

China Economy

Reflation broadens upstream, while final demand still lags

YoY CPI stayed positive in Mar, although it eased from Feb as post-CNY normalization in food and services outweighed the sharp rebound in fuel costs. Core CPI moderated as domestic demand remained soft. PPI turned positive YoY for the first time since Sep 2022, led mainly by energy and related sectors like chemical products and rubber & plastic products, while final consumer goods prices stayed subdued. We are seeing a more visible reflation in upstream sectors, but the still-weak housing and big-ticket consumption data suggest the reflation remains uneven and is not yet fully demand-led, which should compress profit margin in lower-stream sectors and consumer demand. This backdrop is constructive for upstream resources, energy, industrials and high-dividend value names in the near term, while a broader rerating in consumption, property and domestic cyclicals still requires a clearer recovery in household demand. Looking forward, we expect the CPI, PPI and GDP deflator to reflate from 0.1%, -2.6% and -1% in 2025 to 0.8%, 1% and 0.9% in 2026. The rise in price levels may push back the PBOC's rate cut to the end of 3Q with room for a 10bps LPR cut and a 50bps RRR cut.

■ **CPI moderated on the back of post-holiday normalization in food despite surging energy prices.** China's CPI YoY softened to 1.0% in Mar from 1.3% in Feb, below market expectation of 1.3%. In sequential terms, CPI fell 0.7% in Mar after rising 1.0% in Feb, largely reflecting the payback after the Chinese New Year holiday. Food inflation remained positive at 0.3% YoY, but cooled from 1.7% in Feb. Food price dropped 2.7% MoM in Mar, as fresh vegetable and meat prices fell 10.1% and 3.9%, with pork down 7.3%. By contrast, vehicle fuel prices surged 10.0% MoM as oil prices moved higher, lifting YoY growth to 3.4% from -9.0% in Feb. Looking forward, food price may continue to soften, as pork and vegetable prices keep falling in Apr, weighing on CPI, while vehicle fuel prices continue to rise.

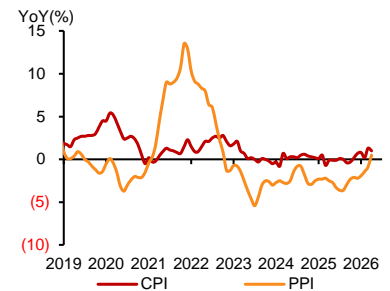
■ **Core CPI edged down as service inflation cooled.** Core inflation eased to 1.1% YoY in Mar from 1.8% in Feb, while service inflation slowed to 0.8% from 1.6%. Core CPI fell 1.1% MoM after rising 1.1% in Feb mainly due to post-holiday normalization, as tourism prices dropped 12.9% in Mar after a 14.1% surge in Feb, while home service prices fell 2.8% after rising 1.7% in the prior month. Other services remained subdued as housing rent, telecom service and education service remained flat and express service dropped 0.5% MoM. Durable goods prices remained weak, as transport vehicle prices remained negative at -1.1% YoY, home appliance inflation slowed to 2.4% from 5.3%, while telecom equipment rose to 2.6%. Prices of nondurable goods including shoes and clothing also edged down. Overall, the moderation in core and service inflation indicates that domestic demand remains subdued and is not yet strong enough to underpin a broad consumption-led reflation.

■ **PPI turned positive YoY but the rebound remained concentrated in energy and upstream materials.** YoY PPI rose to 0.5% in Mar from -0.9% in Feb, marking its first positive reading since Sep 2022. MoM PPI growth accelerated to 1.0% from 0.4%, with production materials up 1.3%. Mining industries surged 3.9% MoM, led by oil and gas extraction at 15.8%, while coal, ferrous and non-ferrous prices moderated. Raw material and processing industries rose 2.4% and 0.5%, respectively. Chemical products and rubber & plastic products also surged 3.6% and 0.6% MoM in Mar driven by crude oil price. However, downstream sectors remained subdued: consumer goods PPI slipped 0.1% MoM, and on a YoY basis daily

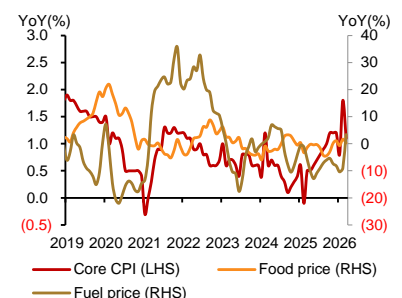
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Source: Wind, CMBIGM

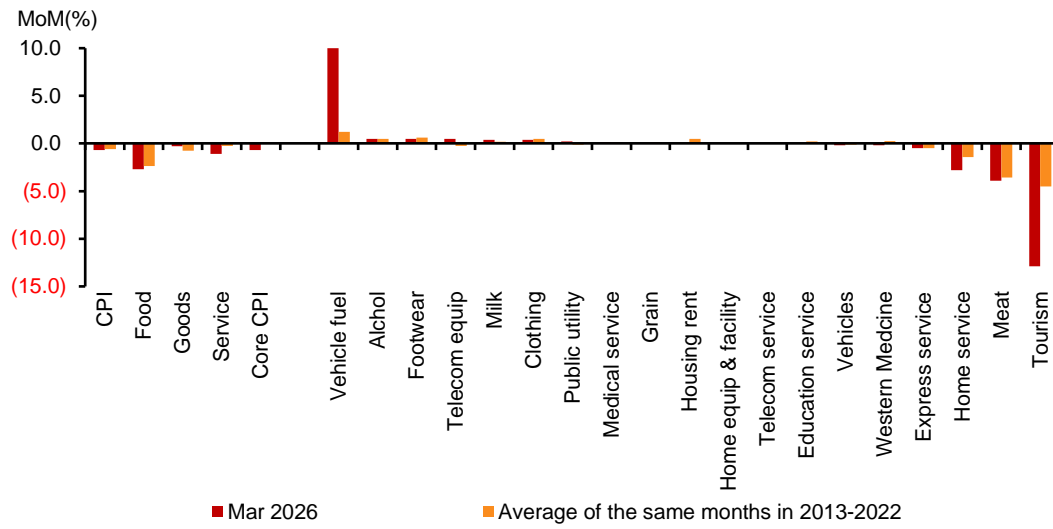


Source: Wind, CMBIGM

consumer goods and durable goods were still down 1.4% and 1.0%, auto manufacturing fell 2.5%, while computer, telecom and electronic equipment merely turned slightly positive at 0.4% thanks to surging storage and DRAM prices.

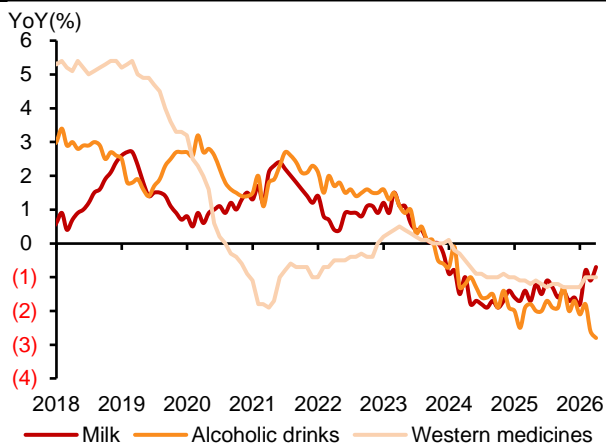
- **Demand-driven reflation will be essential for sustaining a more consistent price recovery and a broader China equity rerating.** The Mar data confirmed that China's reflation is becoming more visible, but it is still more commodity-led than household demand-led. The turn in PPI into positive territory should support nominal revenue, earnings expectations and cash flow for upstream resources, energy, metals and industrials. Yet downstream demand has not fully recovered as housing and vehicle sales continued to dip YoY, suggesting the property chain and big-ticket discretionary demand have yet to form a convincing upcycle. This means a broad rerating in consumer, property, building materials and other domestic cyclicals still requires stronger household income expectations and firmer policy transmission. We believe demand-pull reflation will prove more sustainable than supply-induced price gains, which should keep policymakers inclined toward further support for households and the real estate sector. Looking forward, we expect the CPI, PPI and GDP deflator to reflate from 0.1%, -2.6% and -1% in 2025 to 0.8%, 1% and 0.9% in 2026. The rise in price levels may push back the PBOC's rate cut to the end of 3Q with room for a 10bps LPR cut and a 50bps RRR cut if housing and durable-goods demand fail to improve more meaningfully.

Figure 1: MoM Changes of China CPI in Mar



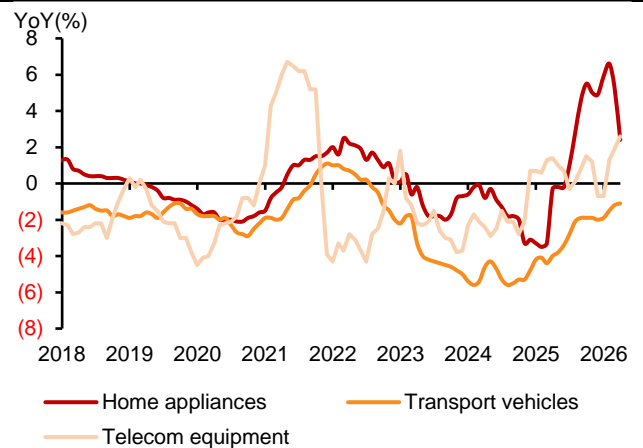
Source: Wind, CMBIGM

Figure 2: China CPI growth in staples



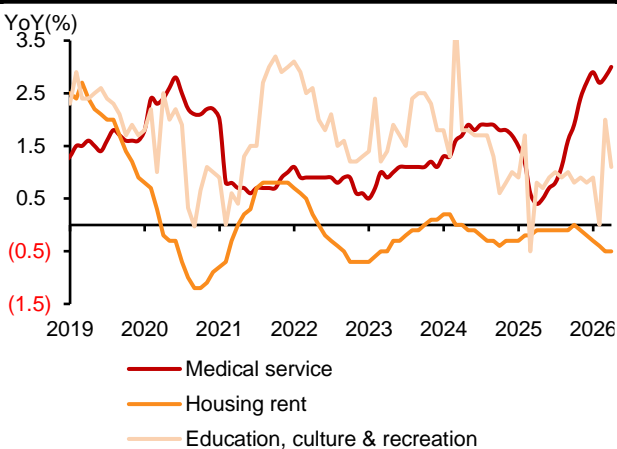
Source: Wind, CMBIGM

Figure 3: China CPI growth in durables



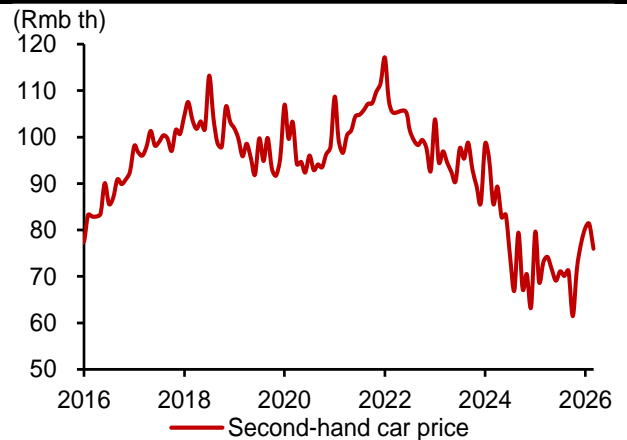
Source: Wind, CMBIGM

Figure 4: China CPI growth in services



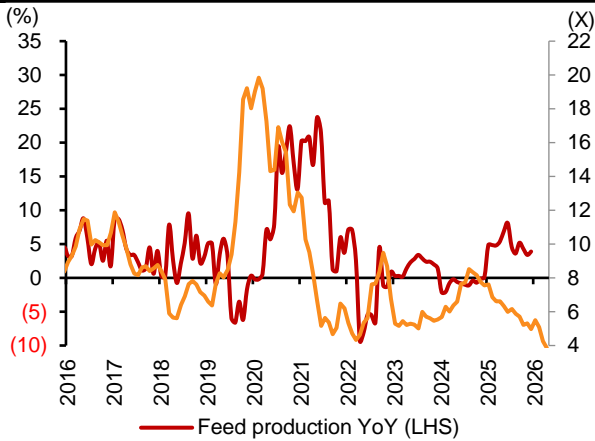
Source: Wind, CMBIGM

Figure 5: Second-hand car price in Shanghai



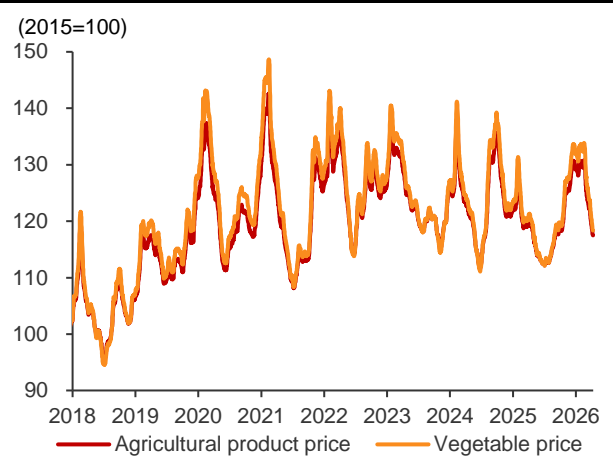
Source: Wind, CMBIGM

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



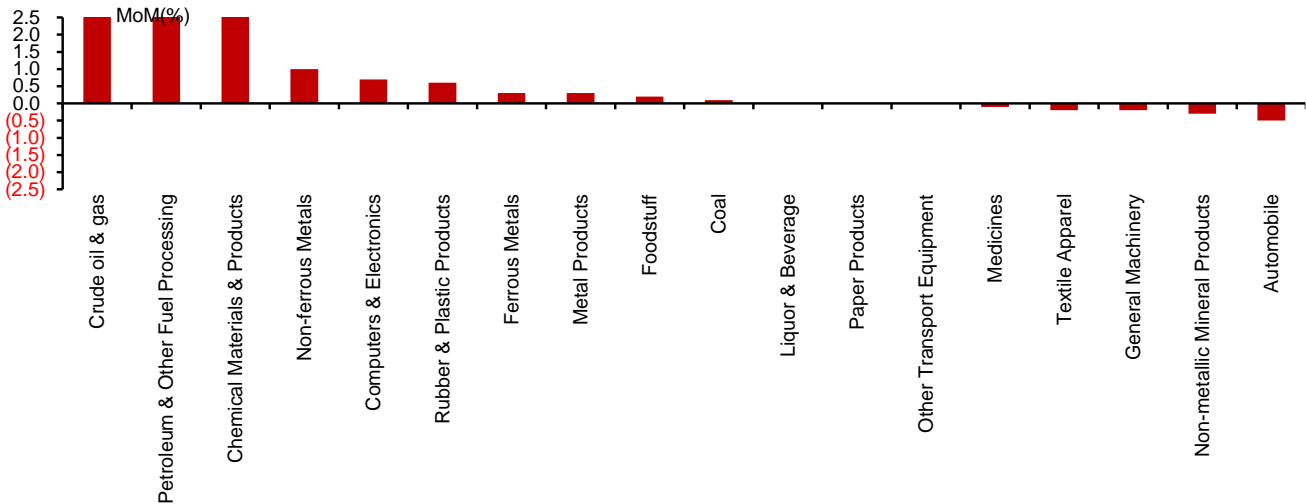
Source: Wind, CMBIGM

Figure 7: Agricultural and vegetable prices



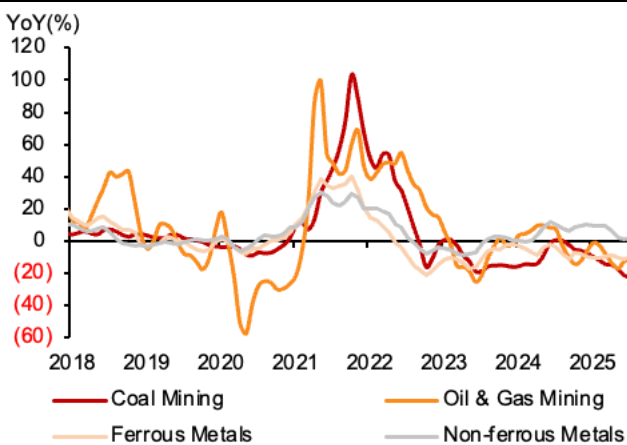
Source: Wind, CMBIGM

Figure 8: MoM changes of China PPI in Mar



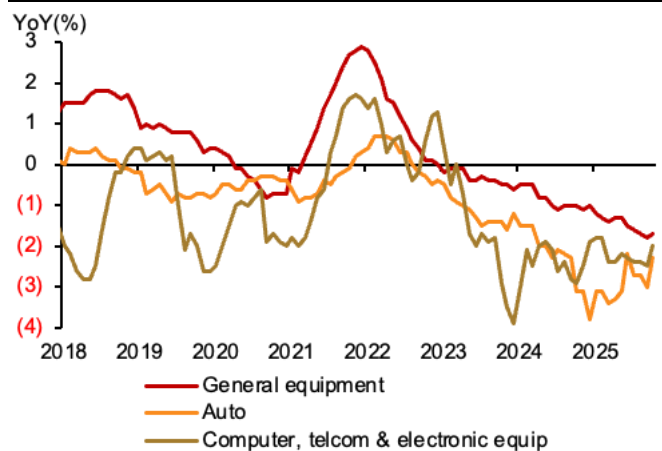
Source: Wind, CMBIGM

Figure 9: China PPI in energy & metals



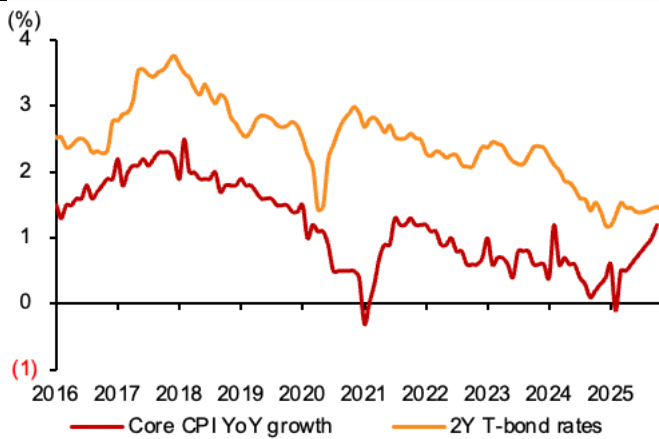
Source: Wind, CMBIGM

Figure 10: China PPI in equipment



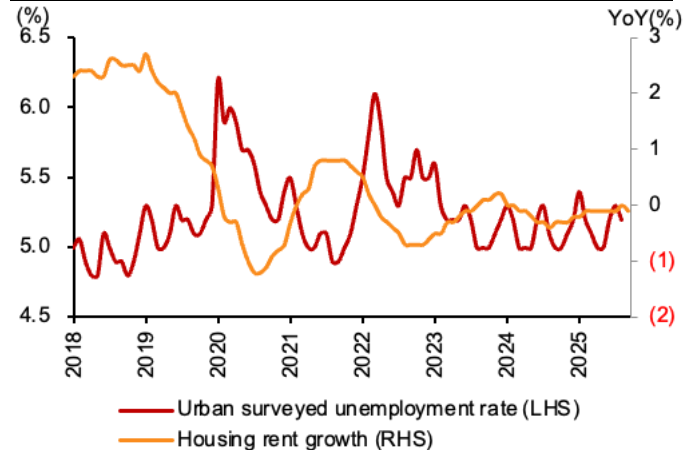
Source: Wind, CMBIGM

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



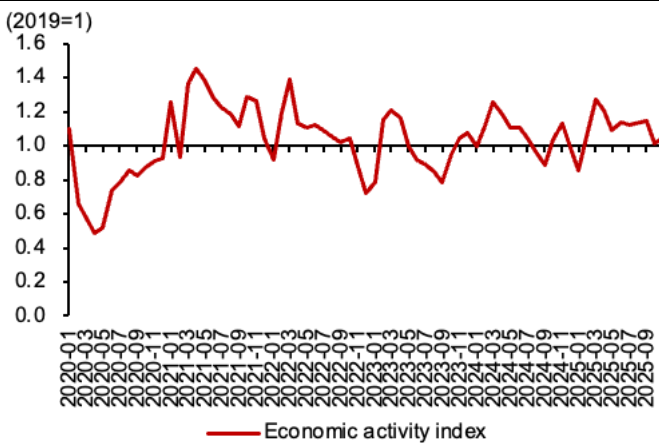
Source: Wind, CMBIGM

Figure 12: Unemployment rate and rent growth



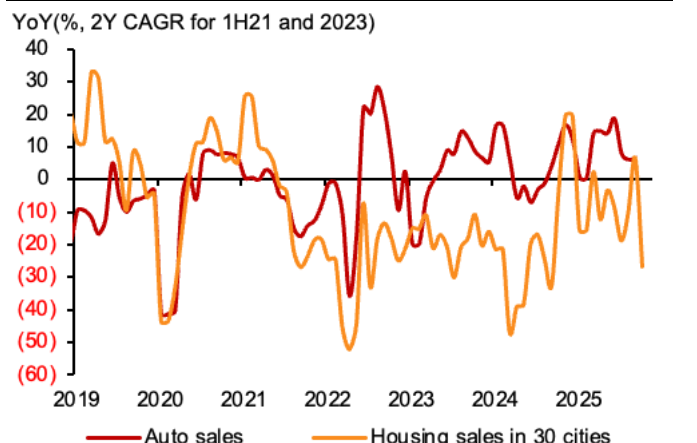
Source: Wind, CMBIGM estimates

Figure 13: China Economic Activity Index



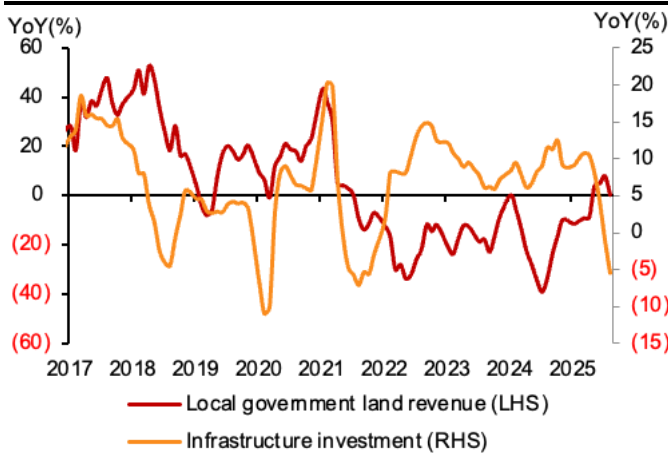
Source: Wind, CMBIGM

Figure 14: China auto & housing sales



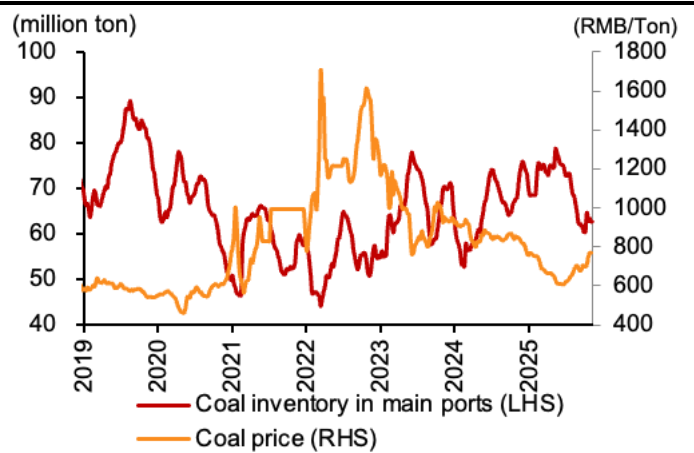
Source: Bloomberg, CMBIGM

Figure 15: Infrastructure investment in China



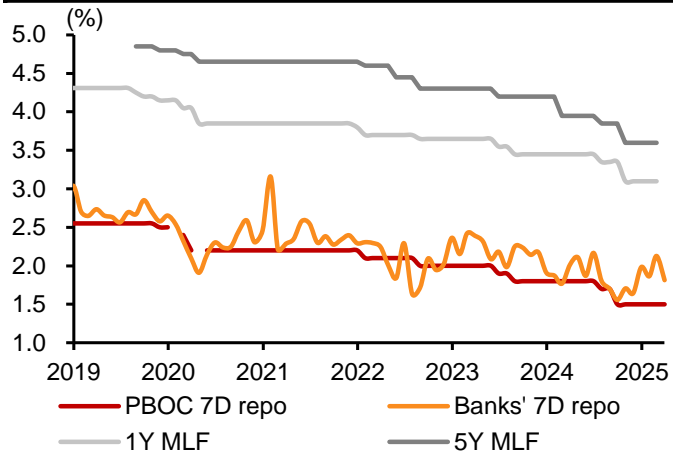
Source: Bloomberg, CMBIGM

Figure 16: China coal inventory & price



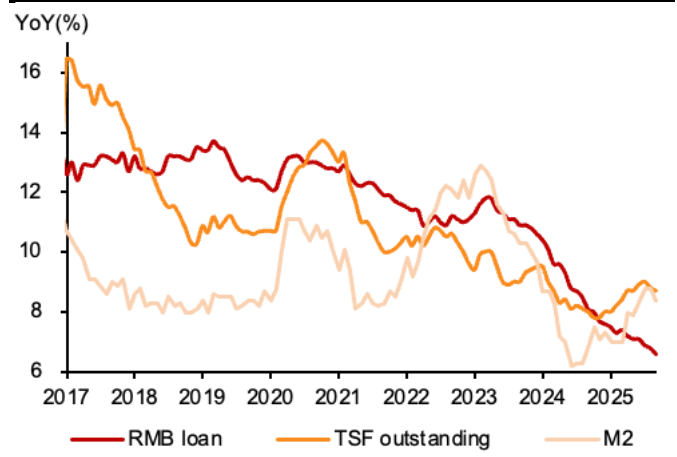
Source: Wind, CMBIGM

Figure 17: PBOC policy rates & liquidity condition



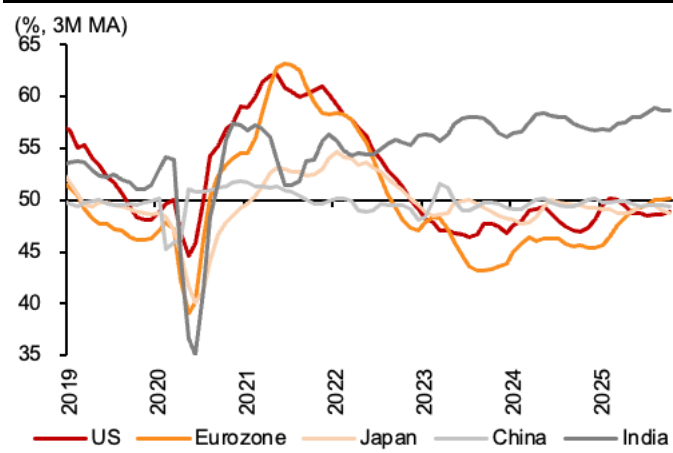
Source: Bloomberg, CMBIGM

Figure 18: China credit growth



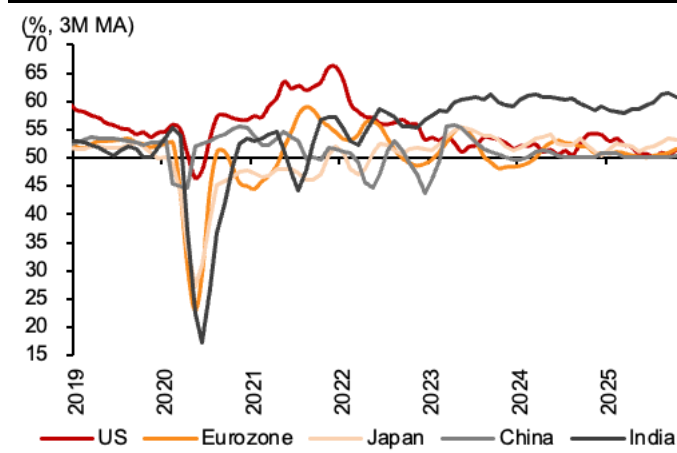
Source: Wind, CMBIGM

Figure 19: Manufacturing PMI of major economies



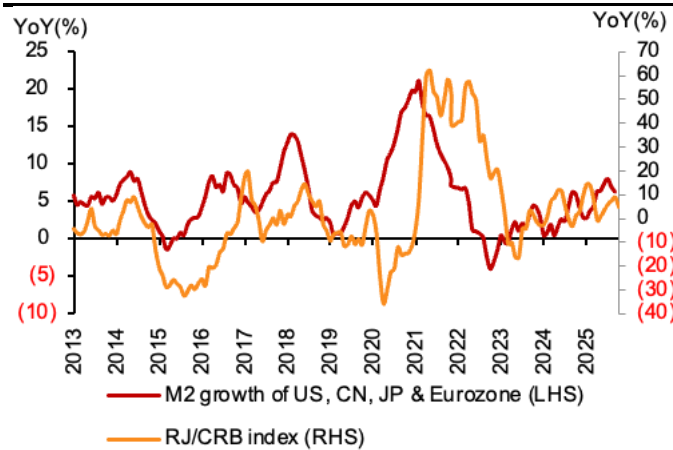
Source: Bloomberg, CMBIGM

Figure 20: Service PMI of major economies



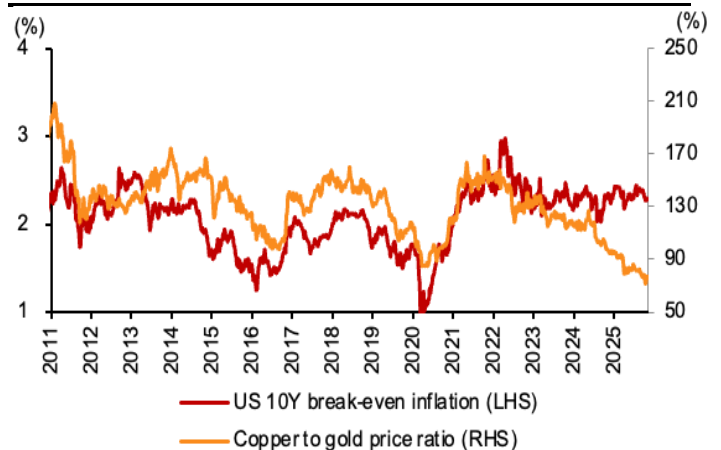
Source: Wind, CMBIGM

Figure 21: M2 growth & commodity inflation



Source: Bloomberg, CMBIGM

Figure 22: Copper-to-gold ratio



Source: Wind, CMBIGM

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