

China Economy

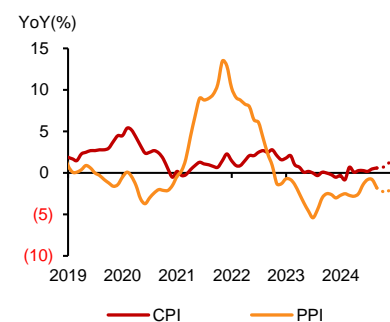
Deflation pressure intensified

Aug CPI growth edged up but still came in below expectation. Food price remained the major driver as vegetable price remarkably surged. Core CPI growth reached a post-Covid low as home service price was the only item registering subtle MoM growth in Aug, indicating the subdued consumer demand. PPI sharply declined as global commodity prices retreated amid weakening demand and overcapacity pressure. Persistent deflation has pushed up real debt burden, restrained durables consumption and eroded business earnings. The good news is that deflation may have drawn the attention of the top policymakers as previous governor of the PBOC indicated monetary policy should focus on addressing deflation pressure recently. The policymakers may start to consider how to defy a deflation like in 1998-2001 in the next several months. The monetary policy may remain accommodative with additional cuts by 10-20bps in LPRs, refinancing rates and deposit rates in the remainder of the year. We expect deflation pressure might last in the remainder of this year before possible alleviation next year. We estimate China's CPI and PPI growth rates may rise from 0.2% and -3% in 2023 to 0.5% and -1.5% in 2024 and 1.2% and 1% in 2025.

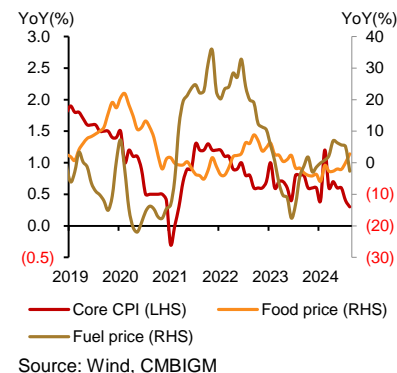
- Food price continued to drive CPI recovery.** CPI YoY growth rebounded to 0.6% in Aug from 0.5% in July, slightly below market expectation of 0.7%. In sequential terms, CPI moderated to 0.4% after growing 0.5% in July. Food price remarkably surged by 3.4% MoM in Aug after rising 1.2% due to shortage of supply resulted from high temperature or rainy weather in most provinces, the biggest jump since Jan 2021, with vegetable price notably increasing by 18.1% MoM in Aug. YoY growth of food price increased to 2.8% in Aug from 0%. According to high-frequency data, price of agricultural products and vegetables has slowed down in early Sep. Pork prices accelerated from 2% MoM growth in July to 7.3% in Aug. Vehicle fuel price notably dropped from 5.1% to -2.7% YoY while its MoM growth dipped 2.9% in Aug after rising 1.5%, due to declining crude oil price.
- Core CPI growth reached a post-Covid low as consumer demand remained soft.** Core CPI surprisingly dropped 0.2% MoM in Aug following a brief month of growth, weaker than previous seasonality. Its YoY growth edged down to 0.3% in Aug from 0.4%, reaching the lowest point since Mar 2021. Service price notably dropped 0.1% in Aug after rising 0.6% in July. Home service was the only item in core CPI that registered positive MoM growth in Aug, while tourism price slowed down to -0.7% after surging 9.4% MoM in July. Education, telecom, rent and medical services all showed 0 growth while express service dropped by 0.1% MoM. Durable goods prices remained subdued as vehicle price dropped 0.3% in Aug following a 0.6% dip. Average unit price in Shanghai second-hand car market has bottoming out, rebounding to -23.5% YoY in early Sep after dropping 30% in early Aug. Telecom equipment price further plunged 0.8% MoM after dropping 0.1% in July. Home appliance price dipped 0.7% MoM in Aug after rebounding 0.4% in July, as effort from government to ramp up subsidy supporting demand might take more time. Looking forward, CPI may continue to modestly recover thanks to the low base although growth of food price might moderated in upcoming months. Core CPI growth may pick up in Sep heading into national holidays but may remain restrained in medium term due to lethargic consumer demand amid an elevated real interest rate and weak employment conditions.
- PPI significantly dipped amid declining global commodity price and weak domestic manufacturing activities.** The MoM growth of PPI markedly declined by 0.7% in Aug compared to -0.2% drop in July, the

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Forecast numbers from Mar 2024
 Source: Wind, CMBIGM

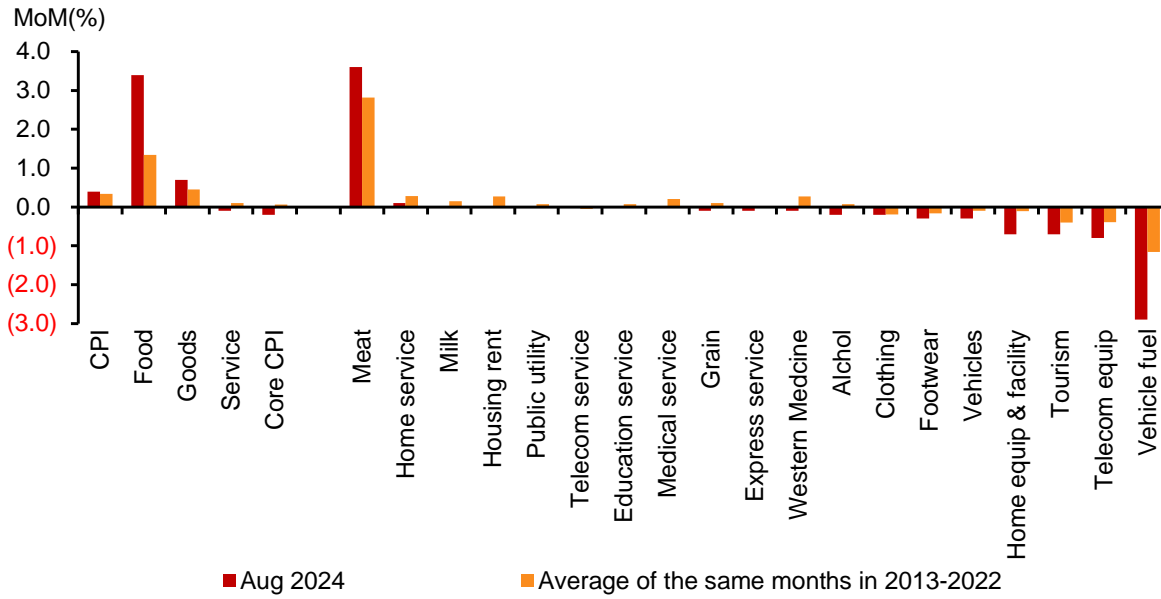


Source: Wind, CMBIGM

largest decline in 14 months. Its YoY contraction dipped to -1.8% in Aug after dropping 0.8% in July, below market expectation at -1.5%. For mining industries, PPI of coal mining, oil & gas, and ferrous metals all dropped to -0.1%, -3.3% and -8% YoY in Aug from 0.3%, 6.7% and -3.7%, while non-ferrous metals moderated to 7.6% from 10.6%. For mid-stream industries, PPI in intermediate goods such as rubber & plastics, metal products and chemical products all dropped by 0.3%, 0.6% and 0.9% MoM respectively. For final goods, auto manufacturing saw a 0.2% MoM decline after one brief month of growth while PCs dipped by 0.2% in Aug. Looking forward, we expect the PPI may widen its YoY decline in the next three months before improving again from late 4Q. CRB commodities index has continued to decline in early Sep, dragged by the weakening manufacturing activities in US, Europe and China.

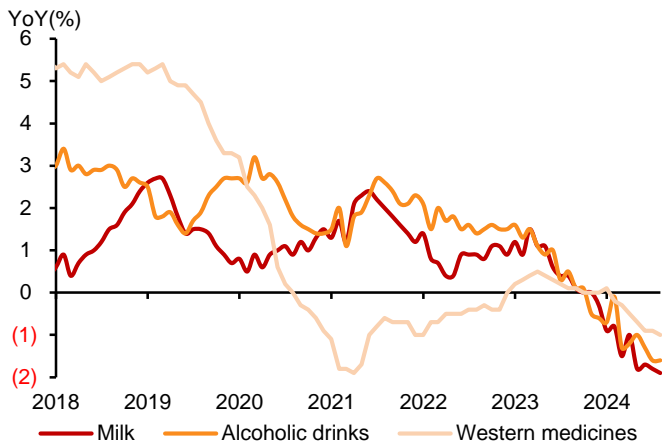
- **Deflation may have drawn the attention of the top policymakers.** Persistent deflation has pushed up real debt burden, restrained durables consumption and eroded business earnings. The good news is deflation may have drawn the attention of the top policymakers as previous governor of the PBOC has pointed out recently that monetary policy should focus on addressing deflation pressure. China may start to consider how to defy a deflation like in 1998-2001 in the next several months. The policymakers have made a subtle shift towards demand-side stimulation as they raised fiscal subsidies to households for their auto & home appliance upgrading and may further lower outstanding mortgage rates. China's monetary policy may remain accommodative with additional cuts by 10-20bps in LPRs, refinancing rates and deposit rates in the remainder of the year. We expect deflation pressure to last in the remainder of this year before possible alleviation next year.

Figure 1: MoM Changes of China CPI in Aug



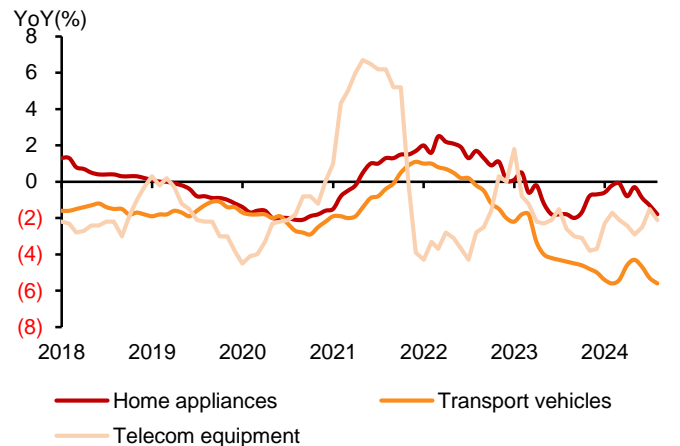
Source: Wind, CMBIGM

Figure 2: China CPI Growth in Staples



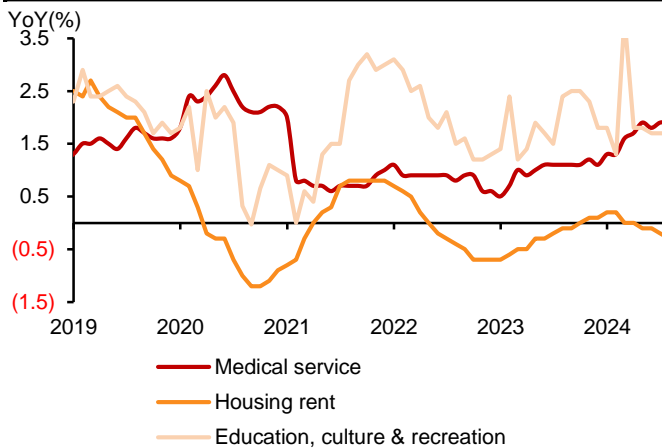
Source: Wind, CMBIGM

Figure 3: China CPI Growth in Durables



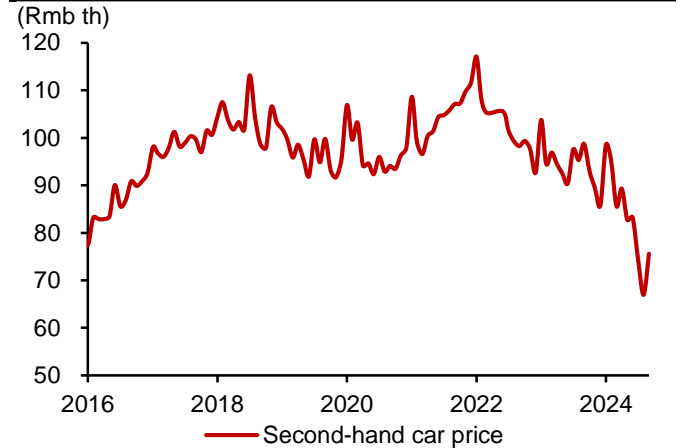
Source: Wind, CMBIGM

Figure 4: China CPI Growth in Services



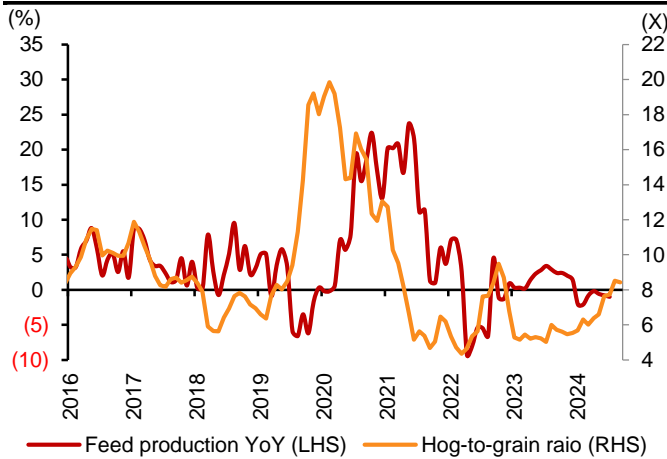
Source: Wind, CMBIGM

Figure 5: Second-hand Car Price in Shanghai



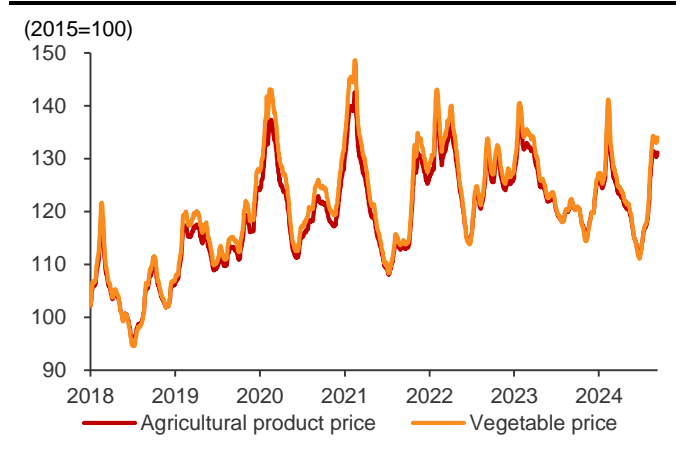
Source: Wind, CMBIGM

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



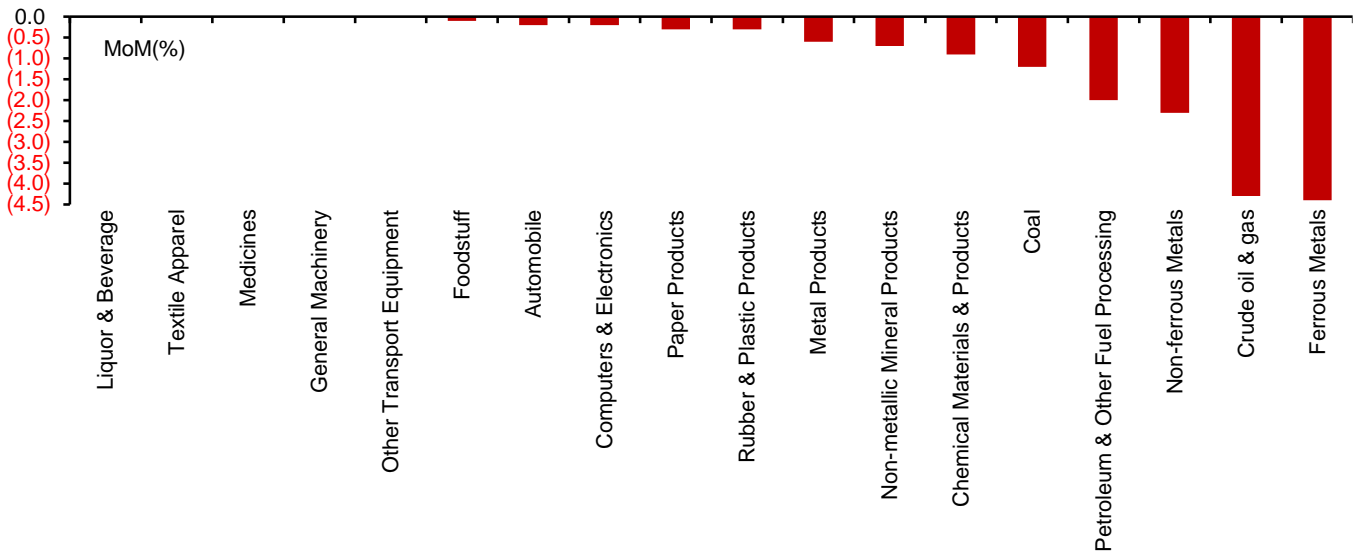
Source: Wind, CMBIGM

Figure 7: Agricultural and Vegetable Price



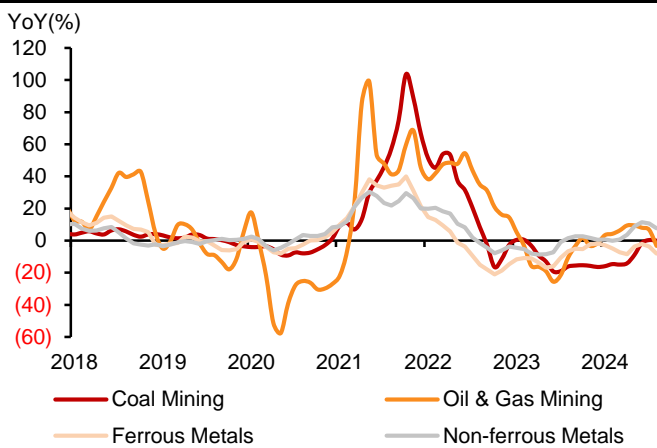
Source: Wind, CMBIGM

Figure 8: MoM Changes of China PPI in Aug



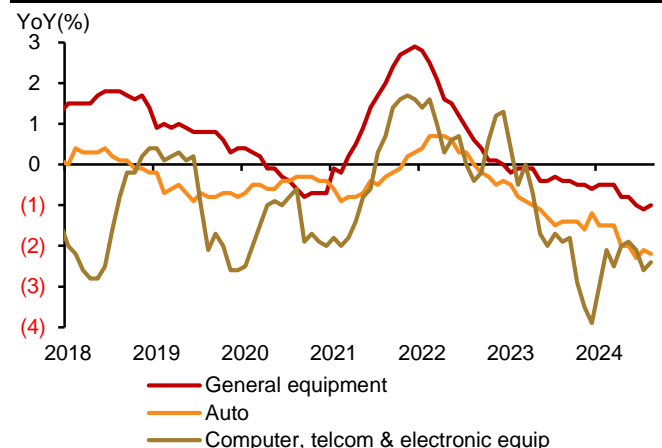
Source: Wind, CMBIGM

Figure 9: China PPI in Energy & Metals



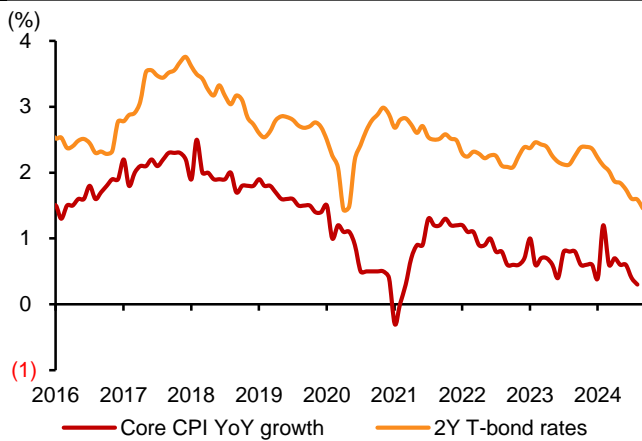
Source: Wind, CMBIGM

Figure 10: China PPI in Equipment



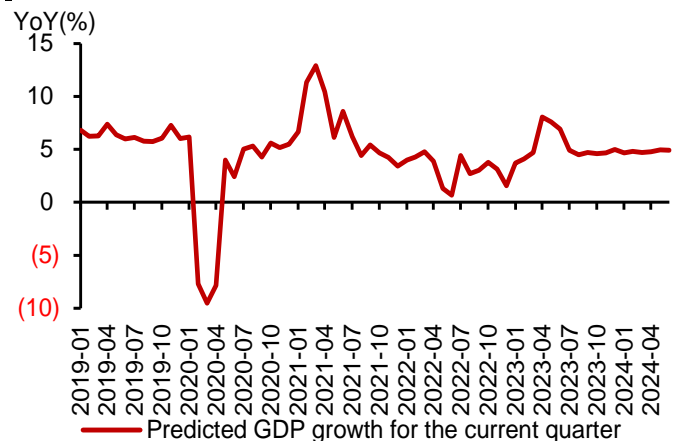
Source: Wind, CMBIGM

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



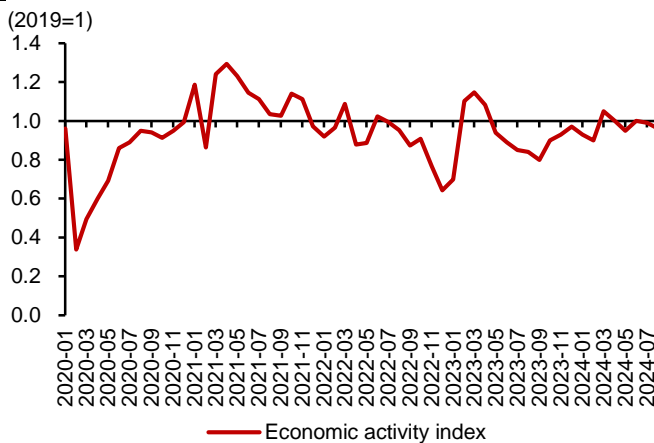
Source: Wind, CMBIGM

Figure 12: GDP Growth Predicted by AI



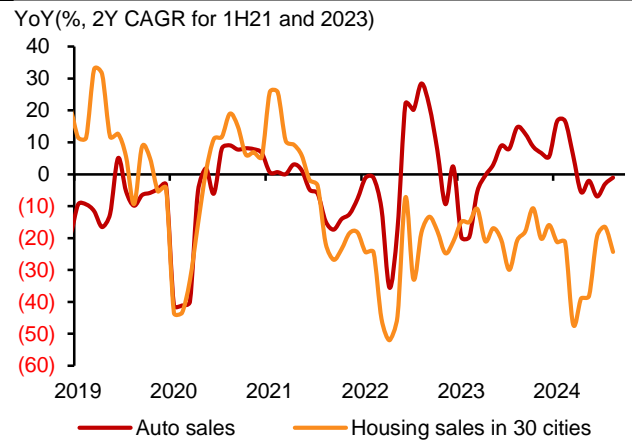
Source: Wind, CMBIGM estimates

Figure 13: China Economic Activity Index



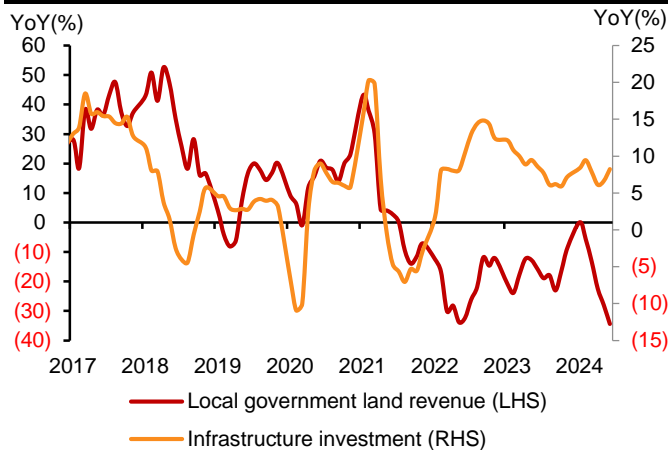
Source: Wind, CMBIGM

Figure 14: China Auto & Housing Sales



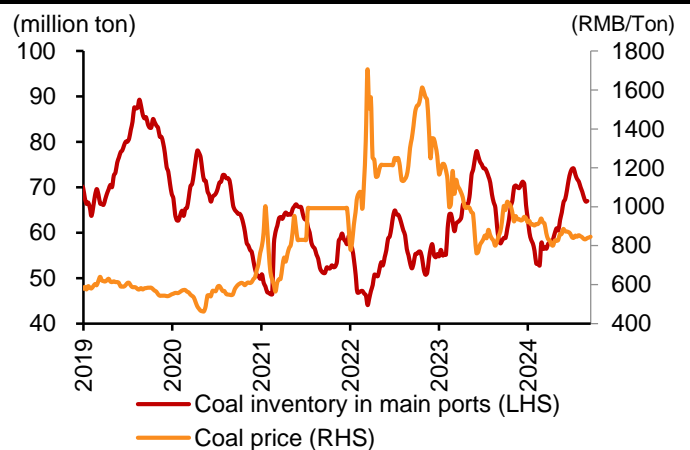
Source: Bloomberg, CMBIGM

Figure 15: Infrastructure Investment in China



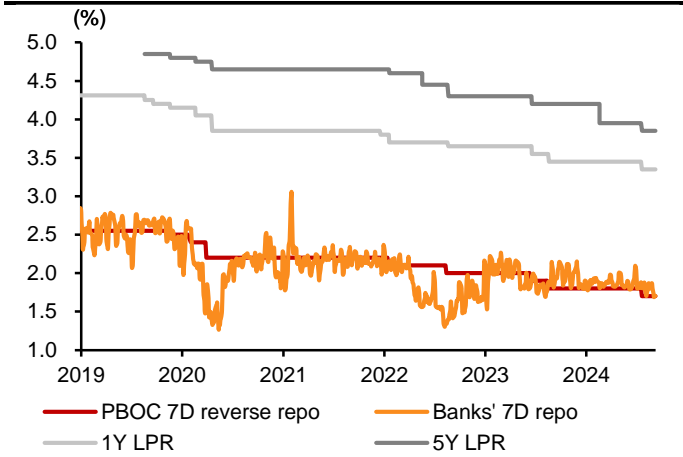
Source: Bloomberg, CMBIGM

Figure 16: China Coal Inventory & Price



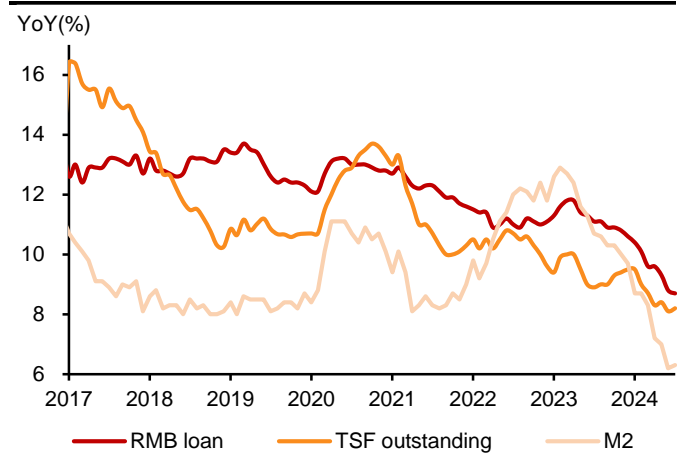
Source: Wind, CMBIGM

Figure 17: PBOC Policy Rates & Liquidity Condition



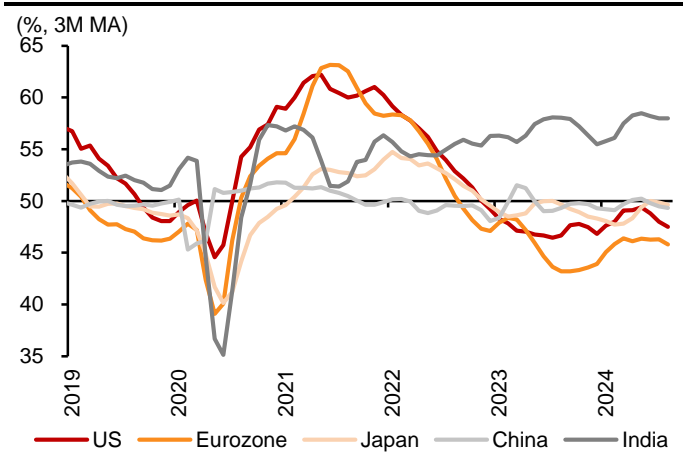
Source: Bloomberg, CMBIGM

Figure 18: China Credit Growth



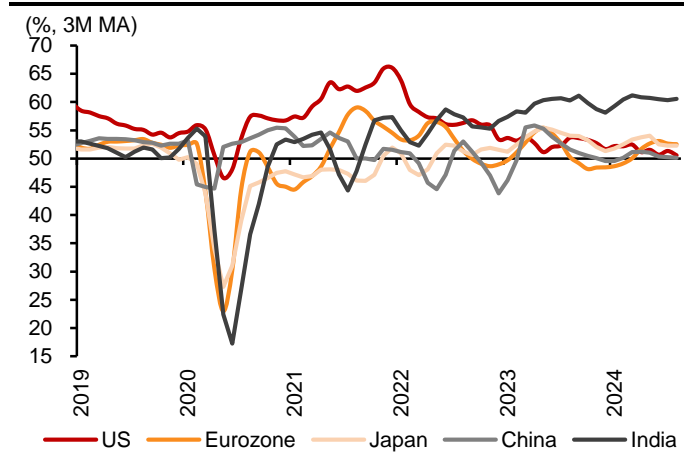
Source: Wind, CMBIGM

Figure 19: Manufacturing PMI of Major Economies



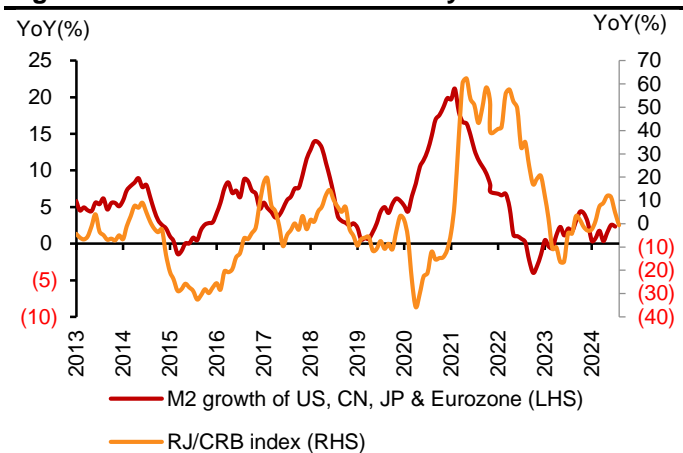
Source: Bloomberg, CMBIGM

Figure 20: Service PMI of Major Economies



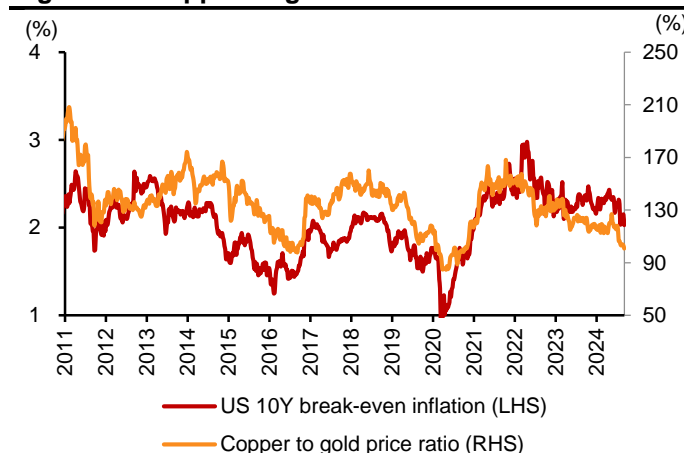
Source: Wind, CMBIGM

Figure 21: M2 Growth & Commodity Inflation



Source: Bloomberg, CMBIGM

Figure 22: Copper-to-gold Ratio



Source: Wind, CMBIGM

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