

China Economy

Inflation slowed amid demand weakening

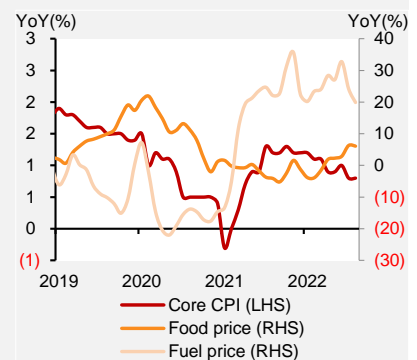
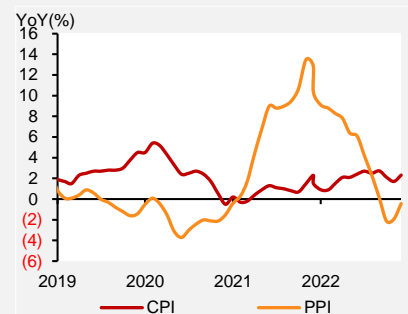
China's CPI growth slowed in August as food & energy inflation declined and core CPI growth remained weak. The PPI growth sharply decreased especially in energy, metals, construction materials and chemical products. The decline of inflation was mainly due to domestic demand weakening, global recession risk and supply chain resumption. Due to the demand deterioration, we revise down our forecast for the CPI growth in 2022 and 2023 respectively from 2.3% and 2.7% to 2.1% and 2.3%. We lower the forecast for the PPI growth in 2022 from 4.8% to 4% and maintain the forecast for 2023 at 1%. A possible mild pick-up of CPI growth will not change China's relatively easing monetary policy. We expect China will maintain easing liquidity condition and credit policy to support the economic resumption.

- **CPI growth was below expectations.** The YoY growth of consumer price index (CPI) decreased from 2.7% in July to 2.5% in August, below market expectations. From a MoM perspective, CPI declined 0.1% in August, lower than the average MoM growth of 0.5% in the same month for the past decade. The slowdown of CPI is mainly due to two factors. One is a decline of food & energy inflation amid supply chain improvement and demand deterioration. The other is weak growth of core CPI as consumer demand remained sluggish.
- **Food & energy inflation declined.** The YoY growth of food and gasoline respectively decelerated from 6.3% and 24.2% in July to 6.1% and 19.9% in August. From a MoM perspective, food price rose 0.5% and gasoline price dropped 4.8%. Their MoM growth rates were much lower than the average levels in the same month for the past decade. The slowdown of food and energy inflation was mainly due to the supply-side resumption and demand-side deterioration. Investors were increasingly concerned about the demand-side as China saw resurgence of Covid-19 virus and Europe and the US faced increasing recession risks in future.
- **Core CPI remained weak.** Core CPI rose 0.8% YoY in August, the same as in July. Core CPI maintained MoM growth rates around zero from March as consumer demand remained weak. In August, prices of air ticket, vehicle leasing, tourism service, clothing, footwear, home appliance, communication equipment and tourism service respectively declined 7.5%, 1%, 0.1%, 0.2%, 0.3%, 0.5% and 0.4% MoM, as the resurgence of Covid-19 virus hurt demand of these items.
- **PPI sharply slowed as demand continued to weaken.** The YoY growth of producer price index (PPI) slowed from 4.2% in July to 2.3% in August. From the MoM perspective, the PPI dropped 1.2% in August after declining 1.3% in July. Breaking down, petroleum & natural gas extraction declined 7.3% MoM as global energy prices retreated amid increasing recession risk. Coal price decreased 4.3% MoM as domestic supply continued to increase. Ferrous metals, metal products and non-metal mineral products respectively declined 4.1%, 1.1% and 1% MoM as property development investment continued to shrink. Producer inflation in equipment sector remained weak as business capex was tepid.
- **We revise down forecast for CPI and PPI growth due to weak domestic demand and overseas recession risk.** The CPI growth may slowly rise in

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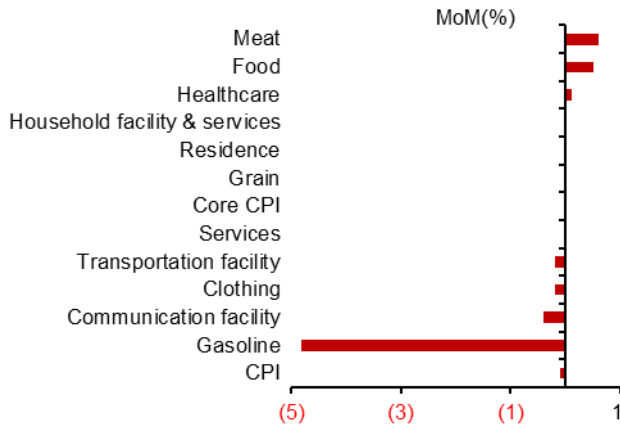
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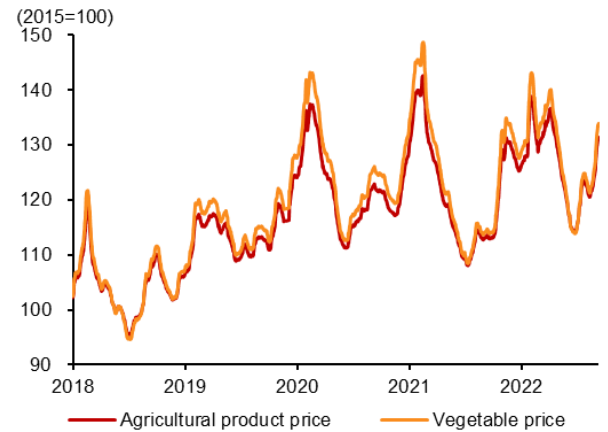


next two quarters. However, it should be lower than our previous forecast as domestic consumption remained weak, global recession risk increased and supply chain condition noticeably improved. We revise down our forecast for CPI growth rates in 2022 and 2023 respectively from 2.3% and 2.7% to 2.1% and 2.3%. The PPI growth may further decline in September and turn negative in October-November. It will see some fluctuations in 1H23 before rebounding in 2H23. Considering weak domestic demand and rising global recession risk, we revise down our forecast on PPI growth for 2022 from 4.8% to 4% and maintain the forecast for 2023 at 1%.

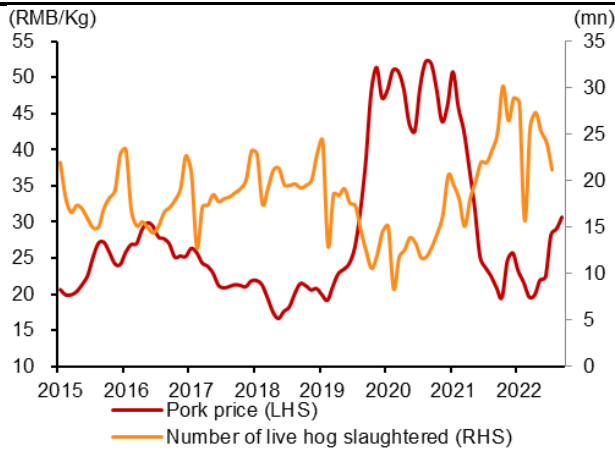
- **Policy implications.** The decline of inflation indicates weakening of domestic demand and rising global recession risk. A possible mild pick-up of CPI growth will not change China's relatively easing monetary policy. We expect China will maintain easing liquidity condition to facilitate credit supply. To spur credit demand, China may further loosen credit policy with moderate declines in loan contract rates especially in mortgage rates. To gain additional room for credit loosening, China may have to keep exchange rates flexible and lower deposit rates.

Figure 1: MoM Changes of China Consumer Prices

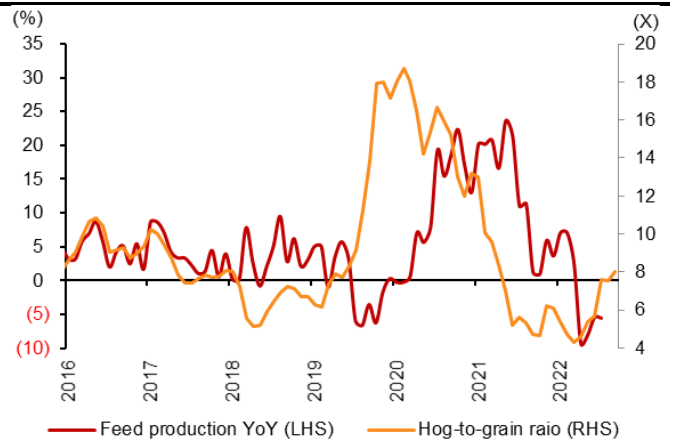
Source: Wind, CMBIGM

Figure 2: China Agricultural Product Price

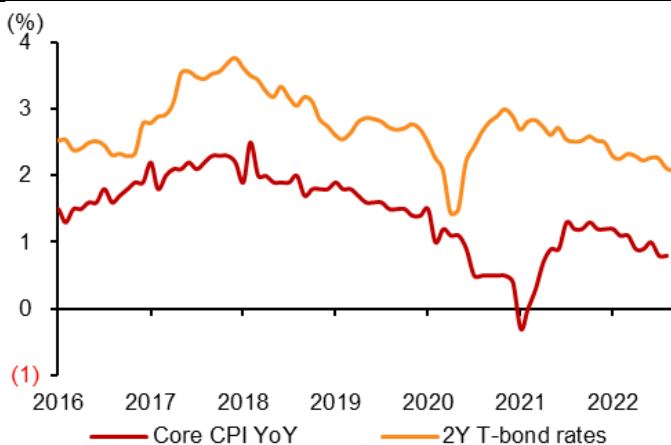
Source: Wind, CMBIGM

Figure 3: China Pork Price and Supply

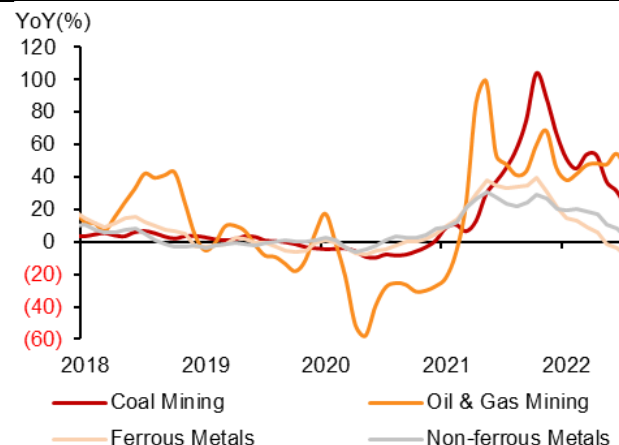
Source: Wind, CMBIGM

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

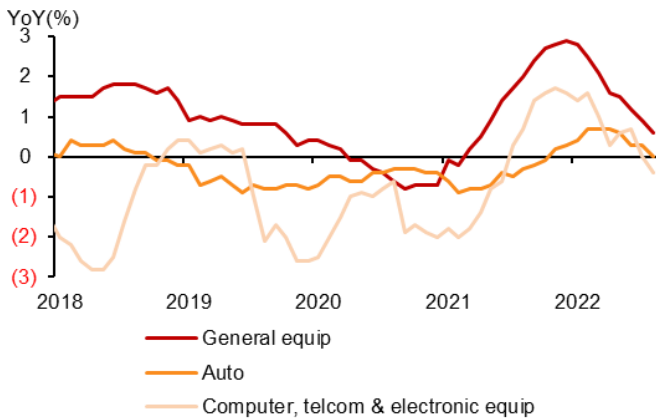
Source: Wind, CMBIGM

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

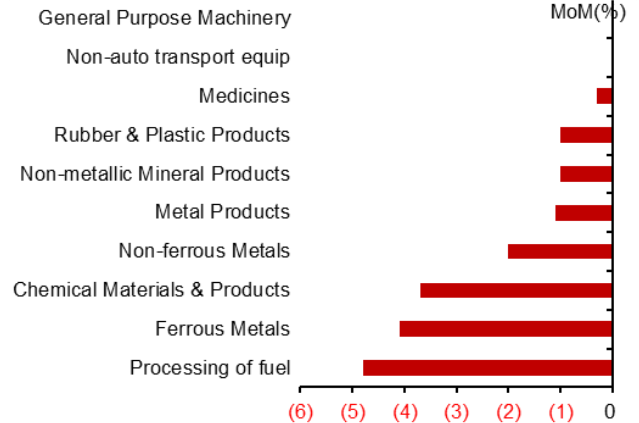
Source: Wind, CMBIGM

Figure 6: China Producer Price Growth in Commodity

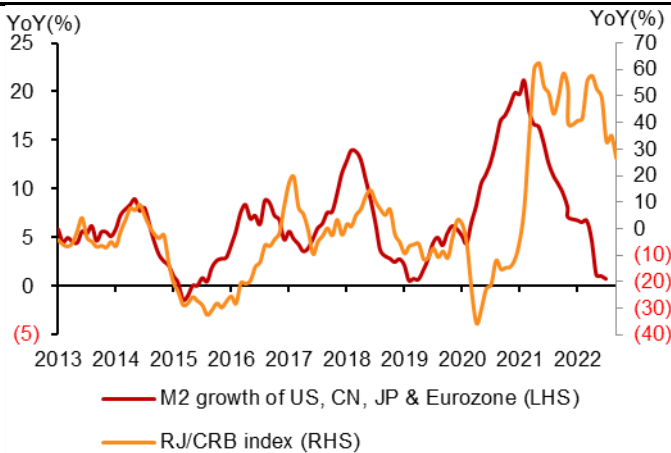
Source: Wind, CMBIGM

Figure 7: China Producer Price Growth in Equipment

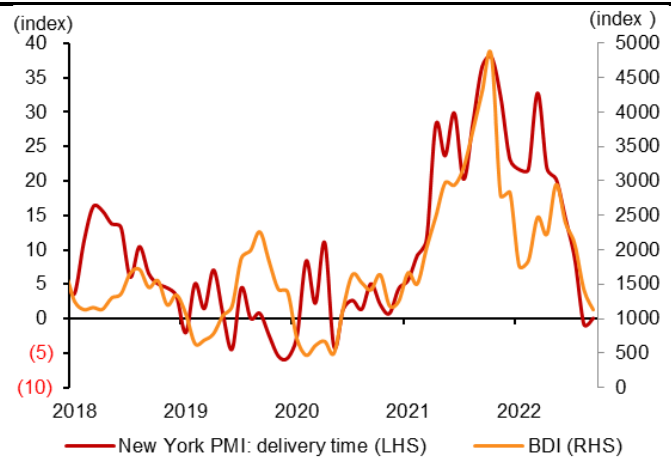
Source: Wind, CMBIGM

Figure 8: China's Producer Price

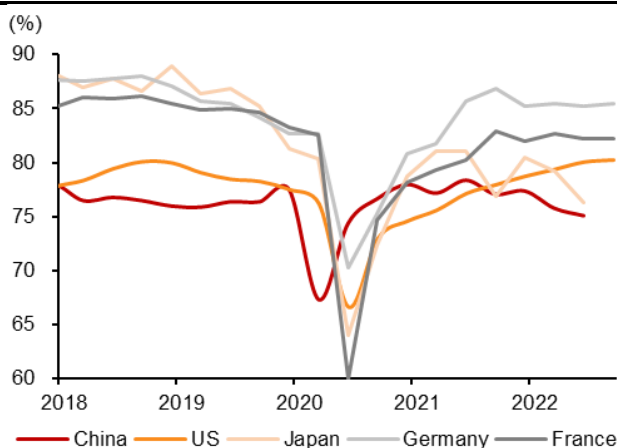
Source: Wind, CMBIGM

Figure 9: Global M2 Growth & Commodity Price

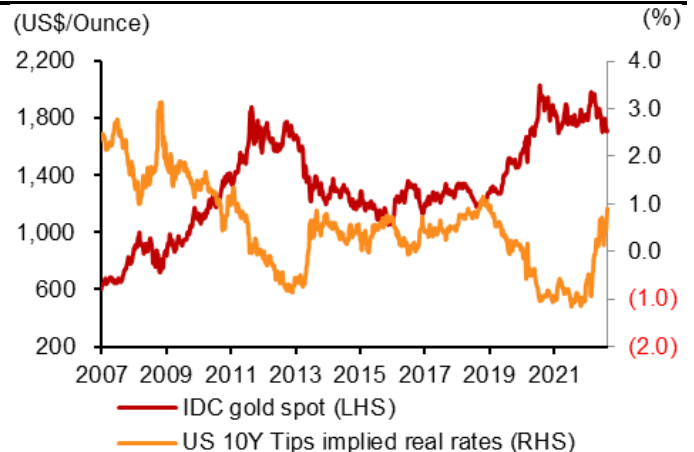
Source: Wind, CMBIGM

Figure 10: Global Supply Chain Pressure

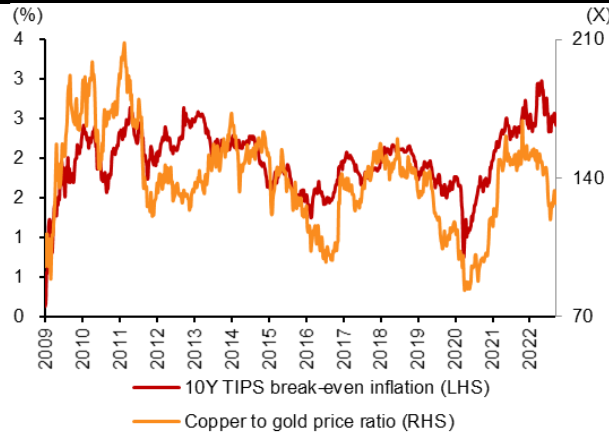
Source: Wind, CMBIGM

Figure 11: Manufacturing Capacity Utilisation Ratio

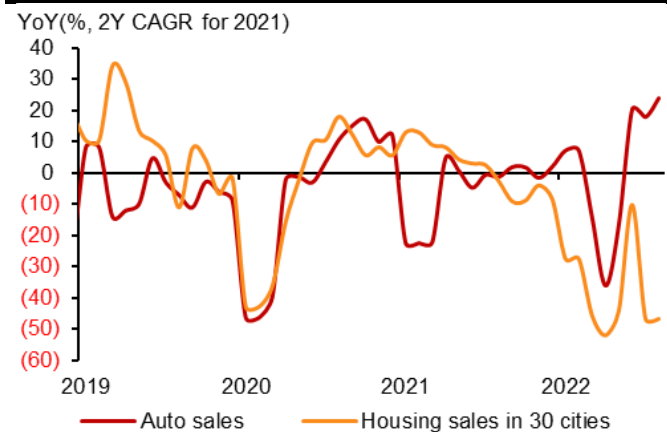
Source: Wind, CMBIGM

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

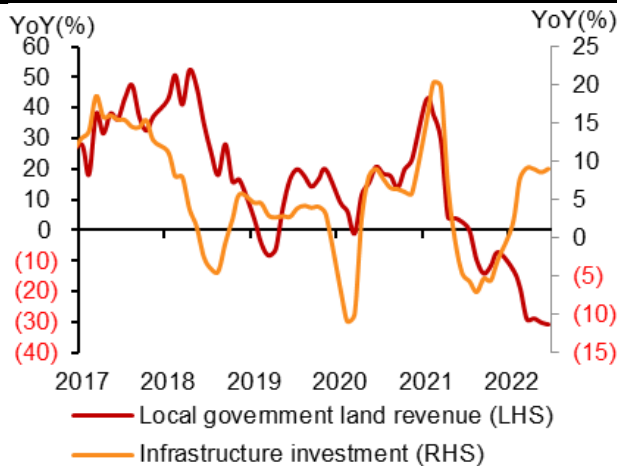
Source: Wind, CMBIGM

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

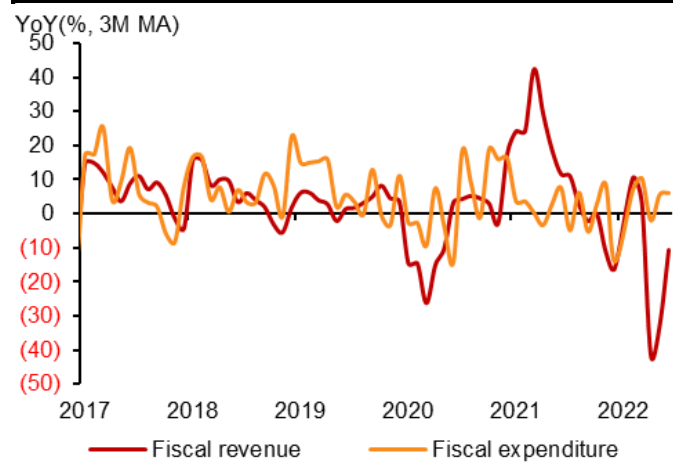
Source: Wind, CMBIGM

Figure 14: China Auto & Housing Sales Growth

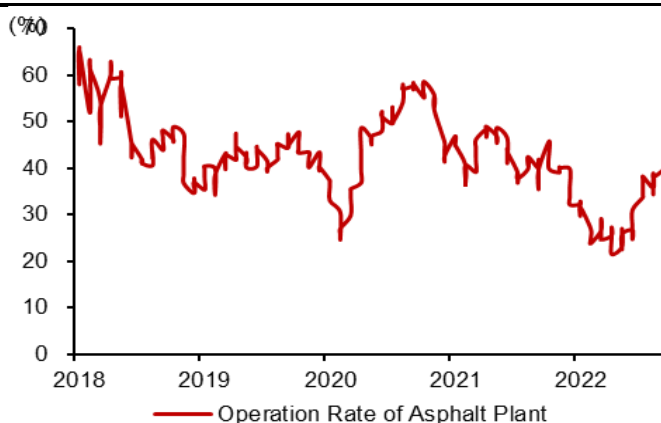
Source: Bloomberg, CMBIGM

Figure 15: Land Revenue & Infrastructure Investment

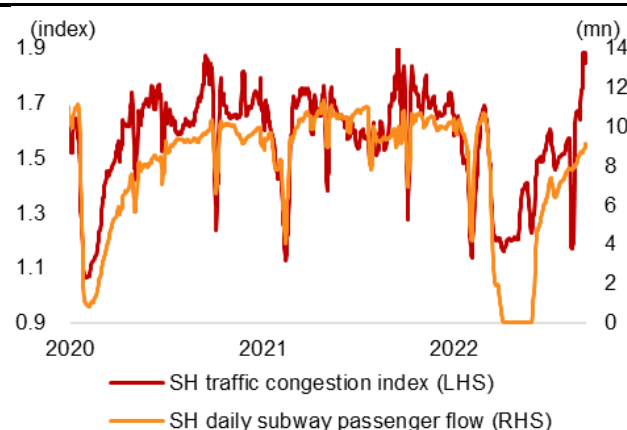
Source: Bloomberg, CMBIGM

Figure 16: China Fiscal Revenue & Expenditure

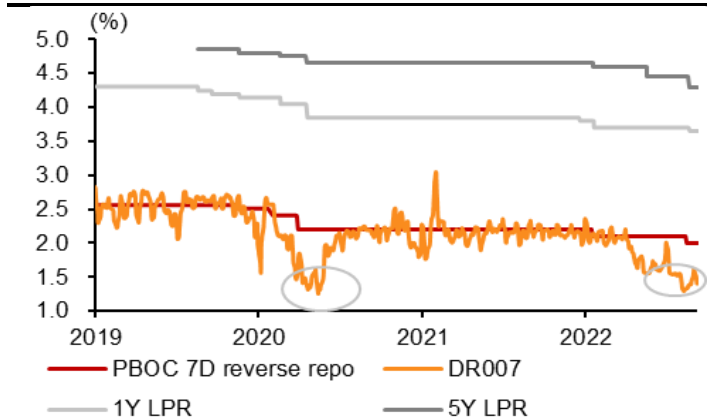
Source: Wind, CMBIGM

Figure 17: Operation Rate of Asphalt Plant in China

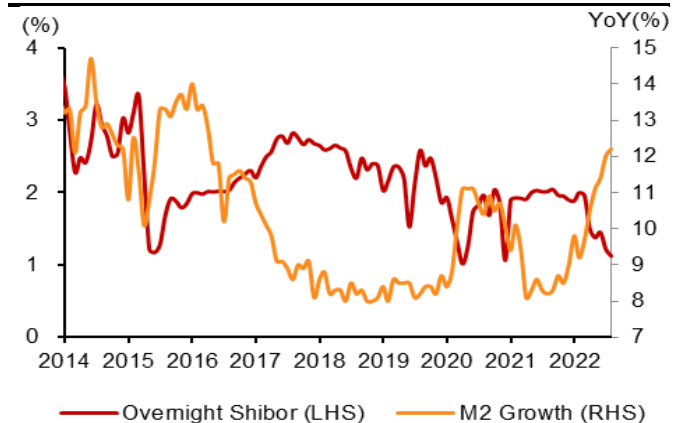
Source: Bloomberg, CMBIGM

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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