

China Economy

Deflation pressure calls for additional fiscal stimulus

May CPI remained negative for the 4th consecutive month, indicating the mounting deflation pressure following the tariff shock. While energy prices were the primary drag, broader price levels remained subdued across categories. Durable goods prices dipped amid weakening demand and intensifying price competition, while service prices moderated after the national holidays. PPI further deteriorated due to sliding energy prices and soft domestic construction activities. The tariff shock has weakened both domestic and external demand, exerting further deflation pressure while the ramped-up supply-side production offers little offset. China economy may face further headwinds in 2H25 given the intensifying deflation, softening property sector and payback effect from the trade-in scheme. China may launch additional fiscal expansion and consumption stimulus after reaching a trade deal with the US as the deal would refer to a rebalance of China economy towards more consumption and less production. We estimate CPI and PPI may rise from 0.2% and -2.2% in 2024 to 0.3% and -2% in 2025.

■ **CPI stayed negative for the 4th consecutive month amid falling food and energy prices.** China's CPI YoY stayed flat at -0.1% in May, slightly above market expectation at -0.17%. In sequential terms, CPI dipped to -0.2% in May from 0.1% in Apr. Vehicle fuel price was the major drag, dropping 3.7% MoM as global crude oil price remained subdued in May. We expect the vehicle fuel price to edge up in June as the NDRC has raised gas price in early June. Food price dropped 0.2% MoM in May as vegetable price dipped 5.9% due to abundant seasonal supply. Pork price also narrowed its decline from -1.6% MoM to -0.7%, but it may start to dip again as wholesale price further declined. High-frequency data indicated continued declines in vegetable price by 1.5% MoM, while pork retail price edged down. We expect the CPI to recover mildly in June to 0% due to rebounding energy prices.

■ **Core CPI softened due to muted durable goods price.** Core inflation edged up to 0.6% YoY in May from 0.5%, while its MoM growth dropped to 0% from 0.2%. Durable goods including telecom equipment, vehicles and home appliances dropped 0.7%, 0.4% and 1.1% respectively, amid weakening demand and intensifying price competition. It is worth noting that the discounts from the trade-in scheme are excluded from CPI calculations. Service price eased to 0% MoM in May from 0.3%, as tourism price dropped to 0.8% from 3.1%. Other services remained subdued, with no price change recorded in categories such as education, express and telecommunications services.

■ **PPI further slumped due to sliding global energy prices.** YoY contraction of PPI further dipped to -3.3% in May from -2.7% in Apr, missing the market expectation at -3.2%. The MoM growth remained flat at -0.4% for the third consecutive month, indicating worsening deflation in manufacturing sector. PPI of mining industries weakened to -2.5% MoM. Energy-related commodities including crude oil & gas and coal saw the notable MoM decline of -5.6% and -3%. Ferrous metals also dropped 1% MoM since the domestic construction activities remained soft. Final consumption goods moderately rebounded from -0.2% MoM to 0% in May, as durable goods notably surged to 0.1% from -0.7%. We expect the subdued PPI should persist due to the drag from trade war and fierce price competition among manufacturers, which should further weigh on overall corporate earnings.

Frank Liu

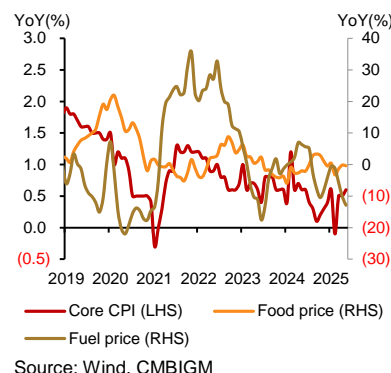
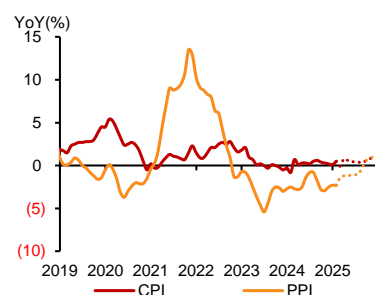
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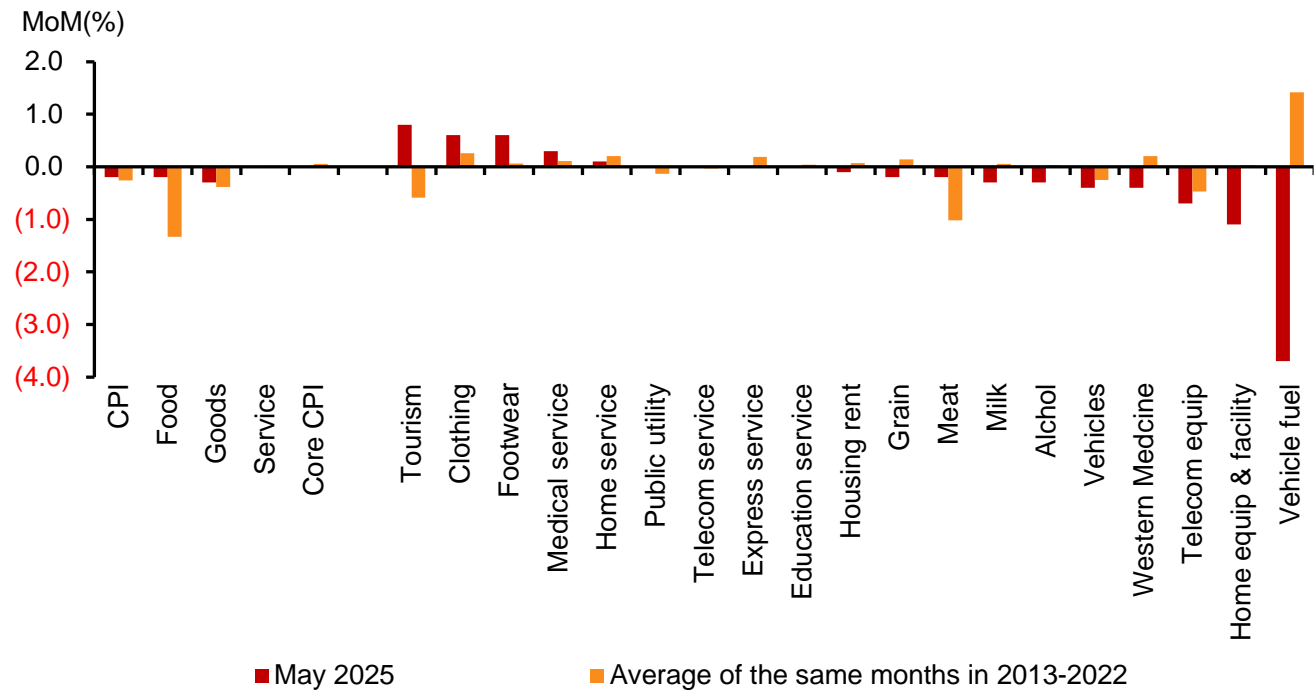
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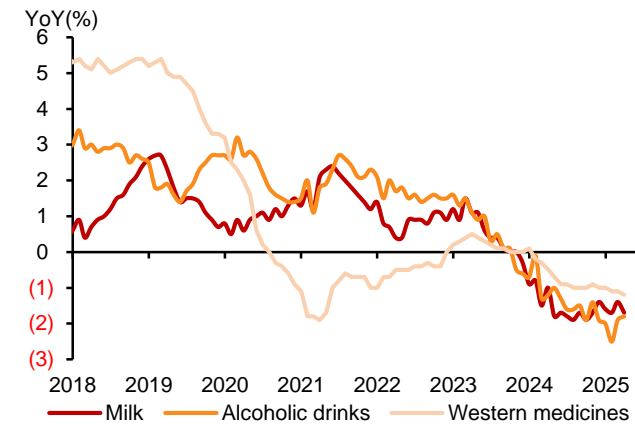
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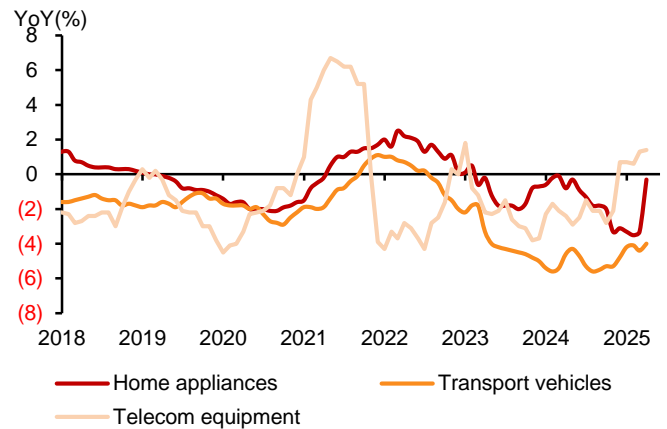
- **The deflation pressure calls for additional fiscal stimulus.** The tariff shock has weakened both domestic and external demand, exerting further deflation pressure while the ramped-up supply-side production offers little offset. China economy may face further headwinds in 2H25 given the intensifying deflation, softening property sector and payback effect from the trade-in scheme. Policy stance might remain stable and moderate during the China-US trade deal negotiations. China may launch additional fiscal expansion and consumption stimulus after reaching a deal with the US as the deal would refer to a rebalance of China economy towards more consumption and less production. In 2H25, we expect a further 10 bps LPR cut, along with a possibly moderate increase in the broad fiscal deficit. Policy may also strengthen transfer payments to low- and middle-income households, the social security system, and multi-child families to more effectively boost household consumption.

Figure 1: MoM changes of China CPI in May

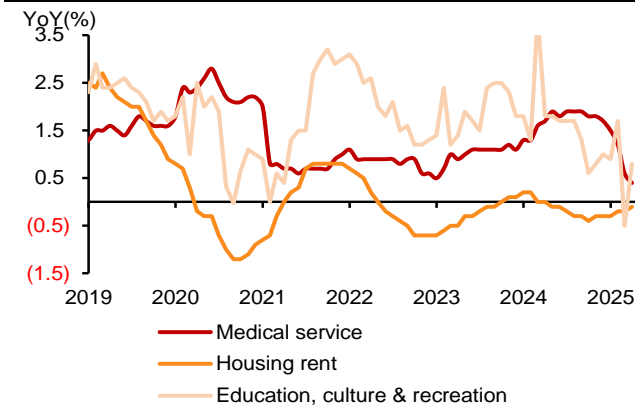
Source: Wind, CMBIGM

Figure 2: China CPI growth in staples

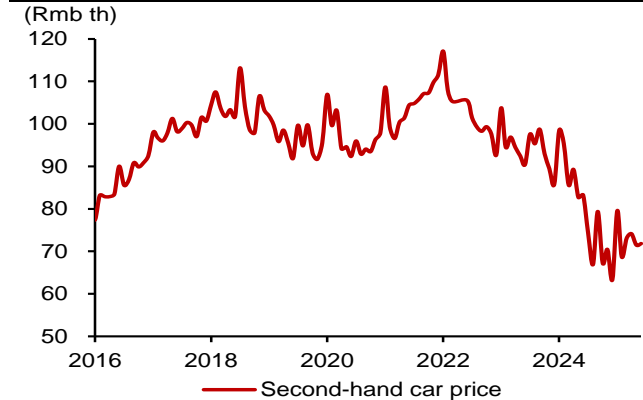
Source: Wind, CMBIGM

Figure 3: China CPI growth in durables

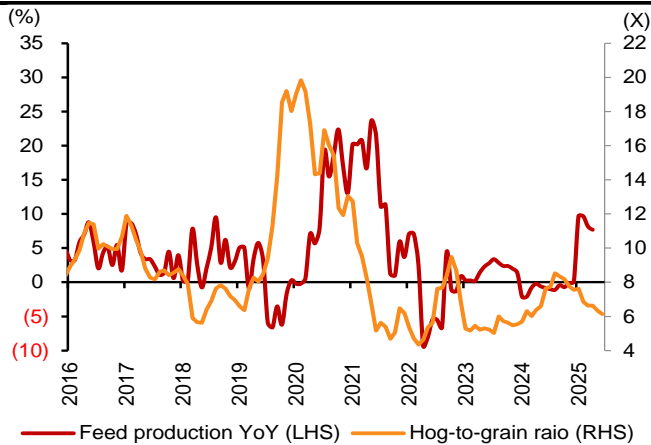
Source: Wind, CMBIGM

Figure 4: China CPI growth in services

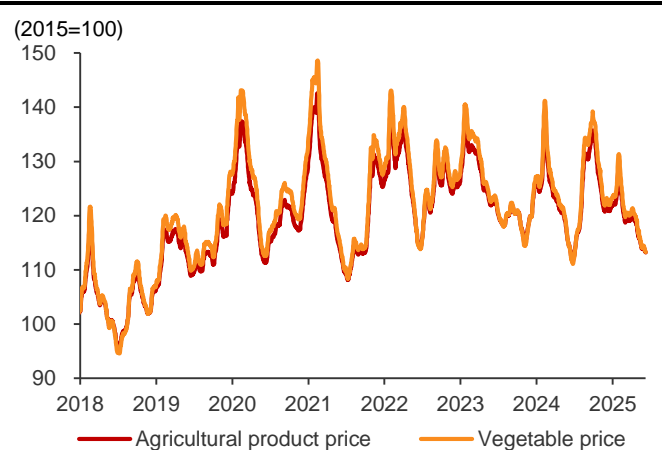
Source: Wind, CMBIGM

Figure 5: Second-hand car price in Shanghai

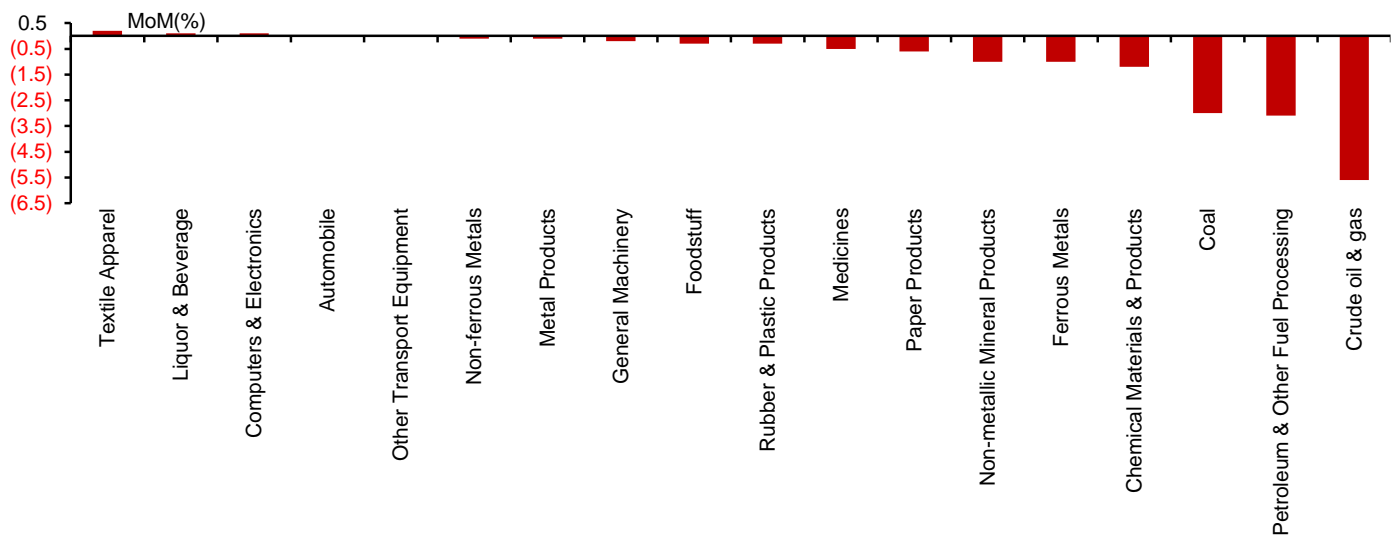
Source: Wind, CMBIGM

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

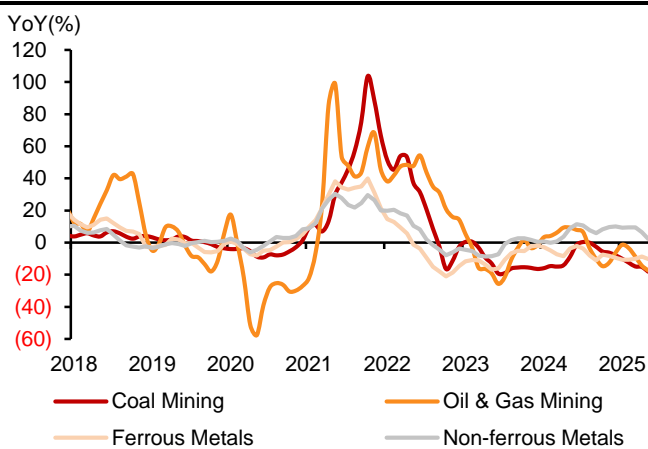
Source: Wind, CMBIGM

Figure 7: Agricultural and vegetable price

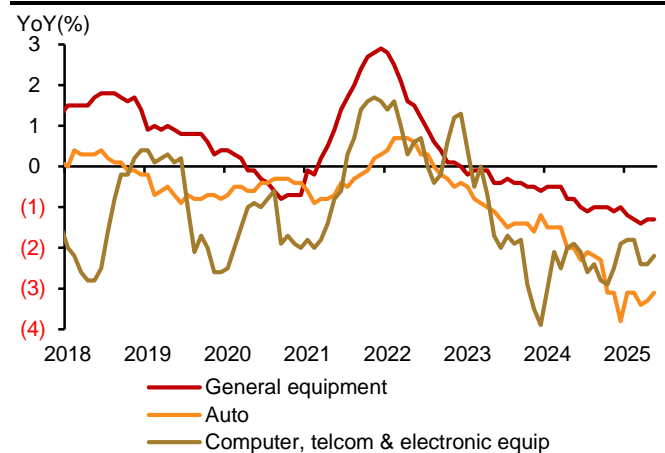
Source: Wind, CMBIGM

Figure 8: MoM changes of China PPI in May

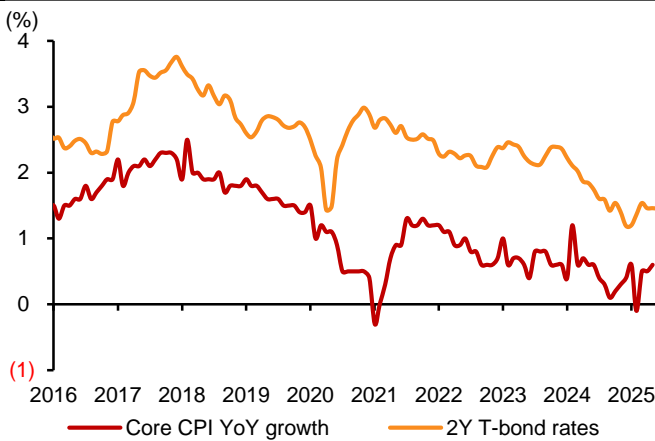
Source: Wind, CMBIGM

Figure 9: China PPI in energy & metals

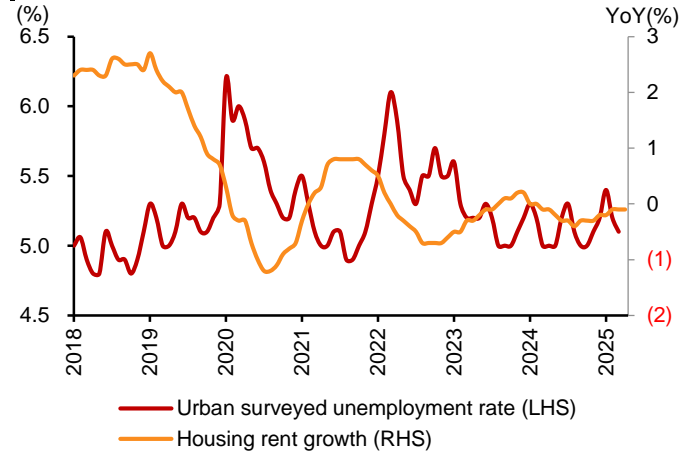
Source: Wind, CMBIGM

Figure 10: China PPI in equipment

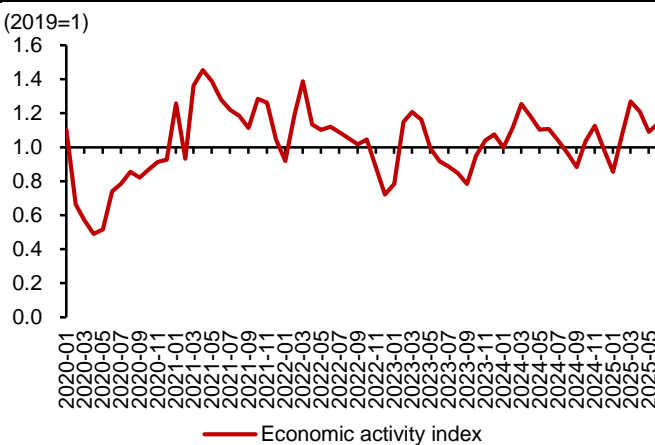
Source: Wind, CMBIGM

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

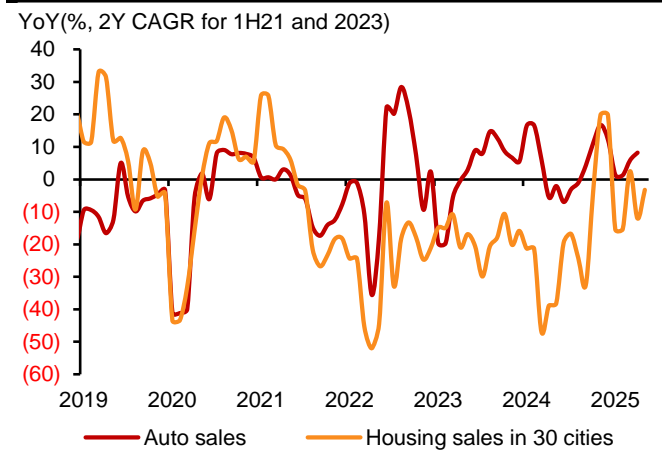
Source: Wind, CMBIGM

Figure 12: Unemployment rate and rent growth

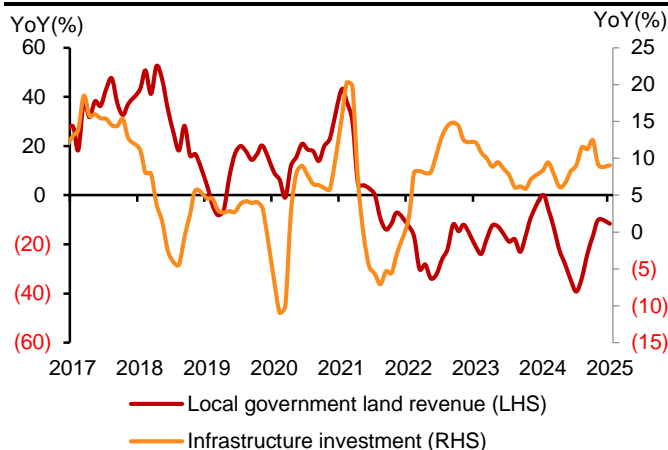
Source: Wind, CMBIGM estimates

Figure 13: China Economic Activity Index

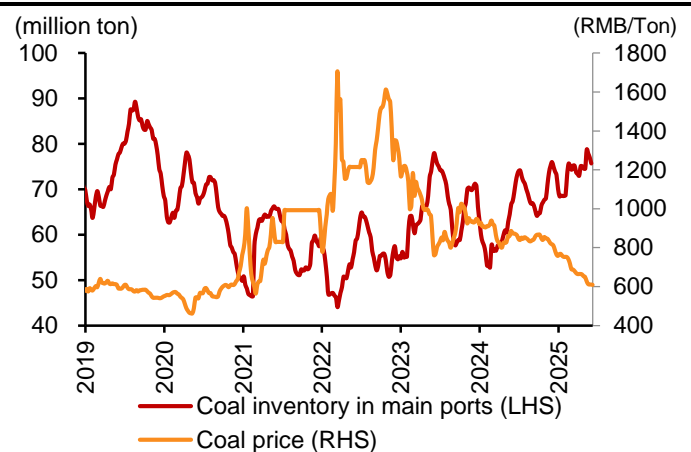
Source: Wind, CMBIGM

Figure 14: China auto & housing sales

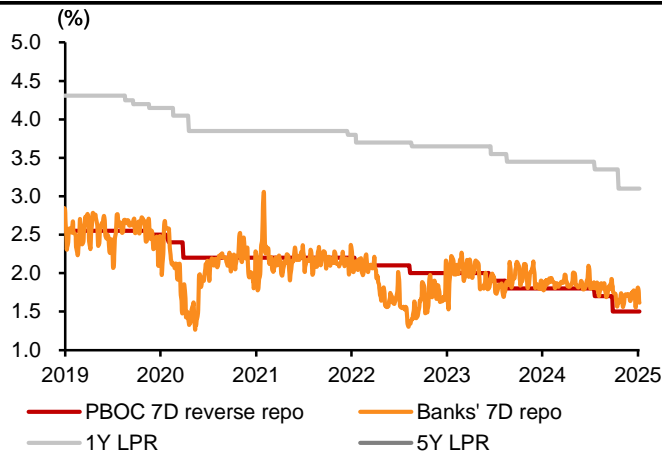
Source: Bloomberg, CMBIGM

Figure 15: Infrastructure investment in China

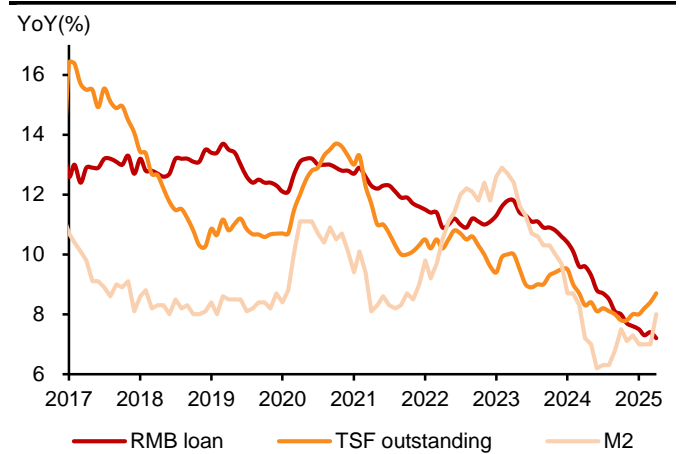
Source: Bloomberg, CMBIGM

Figure 16: China coal inventory & price

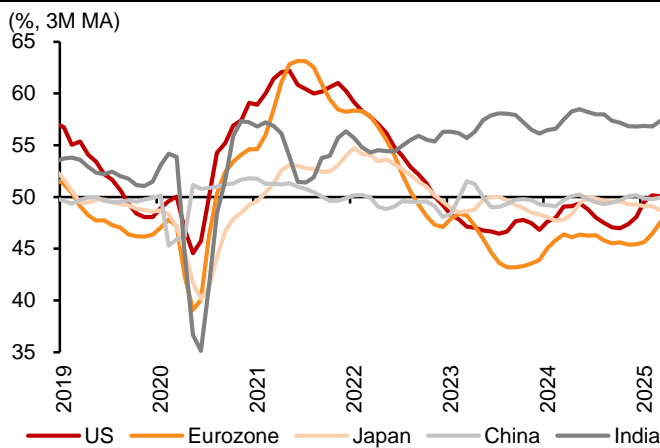
Source: Wind, CMBIGM

Figure 17: PBOC policy rates & liquidity condition

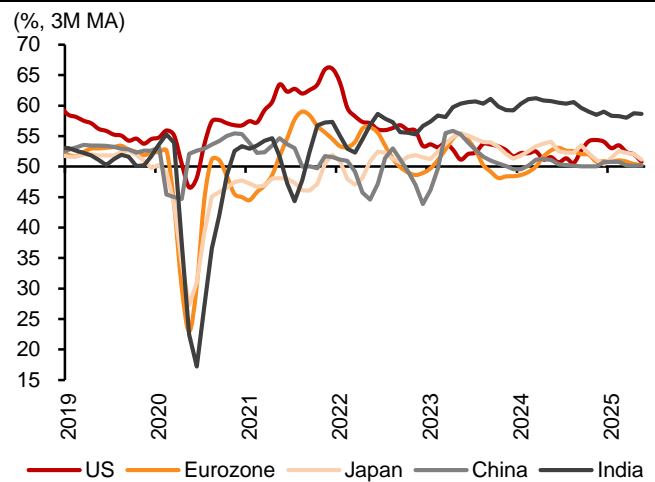
Source: Bloomberg, CMBIGM

Figure 18: China credit growth

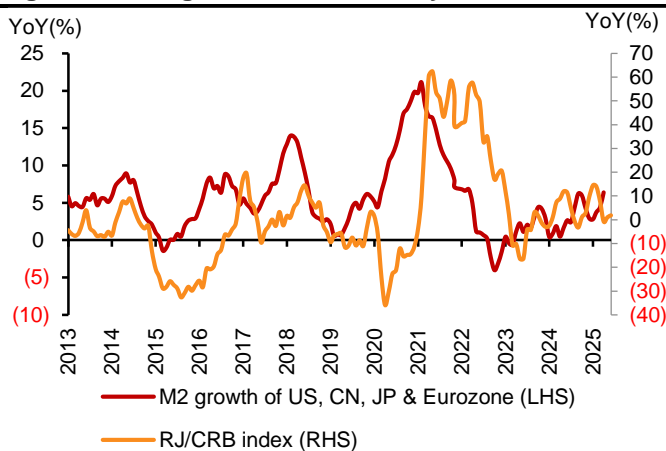
Source: Wind, CMBIGM

Figure 19: Manufacturing PMI of major economies

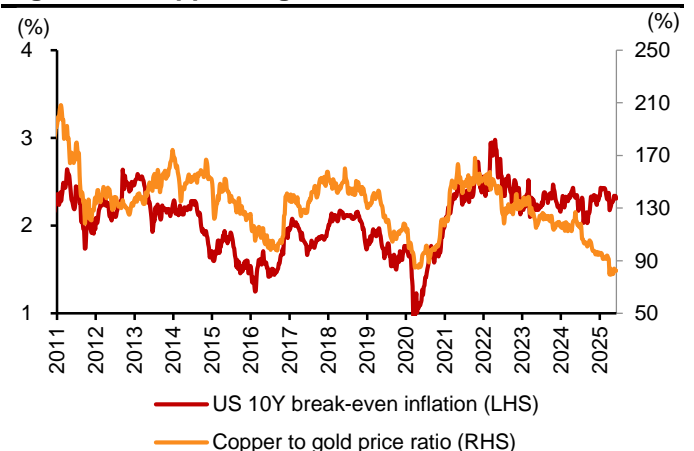
Source: Bloomberg, CMBIGM

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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