

China Economy

Persistent deflation points to continued liquidity easing

After a short-lived uptick, CPI YoY slipped back into negative territory in August, as slumping food prices offset modest non-food gains. Benefiting from anti-involution measures, PPI contraction eased as upstream material prices strengthened, though consumer goods prices at the terminal end stayed muted. Upstream sector momentum has moderated heading into September, yet persistently weak price levels should keep prompting further policy action, with anti-involution firmly established as a government priority, in our view. We expect the subdued PPI should recover in the remainder of the year due to continuous policy effort to curb involution and additional stimulus package on consumer demand. Looking forward, we expect a policy easing window in 4Q25 with a further 10bps LPR cut and 50bps RRR cut, while fiscal policy might expand to support household and property sectors. CPI may remain unchanged at 0.2% in 2025, while PPI may rise from -2.8% in 1H25 to -1.9% in 2H25, in our view.

■ **CPI dropped to negative due to slumping food price.** China's CPI YoY dropped to -0.4% in Aug from 0% in July, missing market expectation at -0.2%. In sequential terms, CPI moderated to 0% in Aug from 0.4% in July. Food prices rose by 0.5% MoM in Aug, well below the 10-year seasonal average increase of 1.4%, bringing YoY growth down to -4.3%. Vegetable price rose 8.5% MoM, while pork price slipped by 0.1% MoM, reversing the brief 0.4% gain recorded in the prior month. Vehicle fuel price declined to -0.9% MoM. High-frequency data indicated continued recovery in vegetable price by 3% MoM in early Sep while pork retail price extended its decline. Guideline gasoline price was revised lower by 2% in late Aug. We expect the CPI to recover to -0.2% YoY in Sep due to a rebounding food price and lower base.

■ **Core CPI edged up.** Core inflation increased to 0.9% YoY in Aug from 0.8%, while its MoM eased to 0% from 0.4%. Durable goods including telecom equipment and vehicles remained subdued with -0.1% and 0% MoM growth, while home equipment expanded by 1.1%. Discretionary goods remained muted as footwear and clothing both dropped by 0.1% in Aug, as export demand deteriorated. Service price slowed down to 0% MoM in Aug from 0.6%, as tourism price dropped 0.6% after the sharp rebound of 9.1% in July. Medical service picked up to 0.5% in Aug from 0.3%, while other services remained subdued, including housing rent, education, express, telecommunications and home services, with 0% MoM growth.

■ **The PPI contraction narrowed supported by firmer upstream material prices.** YoY contraction of PPI recovered to -2.9% in Aug from -3.6%, inline with market expectations. The MoM growth rebounded to 0% in Aug from -0.2%. PPI of mining industries surged to 1.3% MoM in Aug from -0.2%, supported by broad-based price gains across coal, ferrous metals, and non-ferrous metals. Raw material and processing products also rebounded to 0.2% and 0% MoM, as smelting and pressing of ferrous metals and non-ferrous metals saw 1.9% and 0.2% growth. However, final consumption goods dropped 0.1% MoM in Aug, as general daily goods and durable goods dipped 0.2% and 0.3% respectively, indicating the soft final demand. Automobile and computers & electronic devices saw 0.3% and 0.2% declines in Aug. According to NBS, key anti-involution sectors such as photovoltaics and autos saw narrower YoY declines in Aug. However, momentum softened in September, testing the effectiveness of the anti-involution policy in fostering a mild reflation. Photovoltaics slowed down in

Frank Liu

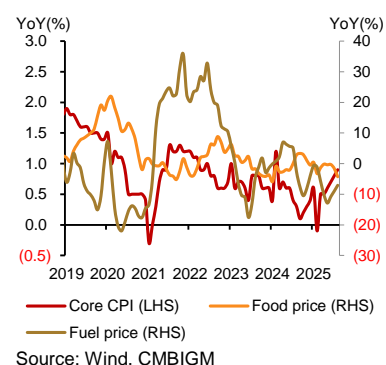
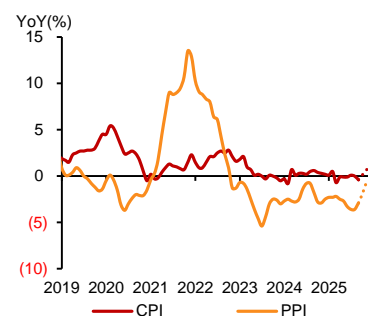
(852) 3761 8957

frankliu@cmbi.com.hk

Bingnan YE, Ph.D

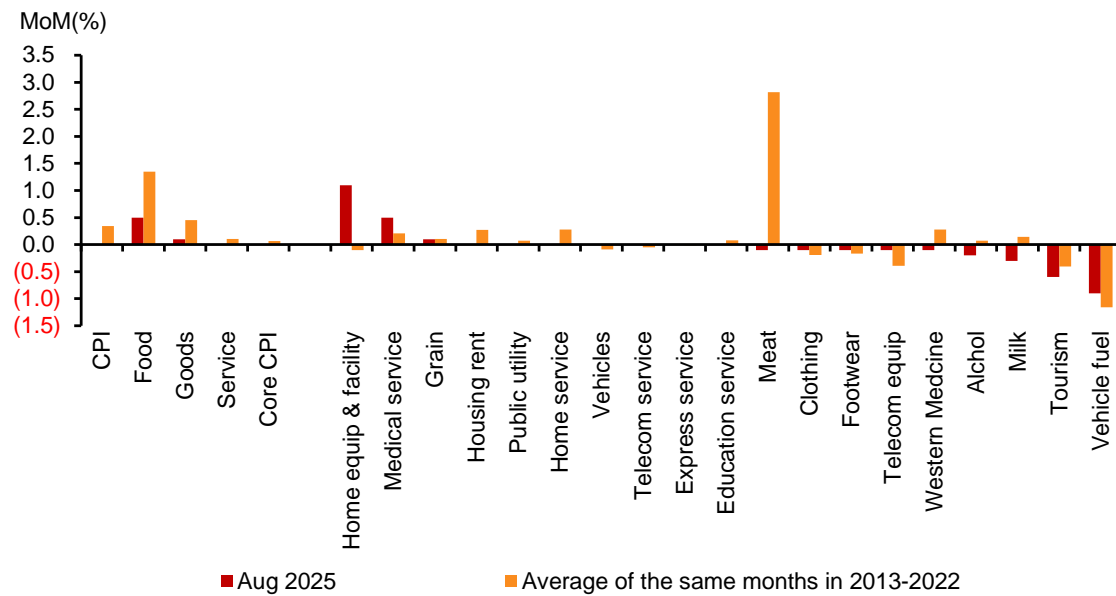
(852) 3761 8967

yebingnan@cmbi.com.hk

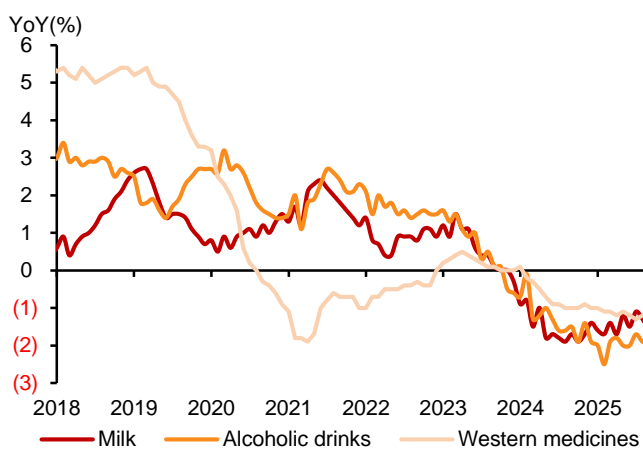


MoM growth in Sep, while lithium batteries, cement, and chemical products returned to negative territory. MoM growth of PPI might remain muted in Sep while YoY growth might continue to recover due to a much lower base last year.

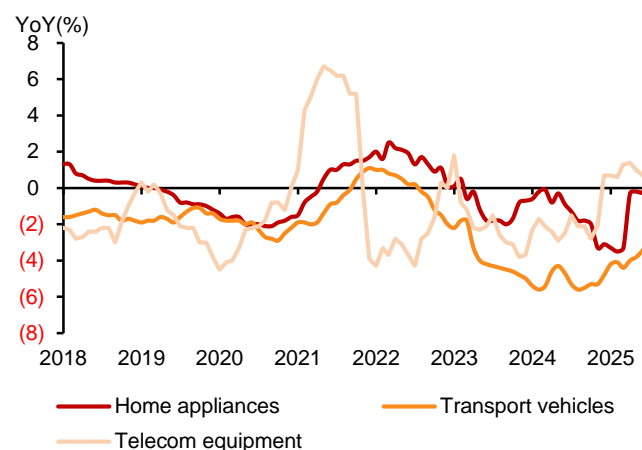
- **Subdued prices may compel further reinforcement of anti-involution policies.** While upstream key sectors have seen a notable rebound in prices in recent months, momentum has started to ease lately. At the same time, insufficient demand has kept terminal consumer goods prices weak. As anti-involution has become a policy priority, weaker-than-expected price levels will continue to necessitate additional policy measures. We expect the subdued PPI should recover in the remainder of the year due to continuous policy effort to curb involution and additional stimulus package on consumer demand. China's economy may face further headwinds in 2H25 given the softening property sector and the demand overdraft from export front-loading and trade-in scheme. Looking forward, we expect a policy easing window in 4Q25 with a further 10bps LPR cut and 50bps RRR cut, while fiscal policy might expand to support household and property sectors.

Figure 1: MoM changes of China CPI in Aug

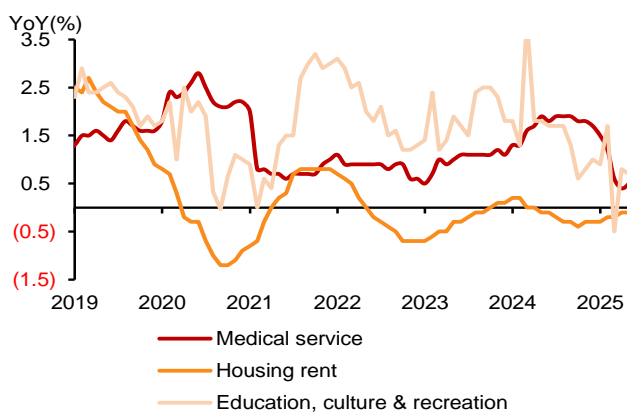
Source: Wind, CMBIGM

Figure 2: China CPI growth in staples

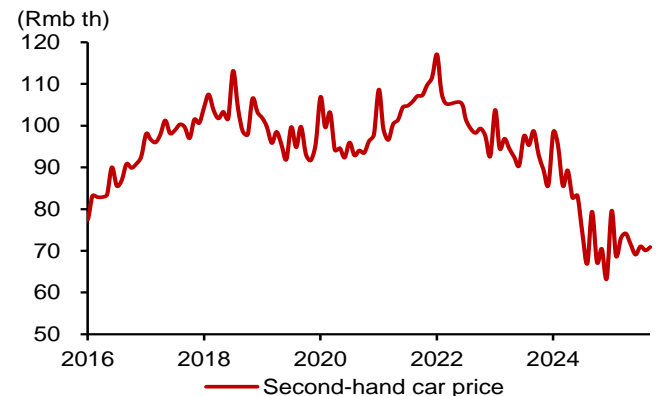
Source: Wind, CMBIGM

Figure 3: China CPI growth in durables

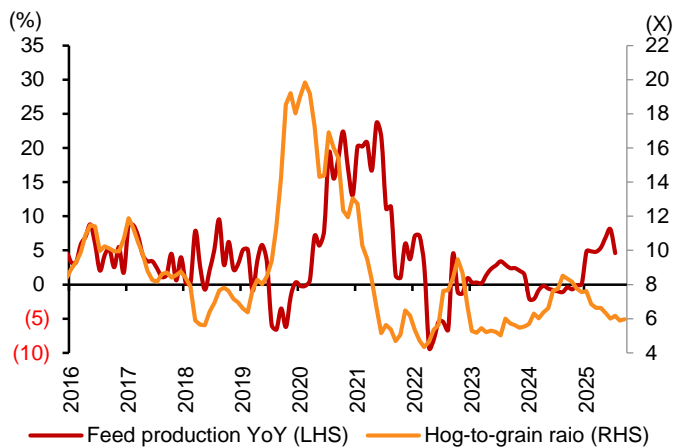
Source: Wind, CMBIGM

Figure 4: China CPI growth in services

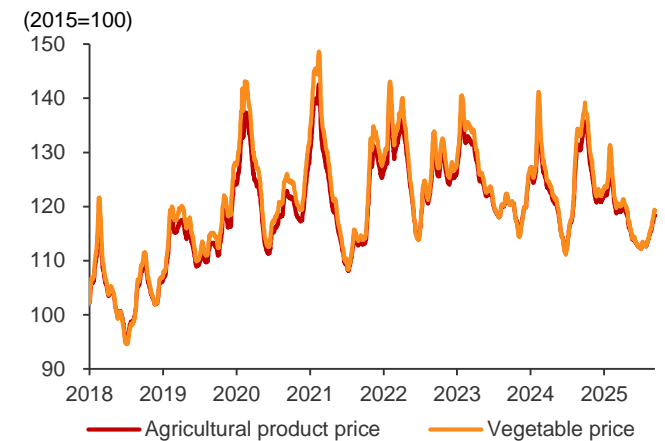
Source: Wind, CMBIGM

Figure 5: Second-hand car price in Shanghai

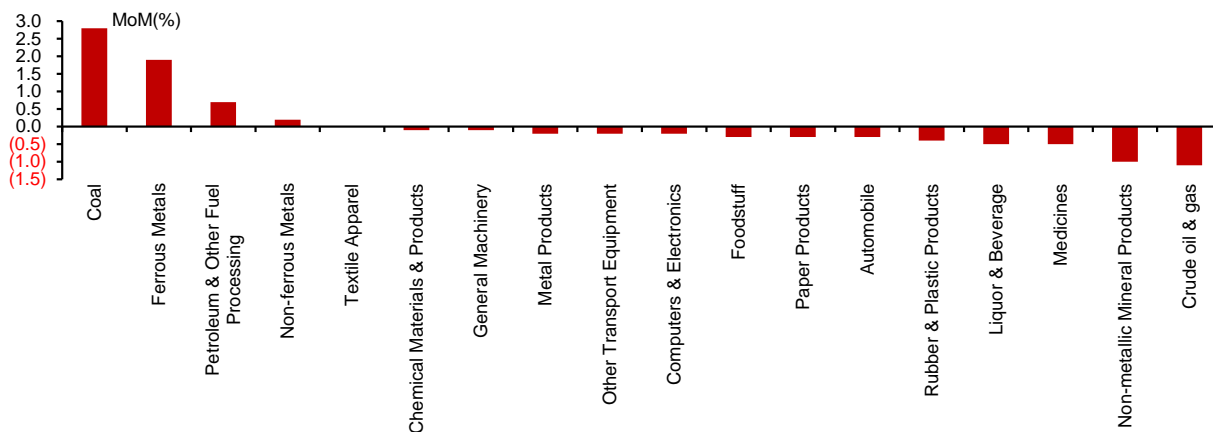
Source: Wind, CMBIGM

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

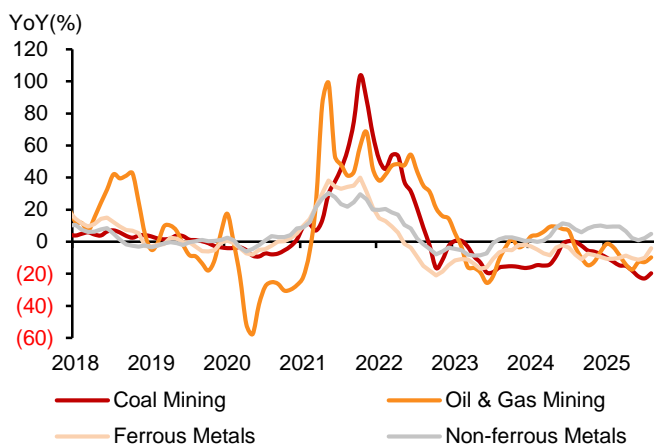
Source: Wind, CMBIGM

Figure 7: Agricultural and vegetable prices

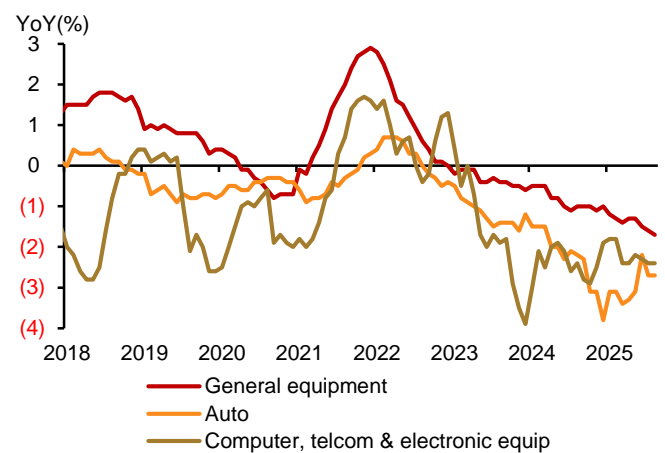
Source: Wind, CMBIGM

Figure 8: MoM changes of China PPI in Aug

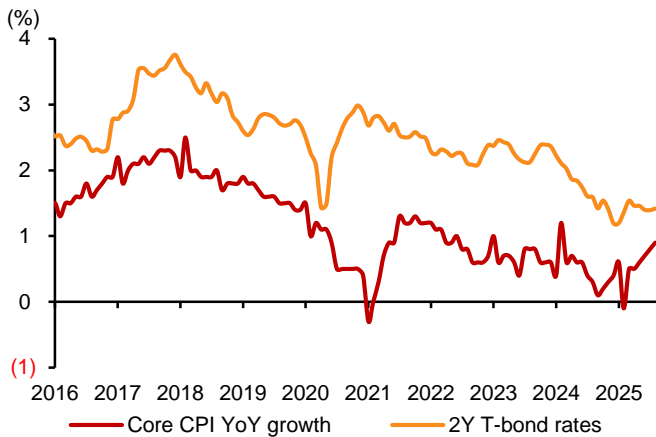
Source: Wind, CMBIGM

Figure 9: China PPI in energy & metals

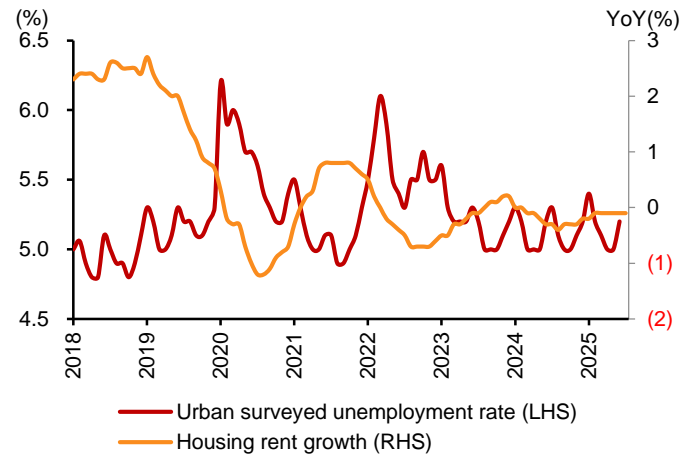
Source: Wind, CMBIGM

Figure 10: China PPI in equipment

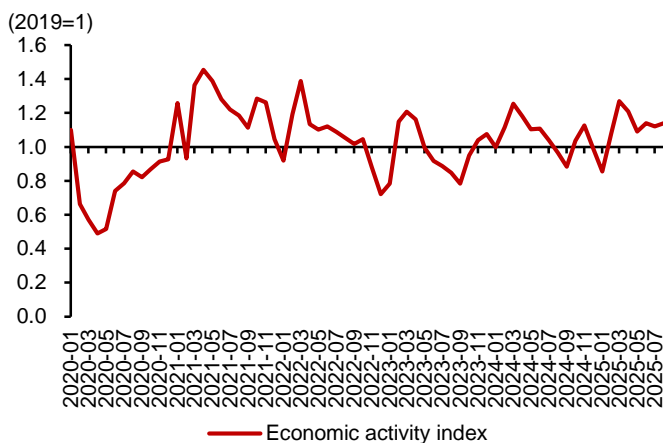
Source: Wind, CMBIGM

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

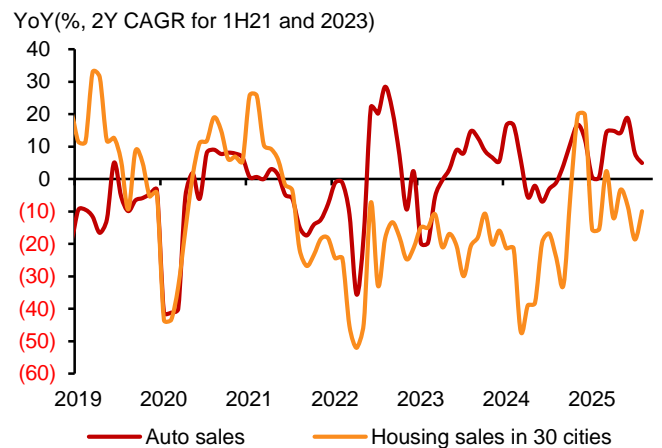
Source: Wind, CMBIGM

Figure 12: Unemployment rate and rent growth

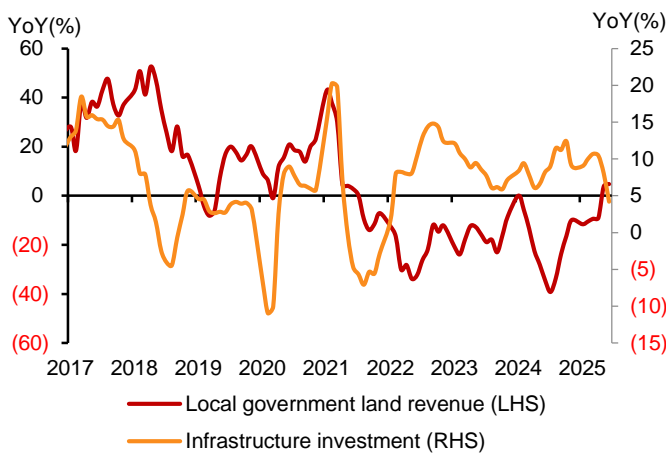
Source: Wind, CMBIGM estimates

Figure 13: China Economic Activity Index

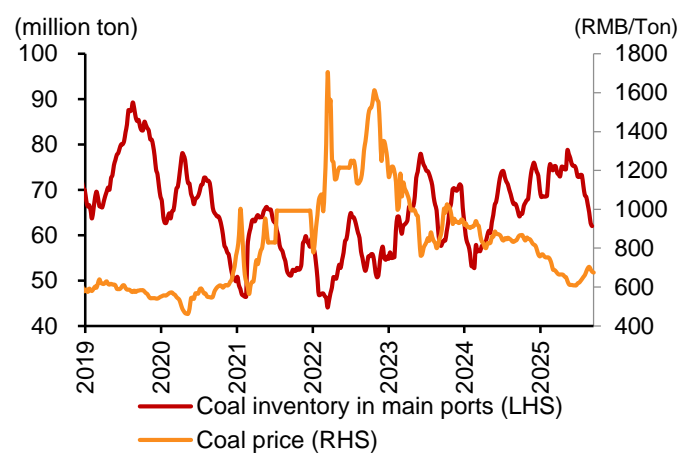
Source: Wind, CMBIGM

Figure 14: China auto & housing sales

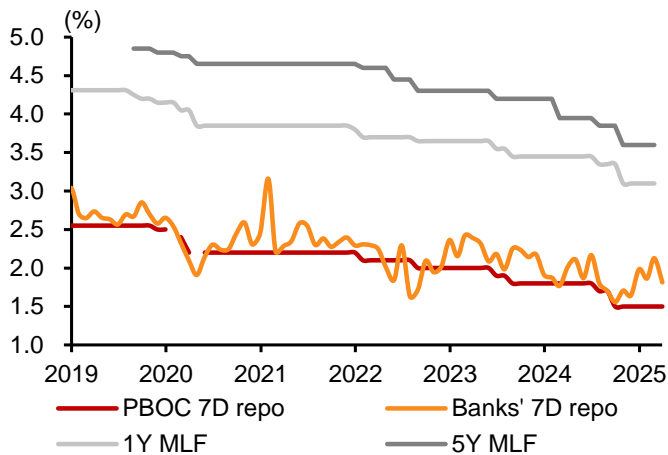
Source: Bloomberg, CMBIGM

Figure 15: Infrastructure investment in China

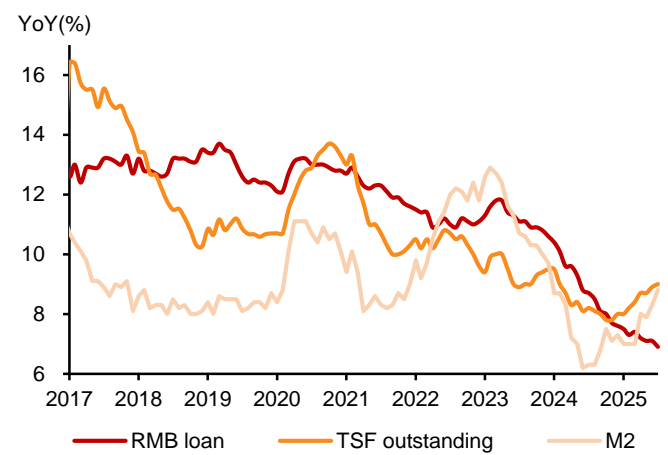
Source: Bloomberg, CMBIGM

Figure 16: China coal inventory & price

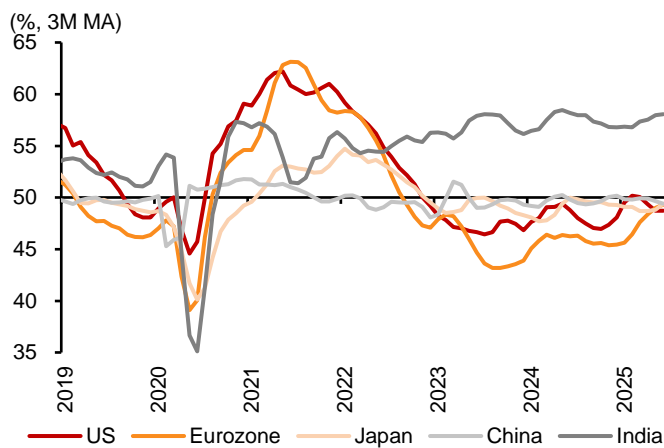
Source: Wind, CMBIGM

Figure 17: PBOC policy rates & liquidity condition

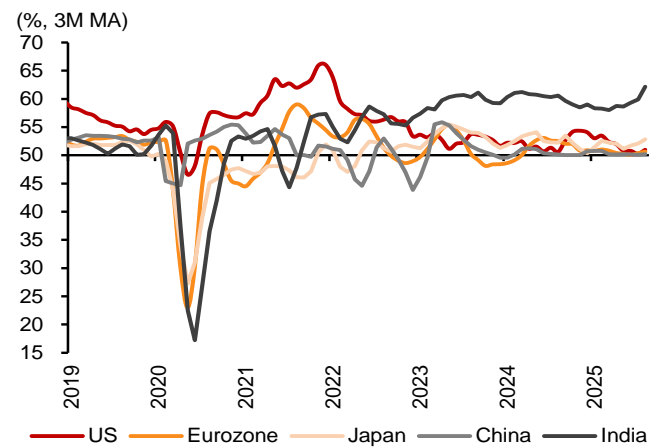
Source: Bloomberg, CMBIGM

Figure 18: China credit growth

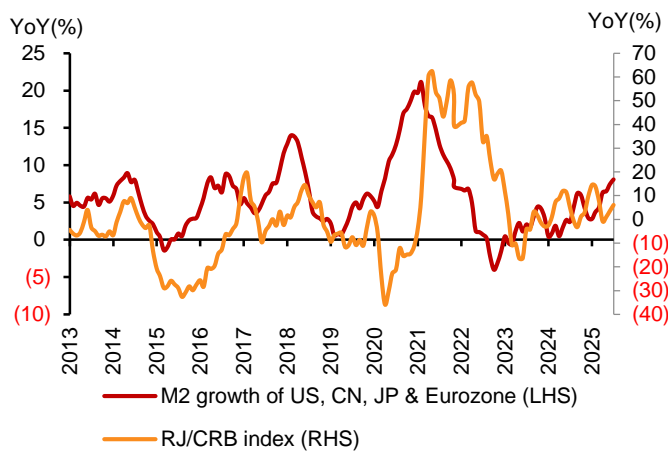
Source: Wind, CMBIGM

Figure 19: Manufacturing PMI of major economies

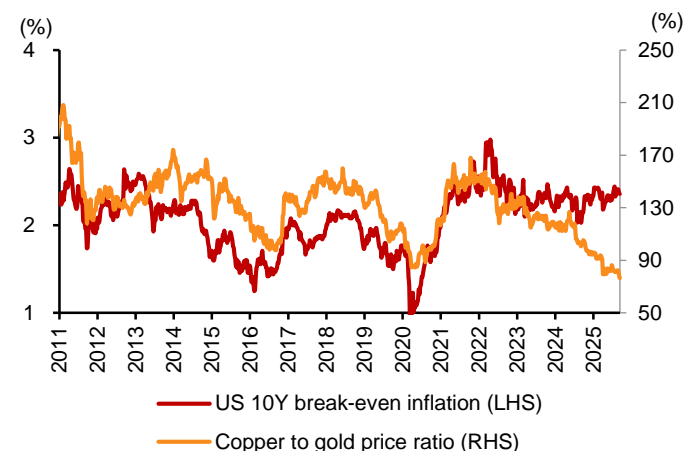
Source: Bloomberg, CMBIGM

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

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