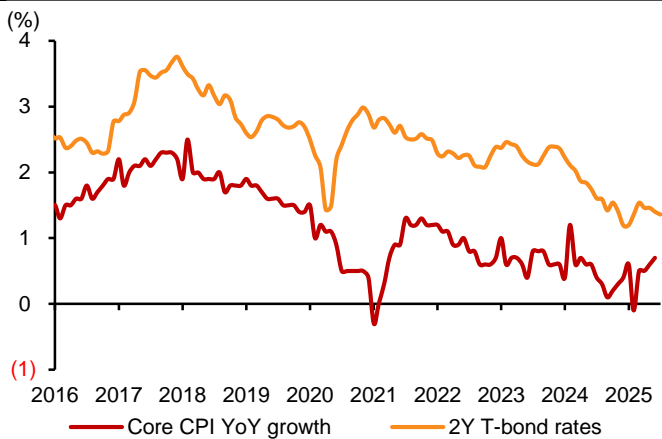
Source: Wind, CMBIGM

Figure 9: China PPI in energy & metals

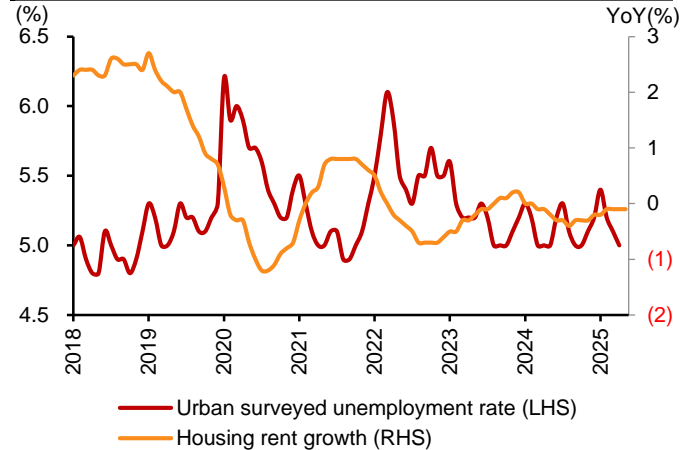
Source: Wind, CMBIGM

Figure 10: China PPI in equipment

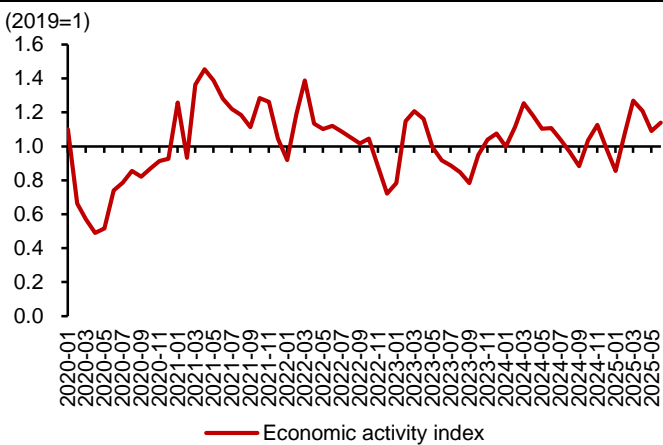
Source: Wind, CMBIGM

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

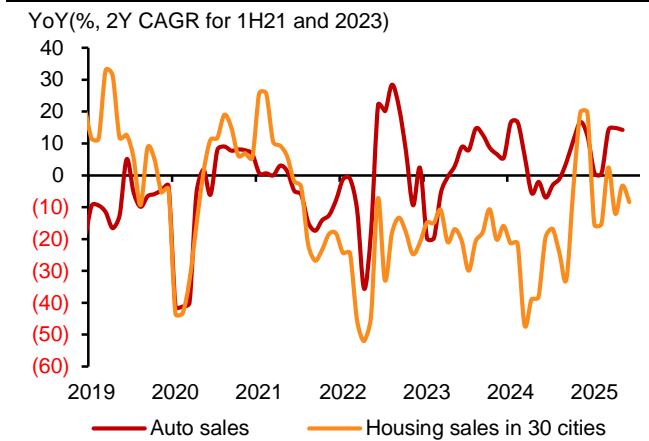
Source: Wind, CMBIGM

Figure 12: Unemployment rate and rent growth

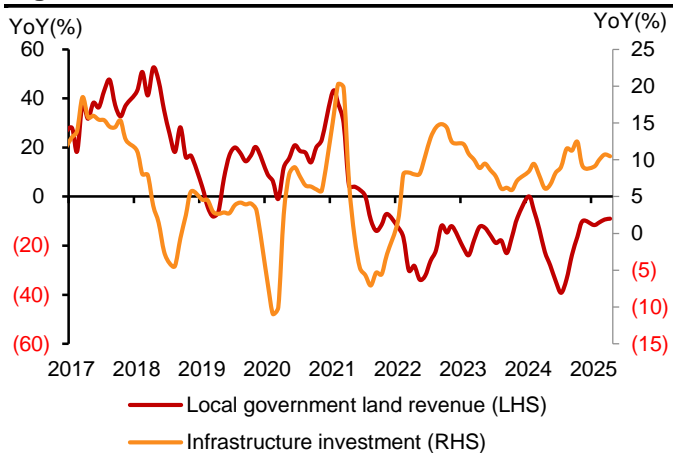
Source: Wind, CMBIGM estimates

Figure 13: China Economic Activity Index

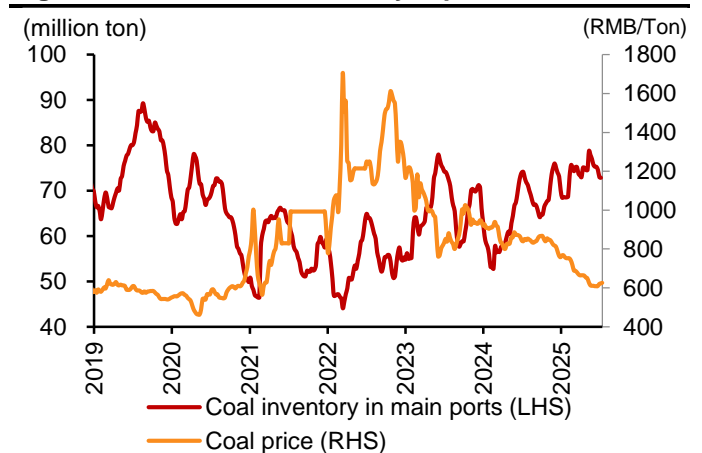
Source: Wind, CMBIGM

Figure 14: China auto & housing sales

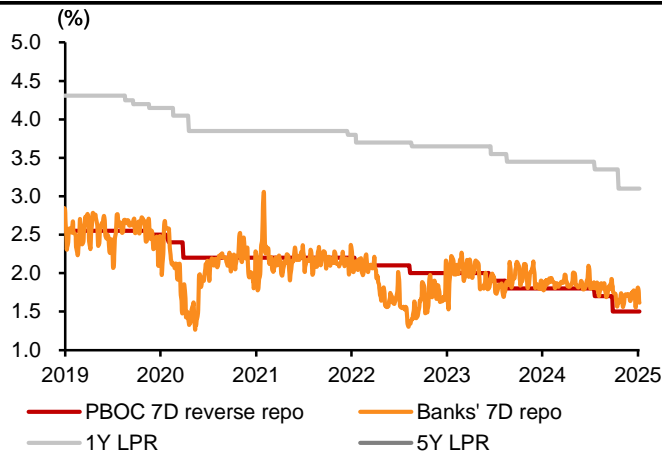
Source: Bloomberg, CMBIGM

Figure 15: Infrastructure investment in China

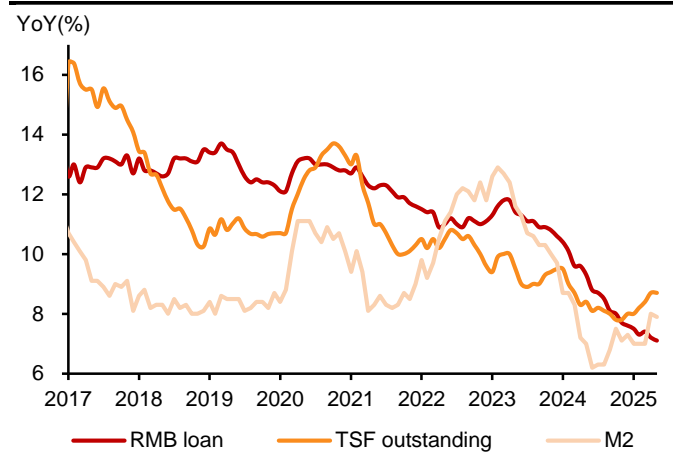
Source: Bloomberg, CMBIGM

Figure 16: China coal inventory & price

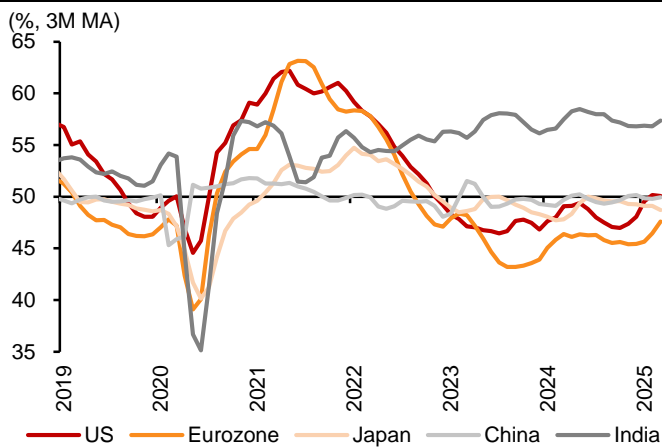
Source: Wind, CMBIGM

Figure 17: PBOC policy rates & liquidity condition

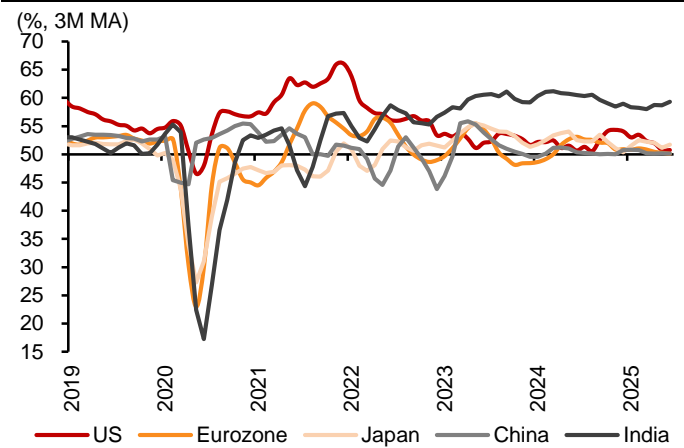
Source: Bloomberg, CMBIGM

Figure 18: China credit growth

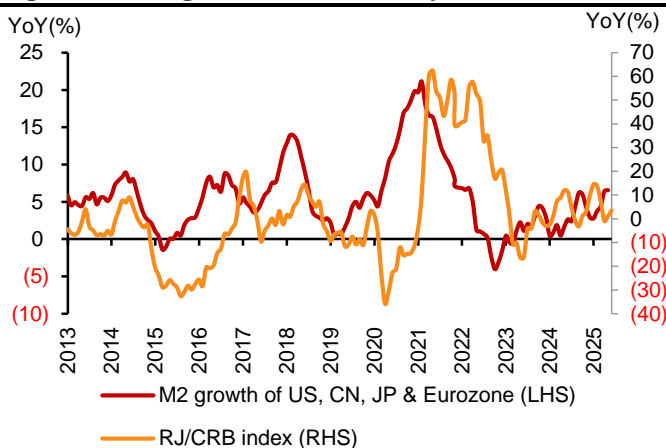
Source: Wind, CMBIGM

Figure 19: Manufacturing PMI of major economies

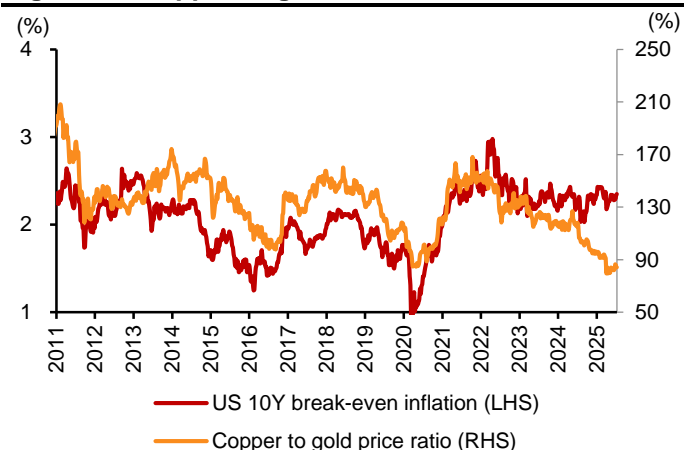
Source: Bloomberg, CMBIGM

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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