

China Economy

Deflation spurs call for additional policy loosening

China's CPI growth fell short of market expectation and returned to negative again at -0.2% in Oct. The continuous slump of food prices is still the major drag of softened CPI as pork price dropped 30.1% in Oct. Domestic demand remained floppy as core CPI inched down to 0.6%. The YoY decline of China's PPI widened for the first time in four months to 2.6% due to the easing of energy prices and higher base effect last year. The deflation increased real-term interest rates and debt burden of the real economy sector and negatively affected durables consumption and business capex. The deflation indicates weak aggregate demand and spurs the call for additional policy loosening. Looking forward, we expect the CPI and PPI may remain weak in the next two months before gradually improving in 2024. We revise down our forecast on CPI growth for 2023 from 0.6% to 0.4% while maintaining the forecast for 2024 at 2%. We revise down the forecast on PPI growth for 2023 from -2.7% to -3% and maintain the forecast for 2024 at 1.3%.

■ **CPI growth railed back to negative due to the drag of food deflation.** CPI came in short of expectation, edging down to -0.2% YoY in Oct after staying flat in Sep. In sequential terms, CPI dropped 0.1% after increasing 0.2% in Sep. The retracted CPI YoY growth is mainly driven by the food price and weak domestic demand for goods and services. Food CPI noticeably dropped 4% YoY after declining 3.2% in Sep, as the pork price dropped 30.1% YoY in Oct. Pork sequential growth dipped to -2% from 0.2% in Sep. As the number of live pigs in stock and breeding sows is still elevated, we expect the drag from pork price due to excessive supply on CPI will not end just yet. The energy price continued to surge as vehicle fuel expanded its YoY growth from -1.1% to 1.8% while public utility price edged up to 0.6% after rising 0.5%. The MoM growth of vehicle fuel moderated from 2.3% to 1.8%. Core CPI growth inched down to 0.6% YoY from 0.8% as its MoM growth dropped to 0% from 0.1%. Demand for durables, which had the greatest impact on production output, was still weak as CPI in transport vehicles and telecom equipment stayed soft while home equipment saw a solid rebound in MoM growth. Services CPI growth edged down to 1.2% YoY in Oct while its MoM growth remained at -0.1%. MoM growth of tourism dropped 0.3% while delivery service dropped 0.1%. Employment condition remained challenging with slow improvement as housing rent slightly increased in October after contracting for several months.

■ **PPI widened its YoY declines as the energy and commodity prices softened.** PPI declined 2.6% YoY in Oct after dropping 2.5% YoY in Aug, which has been in contraction for 13 months. PPI in coal mining and ferrous metals respectively dropped 15.4% and 5.2% in Oct after decreasing 15.6% and 5% in Sep. Meanwhile, PPI in oil & gas mining and non-ferrous metal picked up 1.7% and 2.6% after dropping 3.3% and rising 2.7% in Sep. From the MoM perspective, PPI inched down to 0% in Oct after rising 0.4% in Sep. The MoM growth of crude oil & gas and petroleum eased to 2.8% and 2.5% from 4.1% and 3.1%. Prices of export-intensive industries like ferrous metals, computers & electronics, non-ferrous metals, automobiles and general machinery all saw a decline in MoM growth at -0.6%, -0.3%, -0.2%, -0.1% and -0.1% as effected by the deteriorated export in Oct. The moving trend of PPI

Bingnan YE, Ph.D

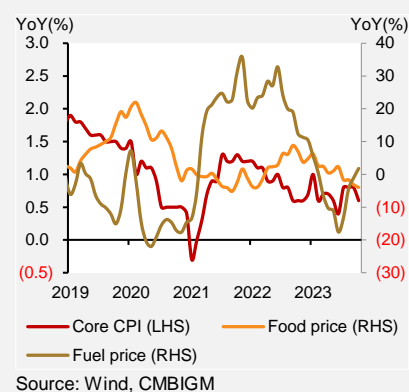
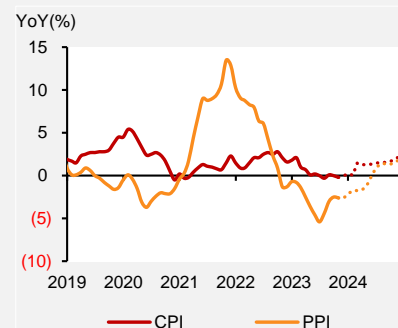
(852) 6989 5170

yebingnan@cmbi.com.hk

Frank Liu

(852) 3761 8957

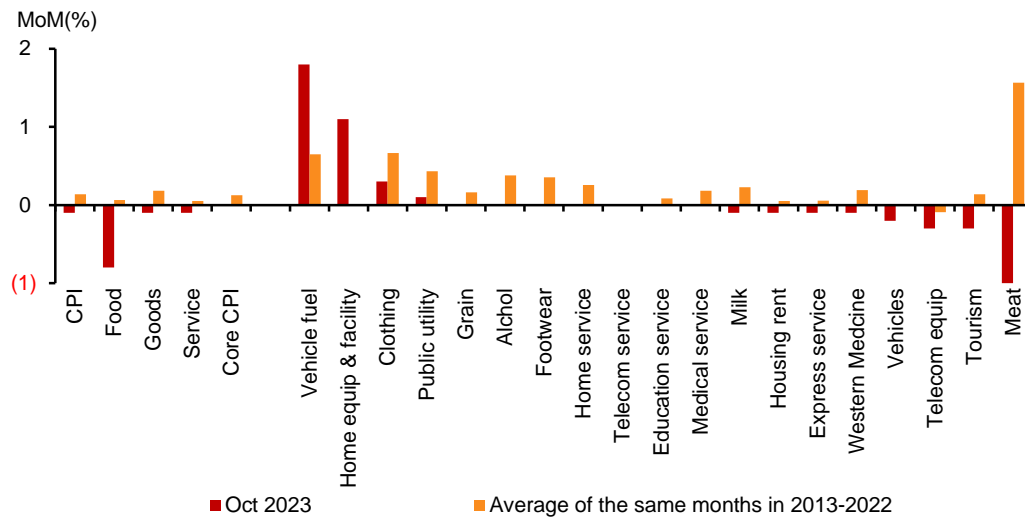
frankliu@cmbi.com.hk



growth is highly related to the inventory cycle as the widened PPI decline as well as the fall of PMI indicate the de-stocking trend in most manufacturing industries has not been alleviated yet.

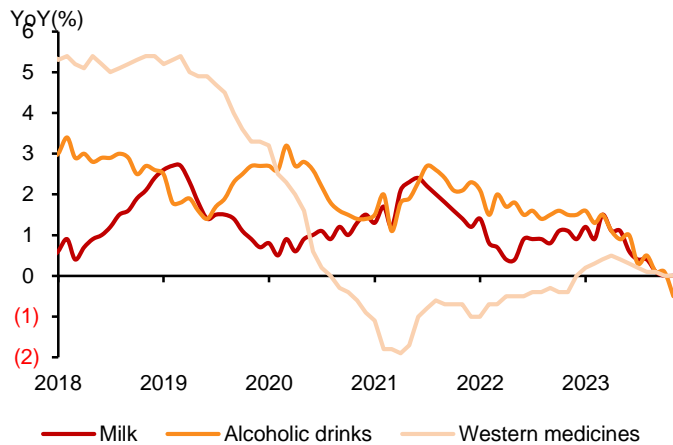
- **We expect a mild reflation in CPI and PPI with continuous credit loosening, gradual demand improvement and base effect ahead.** We expect the central bank to maintain easing liquidity and credit policy with additional cuts in RRR, LPRs and deposit rates in the next three quarters to facilitate credit expansion. The PBOC also vows liquidity support for debt-ridden local governments. Fiscal policy will be more proactive as the central government has allowed provincial governments to issue special bonds to repay the matured hidden debts. However, the improvement of domestic demand may remain slow due to property market slump and weak business confidence. We revise down our forecast on CPI growth for 2023 from 0.6% to 0.4% and maintain the forecast for 2024 at 2%. We revise down the forecast on PPI growth for 2023 from -2.7% to -3% while maintaining that for 2024 at 1.3%.

Figure 1: MoM Changes of China CPI in Sep



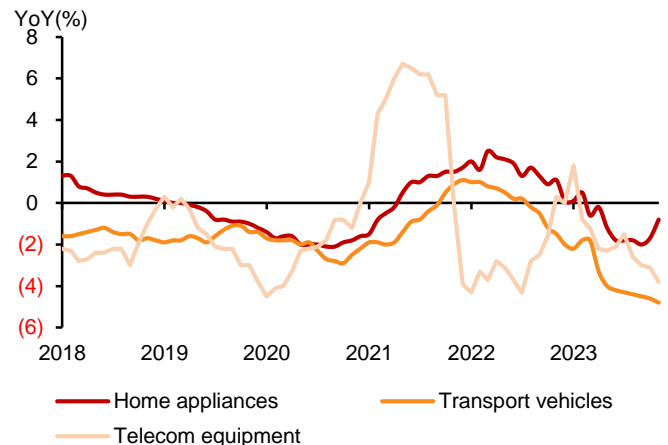
Source: Wind, CMBIGM estimates

Figure 2: China CPI Growth in Staples



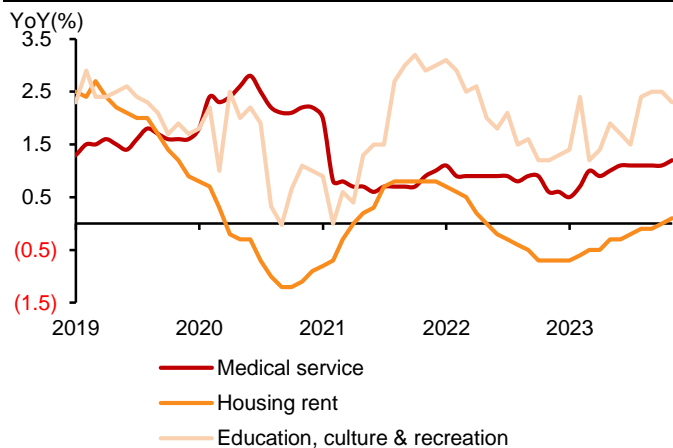
Source: Wind, CMBIGM

Figure 3: China CPI Growth in Durables



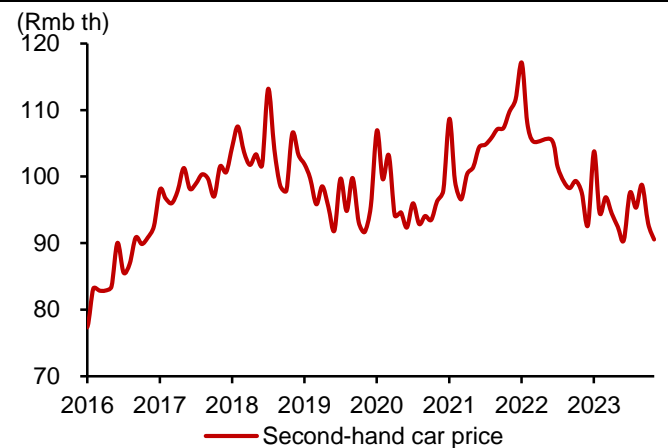
Source: Wind, CMBIGM

Figure 4: China CPI Growth in Services



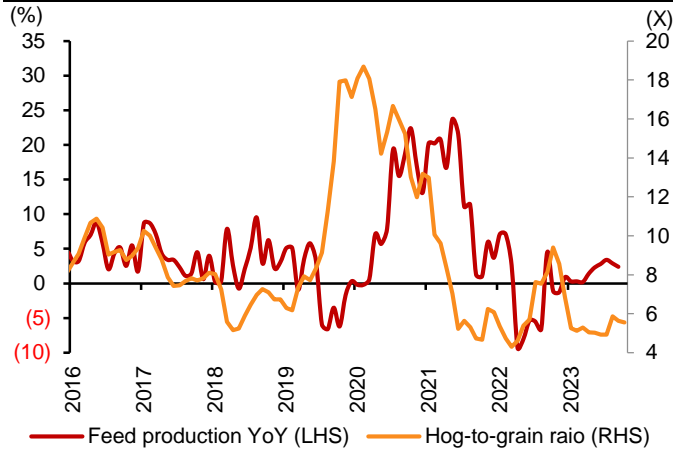
Source: Wind, CMBIGM

Figure 5: Second-hand Car Price in Shanghai



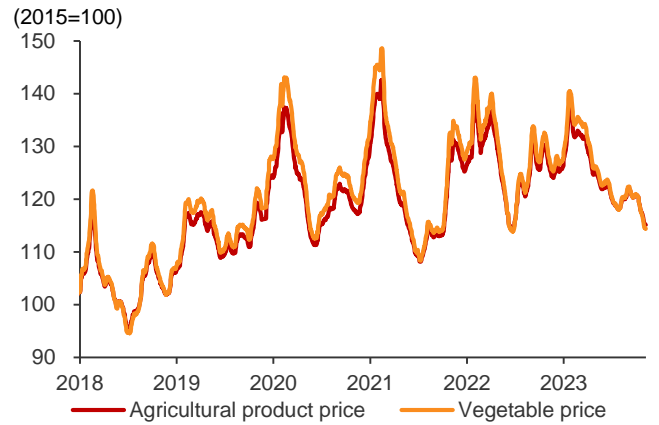
Source: Wind, CMBIGM

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



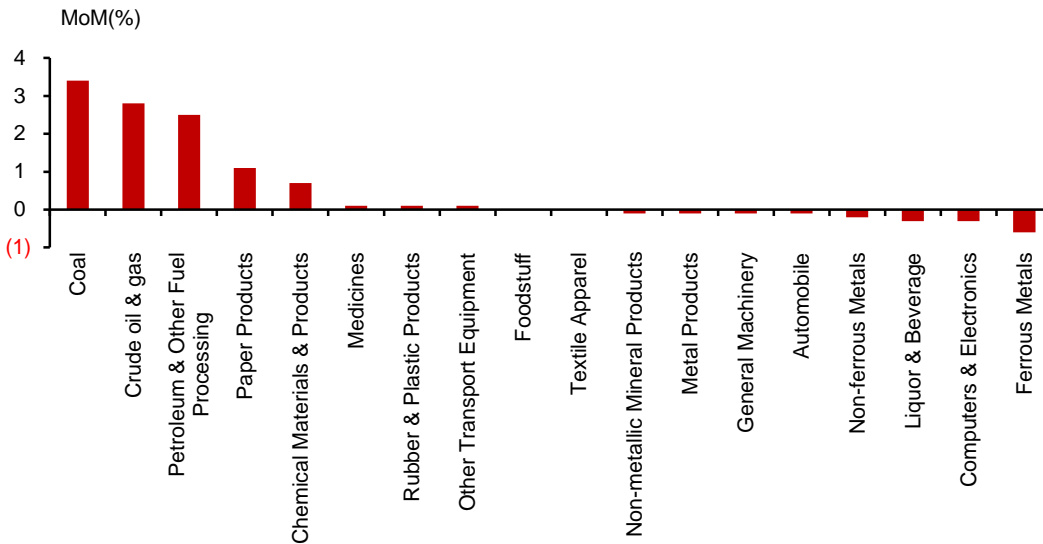
Source: Wind, CMBIGM

Figure 7: Agricultural and vegetable price



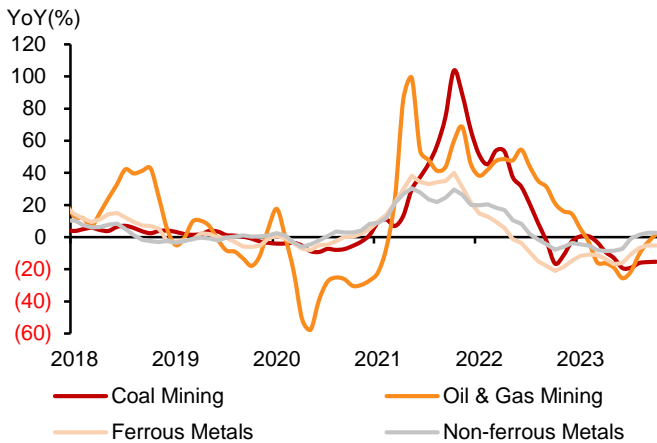
Source: Wind, CMBIGM

Figure 8: MoM Changes of China PPI in Sep



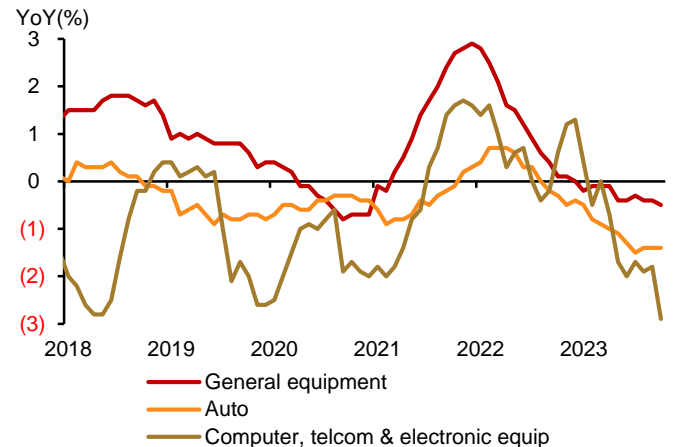
Source: Wind, CMBIGM estimates

Figure 9: China PPI in Energy & Metals



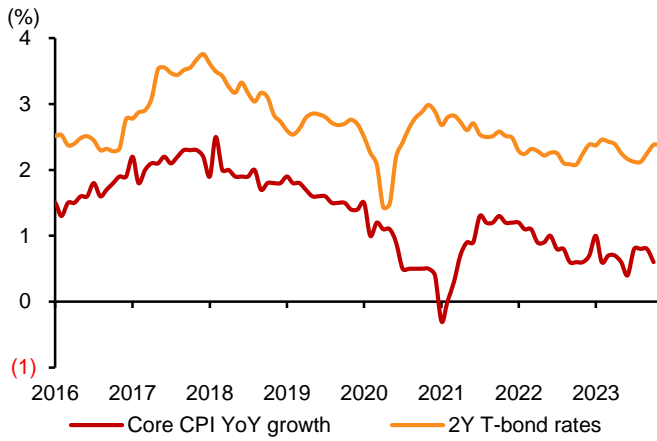
Source: Wind, CMBIGM

Figure 10: China PPI in Equipment



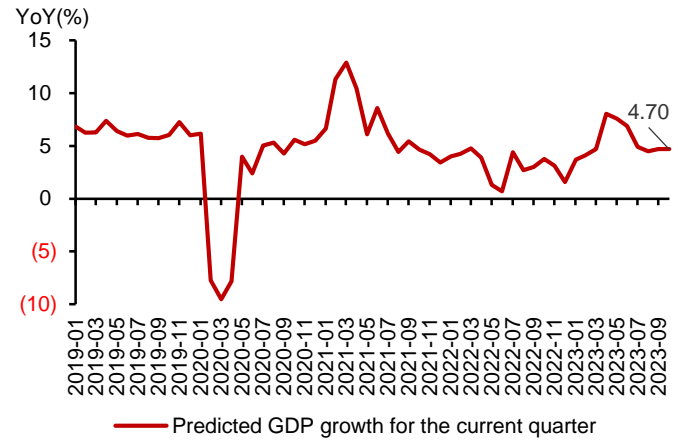
Source: Wind, CMBIGM

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



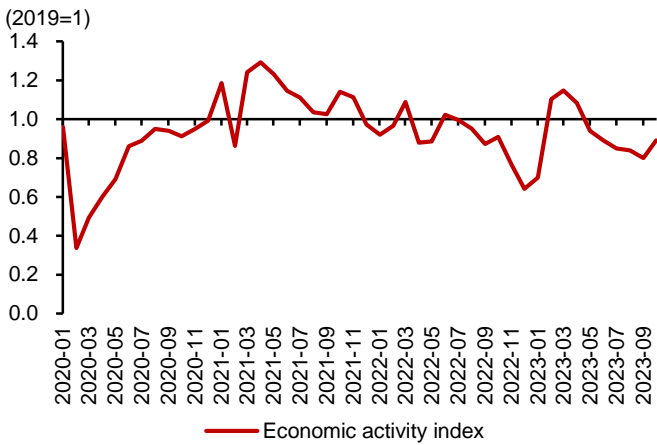
Source: Wind, CMBIGM

Figure 12: China Predicted GDP Growth



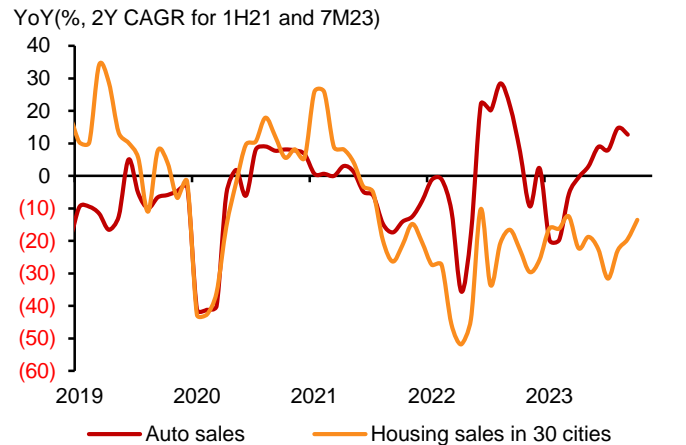
Source: Wind, CMBIGM

Figure 13: China Economic Activity Index



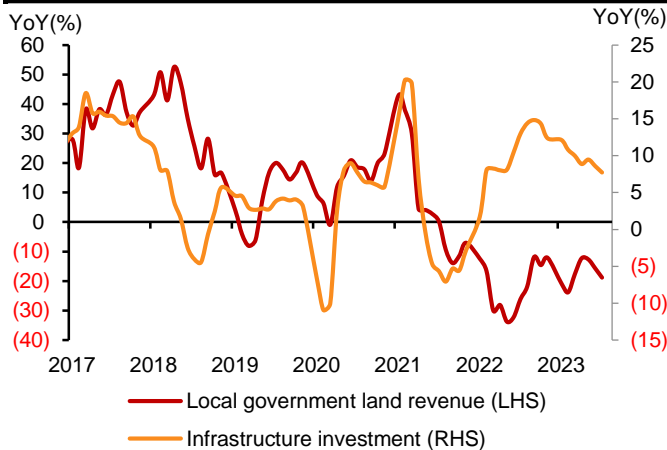
Source: Wind, CMBIGM

Figure 14: China Auto & Housing Sales



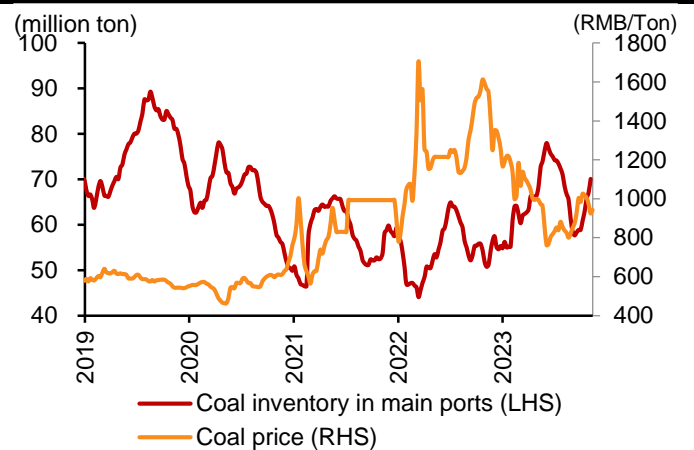
Source: Bloomberg, CMBIGM

Figure 15: Infrastructure Investment in China



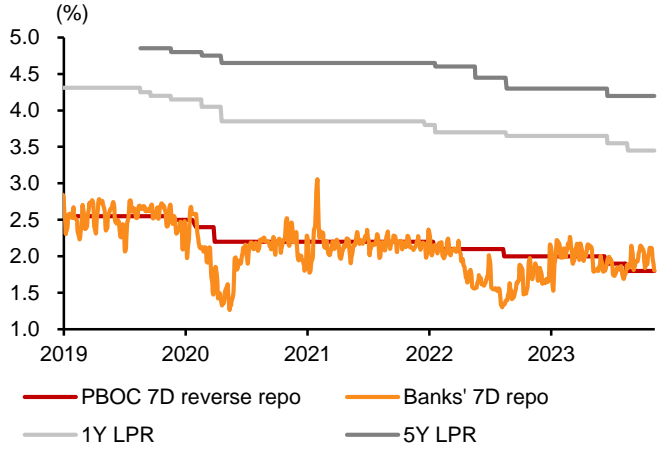
Source: Bloomberg, CMBIGM

Figure 16: China Coal Inventory & Price



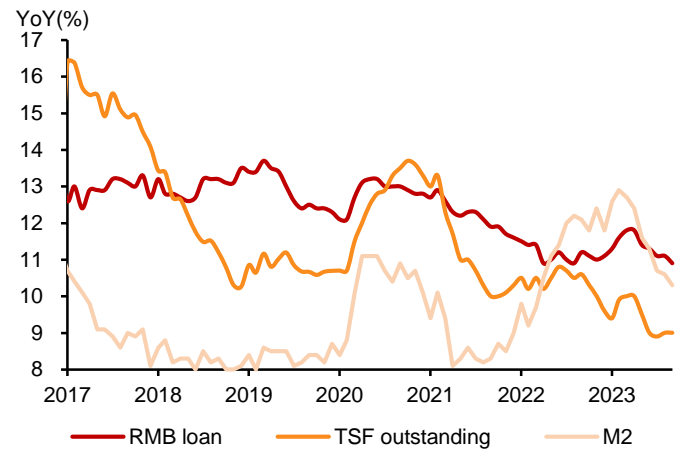
Source: Wind, CMBIGM

Figure 17: PBOC Policy Rates & Liquidity Condition



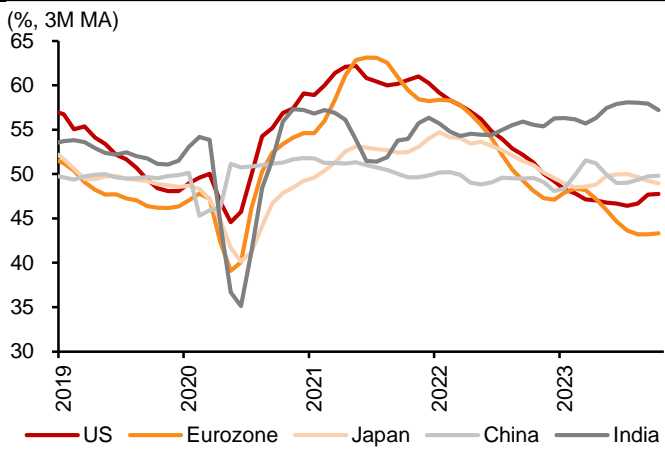
Source: Bloomberg, CMBIGM

Figure 18: China Credit Growth



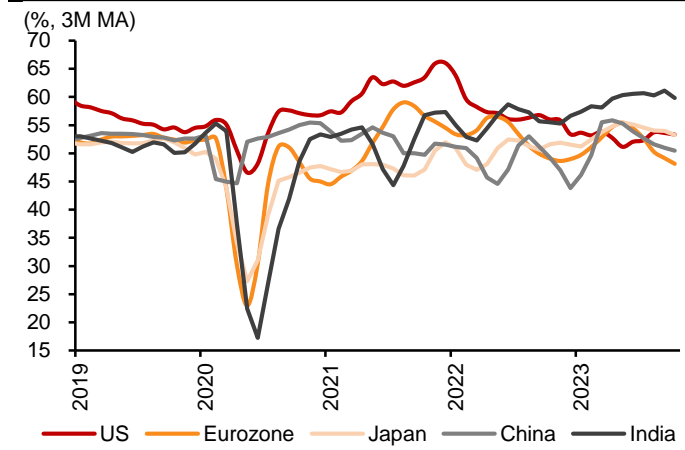
Source: Wind, CMBIGM

Figure 19: Manufacturing PMI of Major Economies



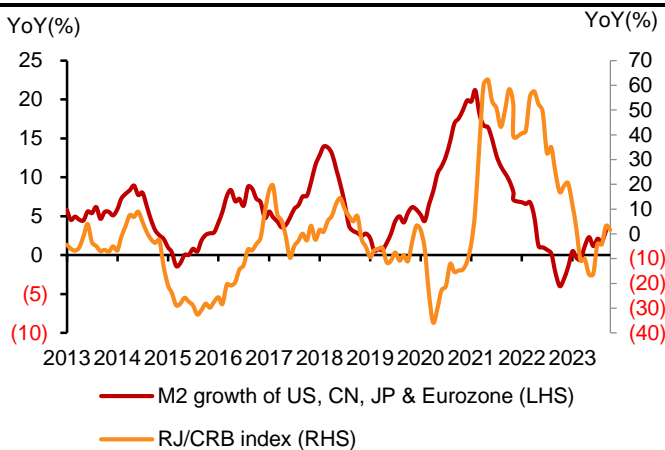
Source: Bloomberg, CMBIGM

Figure 20: Service PMI of Major Economies



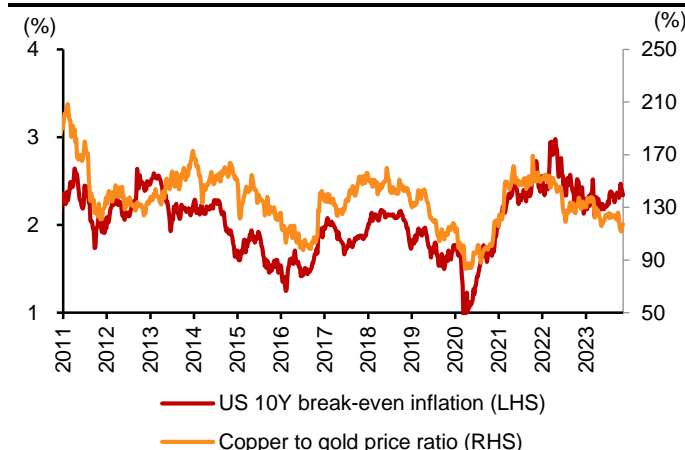
Source: Wind, CMBIGM

Figure 21: M2 Growth & Commodity Inflation



Source: Bloomberg, CMBIGM

Figure 22: Copper-to-gold Ratio



Source: Wind, CMBIGM

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CMB International Global Markets Limited

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

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