

# China Macro Flash

## Dec Data: Weather-Related Inflation Jump Not a Threat Yet

- **The temporary inflation spike should not trigger immediate policy actions** – Consumer prices rose 0.8%MoM and 2.5%YoY, broadly in line with our estimate but beating market expectations. The 0.5ppt jump in YoY CPI inflation relative to Nov was mainly caused by food inflation that was related to the coldest Dec in seven years. Inflation may turn out to be quite volatile up to the Chinese New Year in Feb, but barring exceptional developments, CPI inflation will likely remain below 2.5% on average in 1Q. Inflation at this level does not warrant a tightening of policies in the near term. However, we expect monetary policy to gradually shift from an easing bias to a neutral position as inflation may rise above 3% in 2H.
- **CPI inflation jumped, driven by higher food prices** – Food prices rose 2.4%MoM, and YoY inflation surged from 3% to 4.2%. Specifically, vegetable prices soared 17.5%MoM and 14.8%YoY, as unusually low temperature and snowy/rainy weather disrupted vegetable production and distribution. Pork prices increased 3.9%MoM but fell 6.2%YoY, indicating the price increase was more seasonal. Nonfood prices stayed flat MoM and YoY inflation was well contained at 1.7%.
- **CPI inflation is likely to remain below 2.5% in 1Q on average** – Barring exceptional weather conditions or animal diseases, vegetable prices are likely to return to normal and the case for rapid pork price increases is not strong given still high live pig inventory. However, both MoM and YoY inflation tends to be volatile around Chinese New Year. YoY CPI inflation may retreat significantly in Jan due to last year's high base, to be followed by a jump in Feb and normalize after that.
- **PPI deflation eased to -1.9% suggesting slow restocking** – PPI fell 0.1%MoM and YoY deflation shrank from -2.2% in Nov to -1.9% in Dec. Industrial producer input prices followed the same pattern, falling 0.1%MoM and YoY deflation eased from -2.8% to -2.4%. The data suggest destocking is gradually giving way to restocking. PPI deflation is likely to ease further, as PMI input price index rose from 50.1 in Nov to 53.3 in Dec.
- **Policies may gradually return to a neutral position** – The near-term price outlook remains benign, although we anticipate CPI inflation to rise above 3% in 2H. While maintaining the general tone of prudent monetary policy, PBOC may gradually take out the easing bias. It is reported (China Securities Journal) that the authorities have set M2 growth target at 13% (13.8% actual in 2012) and implicit RMB loan quota at Rmb8.5tn (equivalent to credit outstanding growth of 13.5% relative to 15.0% in 2012). This is in line with our expectation, and confirms a more neutral policy stance.

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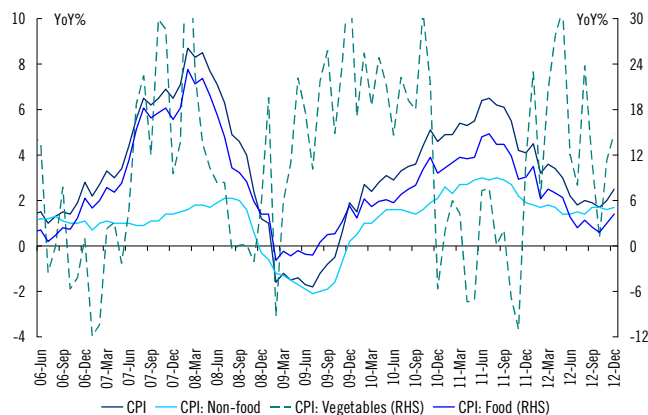
## Weather-Related Inflation Jump Not a Threat Yet

Figure 1. China Data Release

	Date	For	Actual	Citi Fcst	Mkt Fcst	Prev
CPI (% YoY)	11-Jan	Dec	2.5	2.6	2.3	2.0
PPI (% YoY)			-1.9	-1.8	-1.8	-2.2

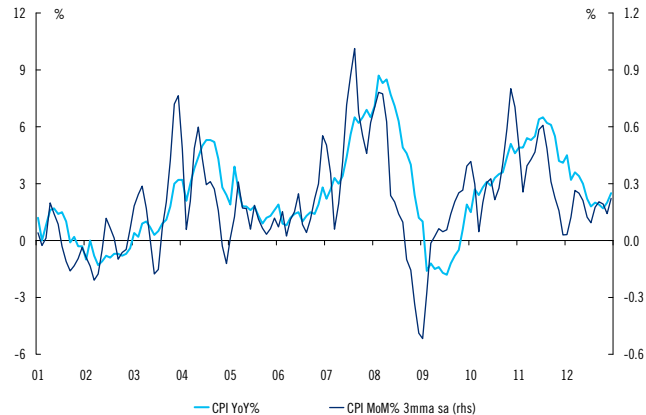
Source: Bloomberg and Citi Research estimates

Figure 2. CPI inflation jump driven by higher food prices



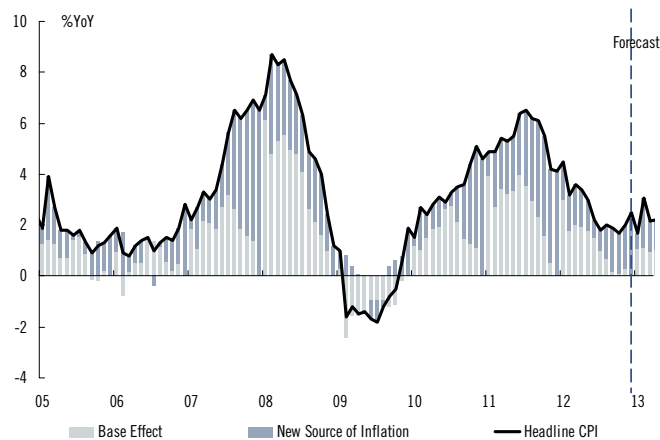
Source: NBS and Citi Research

Figure 3. Inflation fluctuated in a narrow range recently



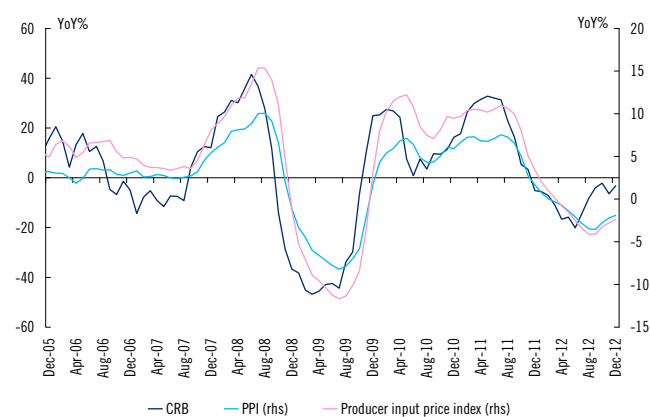
Source: NBS and Citi Research

Figure 4. CPI inflation will likely remain below 2.5% in 1Q on average



Source: NBS and Citi Research

Figure 5. PPI deflation eased to -1.9%



Source: NBS and Citi Research

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