

China Economy

Deflation alleviated, yet demand remains soft

CPI growth rebounded and beat market expectations in July as food price notably surged amid supply disruptions caused by high temperature and flooding in some regions. Consumer demand remained soft as core CPI growth declined. Tourism service price sharply rebounded amid vigorous travel demand in the summer holiday, but vehicle and clothing prices continued to decline amid weak discretionary consumption. PPI continued to decline as energy price rebounded while metal, construction material and chemical product prices dropped. The recent alleviation of China's deflation is mainly due to supply disruptions as consumer demand remains soft. Credit demand is also weak especially in the private sector. The PBOC is under pressure to further loose monetary policy as the central bank has vowed to promote moderate price recovery in its recent quarterly monetary policy report. We expect the PBOC to further cut LPRs and deposit rates by 10-20bps and RRR by 25bps in the remainder of this year. China's CPI and PPI growth rates may rise from 0.2% and -3% in 2023 to 0.5% and -1% in 2024 and 1.2% and 1% in 2025.

■ **CPI rebounded boosted by food price.** CPI YoY growth rebounded to 0.5% in July from 0.2% in June, against market expectation of 0.3%. In sequential terms, CPI further surged 0.5% after dropping 0.2% in June, higher than decade-average at 0.3% of July. Food price significantly rose 1.2% MoM in July from -0.6% due to high temperature or rainy weather in most provinces, the biggest jump since Chinese New Year, while its YoY growth increased to 0% from -2.1%. Pork prices moderated from 11.4% MoM growth in June to 2% in July while its YoY growth edged up from 18.1% to 20.4%. We expect pork price to further rebound as supply-side de-capacity extended, which will be a major support for a CPI pick-up. Other food items also saw significant growth with vegetables and eggs increasing 9.3% and 3.7% MoM in July compared to -7.3% and 1.5% in June. Vehicle fuel price moderated from 5.6% to 5.1% YoY while its MoM growth expanded 1.5% in July after dropping 2% in June. Looking forward, CPI may continue to modestly recover thanks to the low base and rising food price as shown in high-frequency data in early Aug.

■ **Core CPI growth softened as consumer demand remained soft.** Core CPI expanded by 0.3% MoM in July following two consecutive months of decline, while its YoY growth edged down to 0.4%. Durable prices remained weak as vehicle price dropped 0.6% in July following a 1% dip. Average unit price in Shanghai second-hand car market dropped 10.7% and 18.5% MoM in July and early Aug, a result possibly from both over-supply and subdued demand. Telecom equipment price edged down by 0.1% MoM after rising 0.8% in June. It is noteworthy that home appliance price rebounded 0.4% MoM in July after continued declines from March to June as the upgrading subsidy may provide some support to the demand. CPI in services picked up 0.6% MoM in July after the zero growth in June while its YoY growth slowed due to the base effect. Thanks to the vigorous travel demand during the summer holiday, tourism service price markedly surged 9.4% MoM in July after dropping 0.8% in June with flight ticket and hotel prices up 22.1% and 5.8% MoM. Telecom, education and medical services all showed 0 growth while express service dropped by 0.1% MoM. Looking forward, core CPI growth may remain restrained in near term due to lethargic consumer demand amid an elevated real interest rate and weak employment conditions.

■ **PPI continued to decline as rally of global commodities prices ran its course.** The MoM growth of PPI in July saw the same 0.2% decline as June, while its YoY contraction stayed flat at -0.8%, slightly beating market

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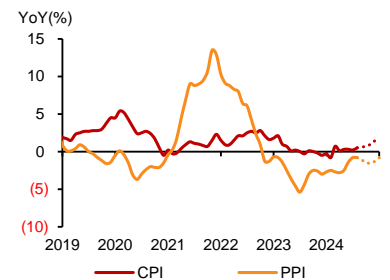
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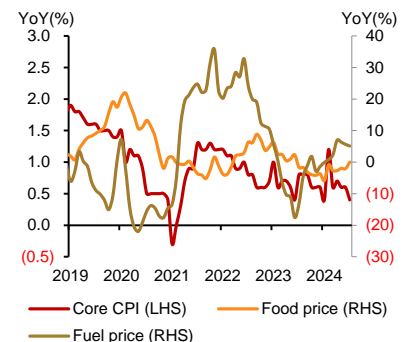
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Forecast numbers from Mar 2024

Source: Wind, CMBIGM

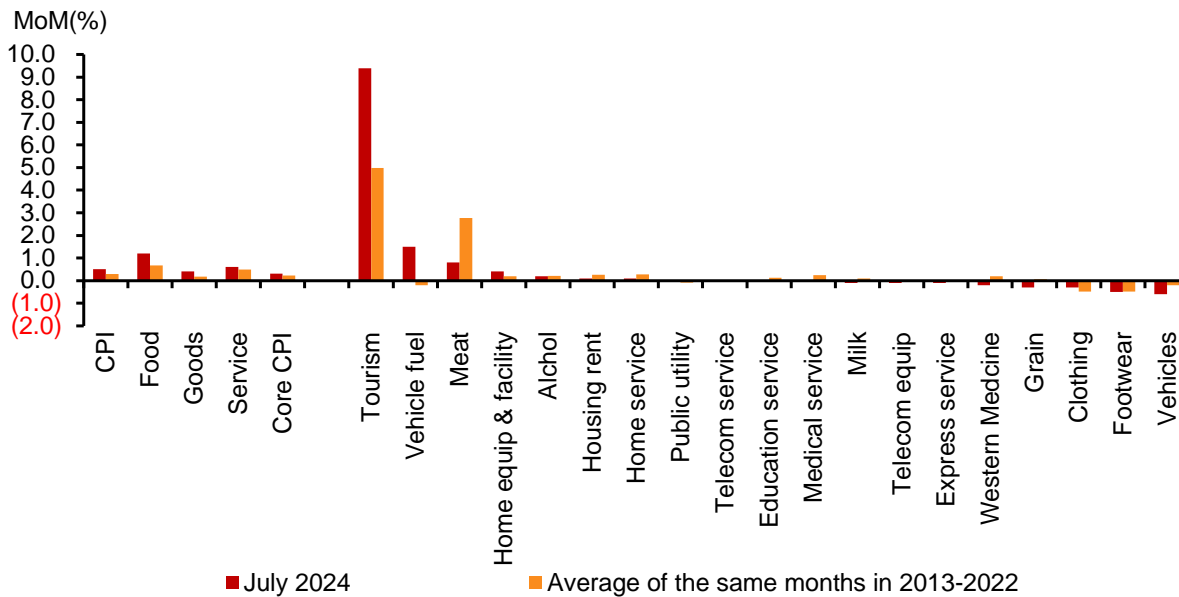


Source: Wind, CMBIGM

expectation at -0.9%. Bloomberg commodities index has declined 4.5% in July to the lowest point since Jan 2022, as the market started trading on weakening US economy prospects. For mining industries, PPI of oil & gas, and non-ferrous metals moderated from 8% and 11.5% to 6.7% and 10.6% YoY, as their prices dipped in July. Coal mining and ferrous metals dropped to -3.7% from -2.1% while coal mining rebounded from -1.6% to 0.3% YoY. For mid-stream industries, PPI in intermediate goods such as rubber & plastics, metal products and general machinery all dropped by 0.1% MoM. For final goods, auto manufacturing saw a 0.2% MoM expansion after six months of decline while prices of lithium batteries and PCs posed negative sequential changes in July. Looking forward, we expect the PPI may widen its YoY decline in the next three months before improving again from late 4Q.

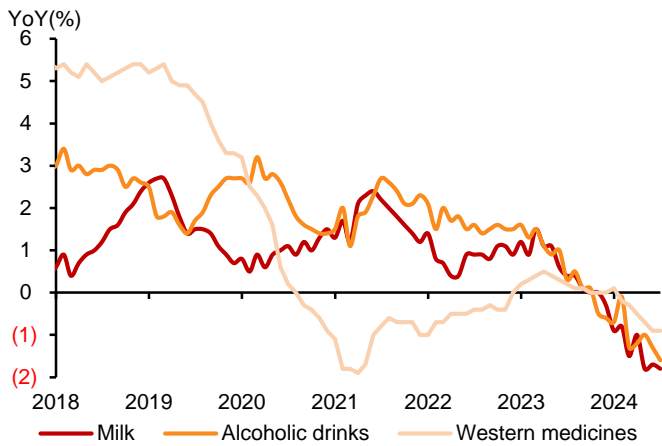
- **Deflation pressure may alleviate in 2025.** We expect deflation pressure might last in the remainder of this year before possible alleviation next year. The recent Politburo meeting shows that the policymakers start to focus on consumption weakness and excessive capacity, yet without details on specific policies. We expect consumer demand may remain weak in the next few months and gradually rebound in 2025. As a leading indicator, housing market recovery should provide some support to household consumption next year. Second-hand housing sales have recovered since last year while new housing sales have started to improve since this year. We expect housing price may gradually stabilize next year. In addition, the Chinese policymakers may start to stimulate consumption and restrain supply capacity expansion next year. For one thing, China exports might slow down again next year as the effect of frond-loaded shipments in anticipation of higher tariffs gradually fades out, external demand gradually softens and trade tensions may further increase. For another, China may have to boost consumer demand and restrain supply capacity to alleviate tensions with the US and Europe after the US presidential election. China's monetary policy should remain accommodative as the PBOC may further cut LPRs and deposit rates by 10-20bps and RRR by 25bps in the remainder of this year. A possible weakening of the US dollar during the Fed's rate cut cycle may expand the PBOC's policy room next year as China's credit growth might gradually stabilize. We maintain our forecast that China's CPI and PPI growth rates may rise from 0.2% and -3% in 2023 to 0.5% and -1% in 2024 and 1.2% and 1% in 2025.

Figure 1: MoM Changes of China CPI in July



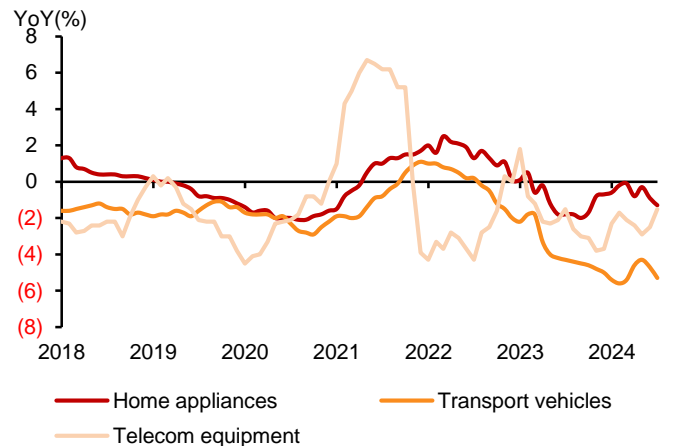
Source: Wind, CMBIGM

Figure 2: China CPI Growth in Staples



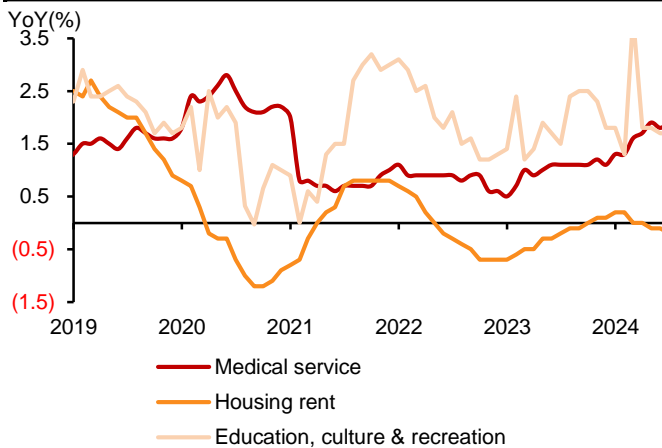
Source: Wind, CMBIGM

Figure 3: China CPI Growth in Durables



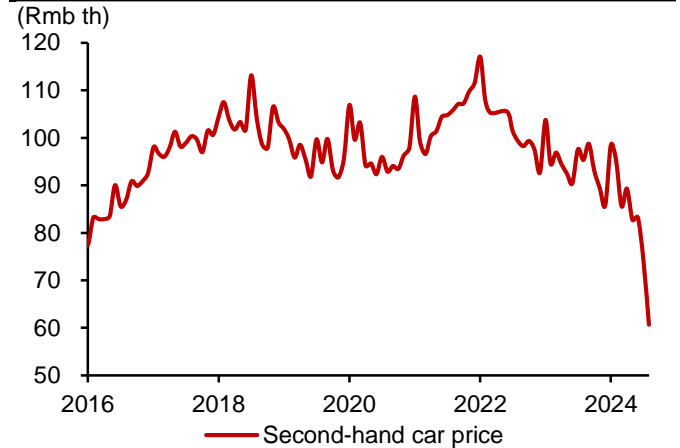
Source: Wind, CMBIGM

Figure 4: China CPI Growth in Services



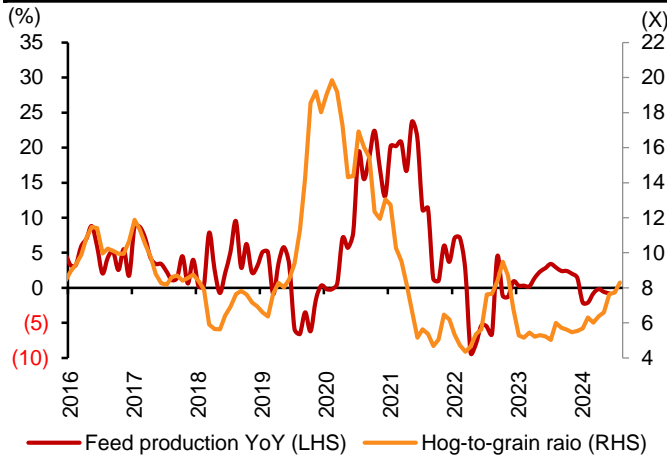
Source: Wind, CMBIGM

Figure 5: Second-hand Car Price in Shanghai



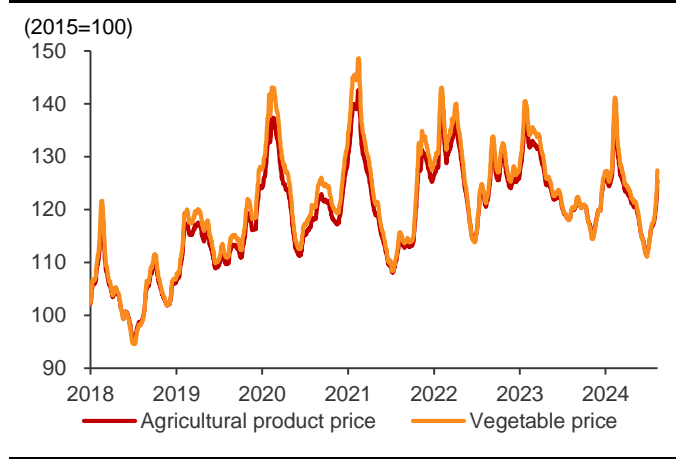
Source: Wind, CMBIGM

Figure 6: Feed Production & Hog-to-Grain Ratio



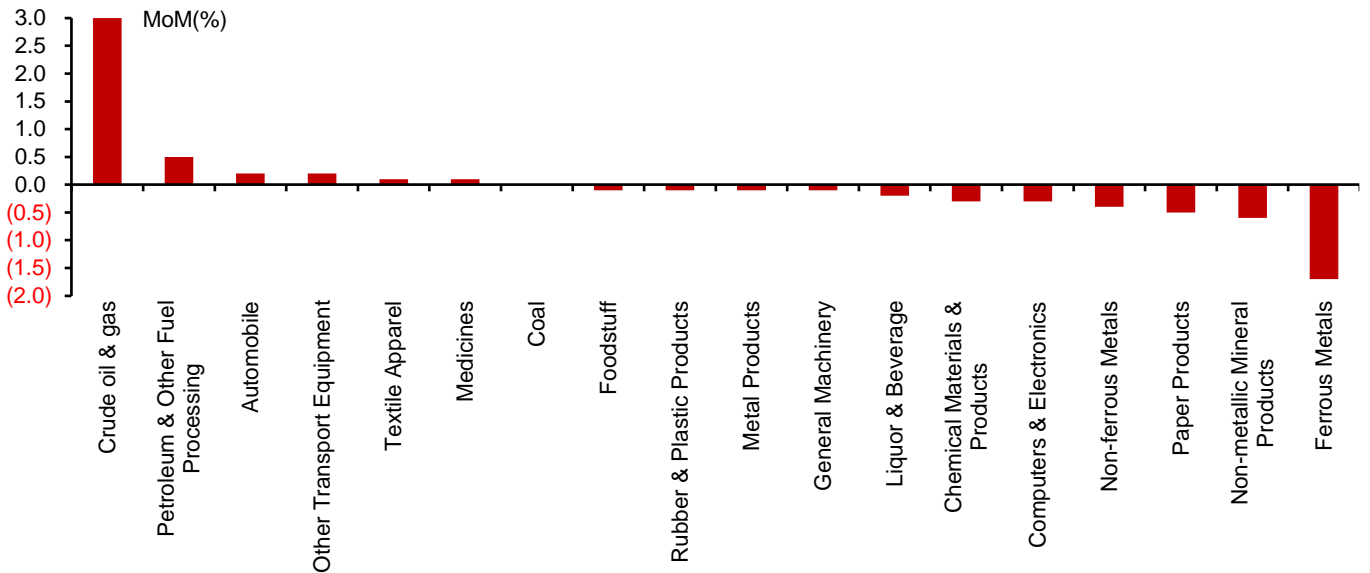
Source: Wind, CMBIGM

Figure 7: Agricultural and Vegetable Price



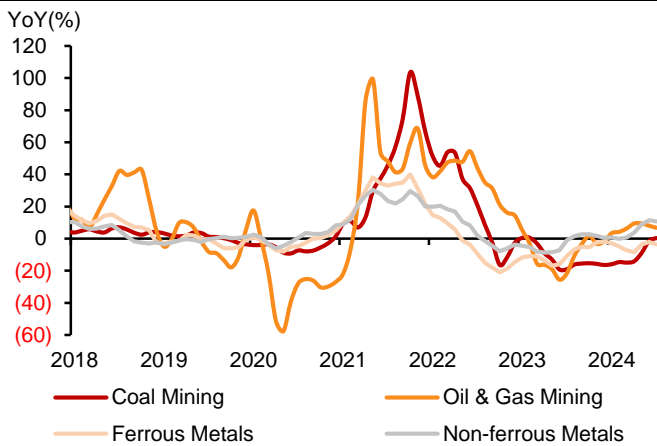
Source: Wind, CMBIGM

Figure 8: MoM Changes of China PPI in July



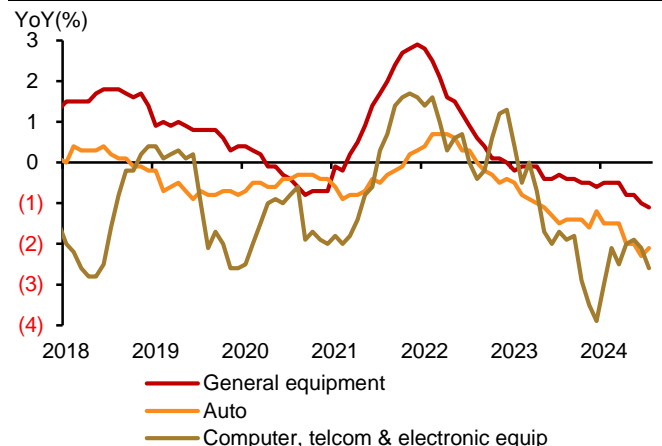
Source: Wind, CMBIGM

Figure 9: China PPI in Energy & Metals



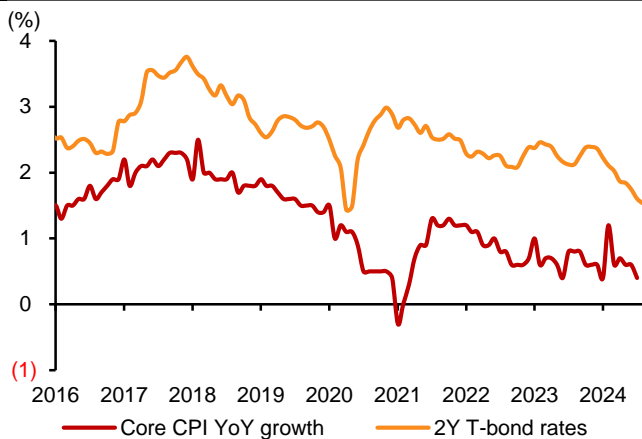
Source: Wind, CMBIGM

Figure 10: China PPI in Equipment



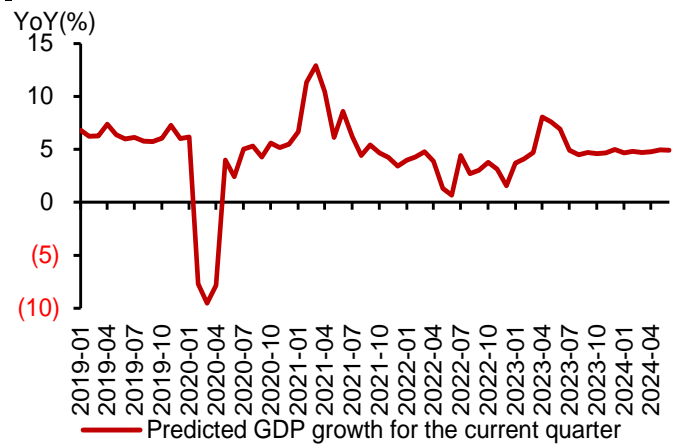
Source: Wind, CMBIGM

Figure 11: China Core CPI Growth & 2Y T-bond Rates



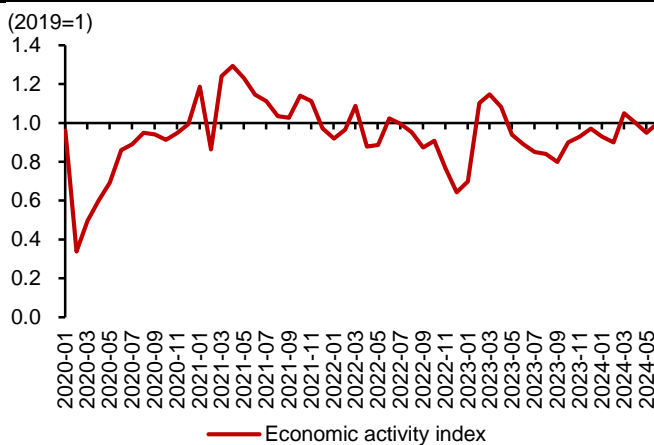
Source: Wind, CMBIGM

Figure 12: GDP Growth Predicted by AI



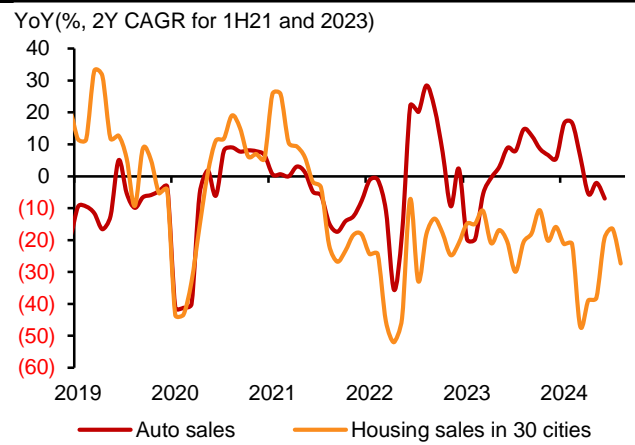
Source: Wind, CMBIGM estimates

Figure 13: China Economic Activity Index



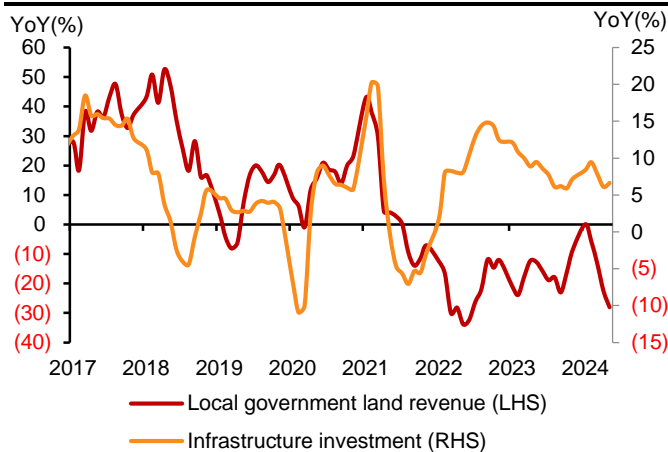
Source: Wind, CMBIGM

Figure 14: China Auto & Housing Sales



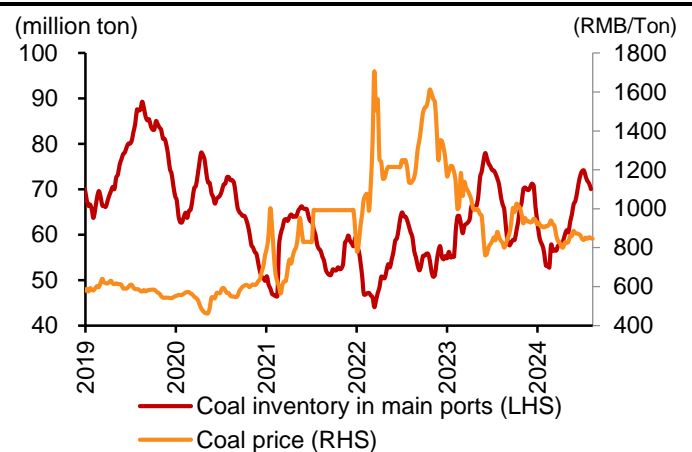
Source: Bloomberg, CMBIGM

Figure 15: Infrastructure Investment in China



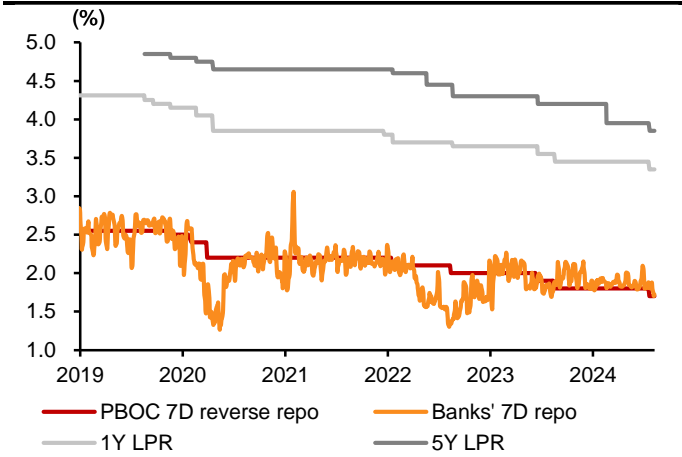
Source: Bloomberg, CMBIGM

Figure 16: China Coal Inventory & Price



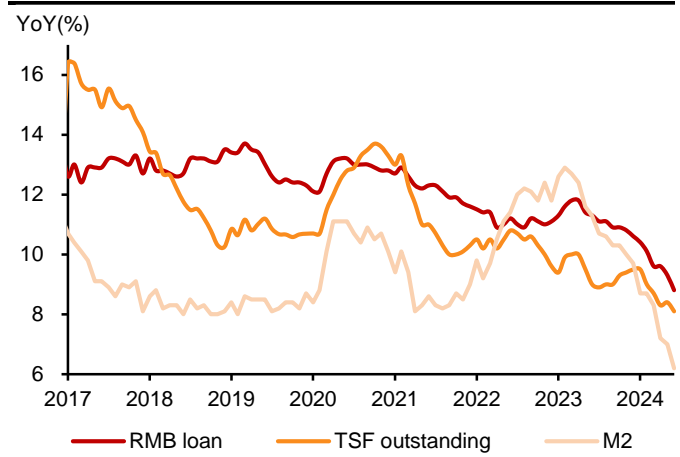
Source: Wind, CMBIGM

Figure 17: PBOC Policy Rates & Liquidity Condition



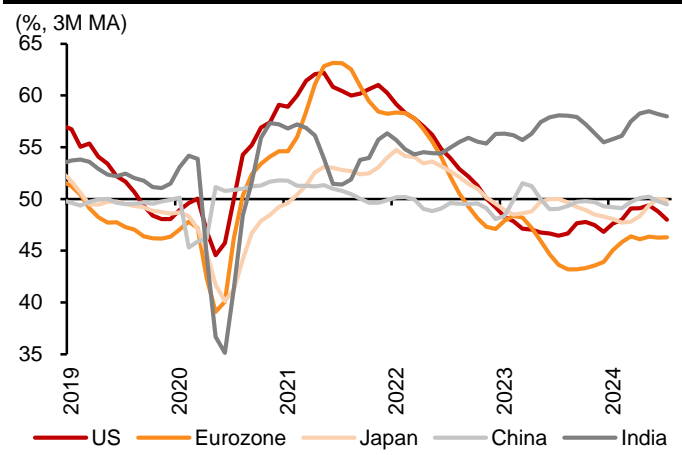
Source: Bloomberg, CMBIGM

Figure 18: China Credit Growth



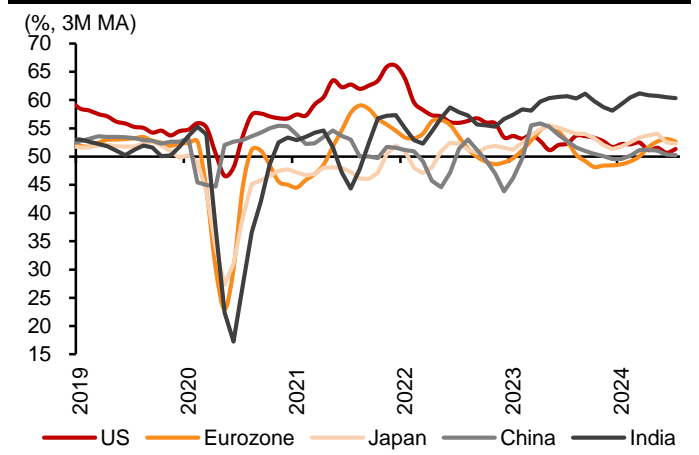
Source: Wind, CMBIGM

Figure 19: Manufacturing PMI of Major Economies



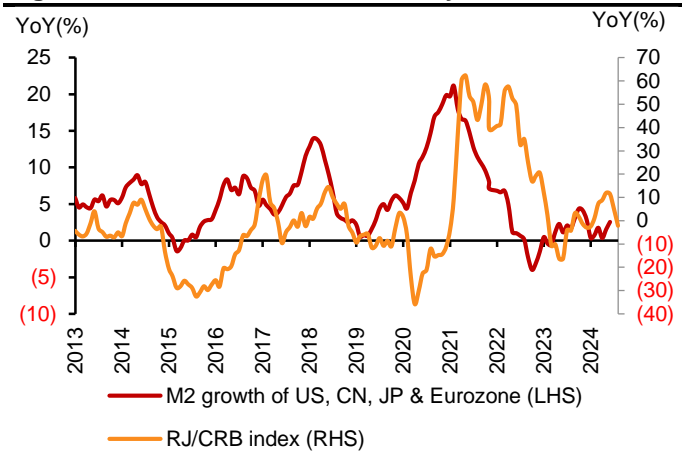
Source: Bloomberg, CMBIGM

Figure 20: Service PMI of Major Economies



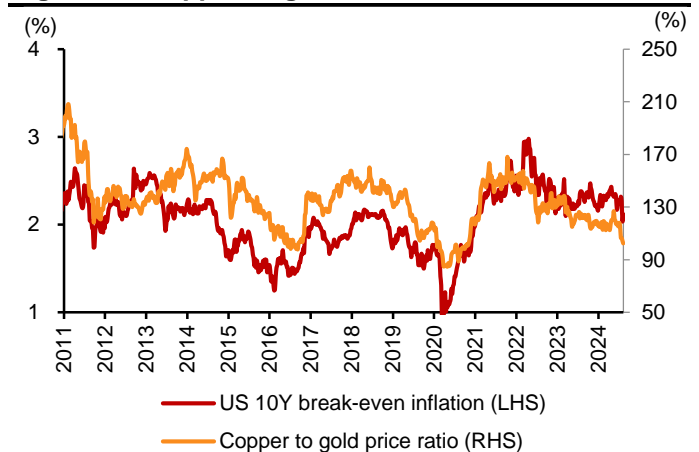
Source: Wind, CMBIGM

Figure 21: M2 Growth & Commodity Inflation



Source: Bloomberg, CMBIGM

Figure 22: Copper-to-gold Ratio



Source: Wind, CMBIGM

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