

China Macro Flash

Inflation Data Strengthens the Case for a Neutral Policy Stance

- **Aug inflation data suggest mitigating downside risks in the near term** – CPI inflation fell slightly to 2.6%YoY, and PPI deflation eased from -2.3%YoY in Jul to -1.6%YoY in Aug, both broadly in line with expectations. Three-month moving average and seasonally adjusted rate of CPI inflation continues to trend up, driven by sticky food and service price increases. We expect CPI inflation to rise to around 3%YoY by year-end. PPI rose 0.1%MoM, the first sequential increase since Mar and an early sign of re-stocking. With downside risks declining in the near term, we expect PBOC to maintain a neutral policy stance to manage inflation expectations and reduce financial risks.
- **CPI inflation may continue to trend up gradually** – CPI inflation edged down from 2.7%YoY in Jul to 2.6%YoY in Aug due to eased base effect (1.1ppts in Aug vs. 1.8ppts in Jul), and MoM inflation (0.5%MoM) recorded the largest gain since Feb. In particular, fresh vegetable, pork and egg prices increased by 7.6%MoM, 4.5%MoM and 7.1%MoM, respectively, as a result of exceptional hot weather and seasonal factors. Non-food inflation (0.1%MoM, 1.5%YoY) was mainly contributed by fuel prices (2.9%YoY) following consecutive fuel price hikes since May, rising household service cost (8.1%YoY) and rental expenses (4.4%YoY). Three-month moving average of CPI inflation rose from 2.5%YoY in Jul to 2.7%YoY in Aug, and seasonally adjusted annualized inflation also increased in Aug.
- **PPI registered MoM increase, indicating better demand** – PPI inched up by 0.1%MoM, the first MoM increase since March this year, and YoY deflation further mitigated from -2.3% in Jul to -1.6% in Aug. Specifically, PPI for mining, raw materials, and processing industries increased by 0.2%, 0.4% and 0.3%MoM, respectively. Easing PPI deflation, together with expanding PMI input price index, provides an early sign of restocking as a result of better external demand and government efforts to manage growth expectations. We expect PPI deflation to ease further in the months ahead, partly benefiting from positive contribution from the base effect.
- **Credit condition is becoming less accommodative** – While inflation is expected to stay below the target level of 3.5% this year, the uptrend of CPI inflation, reduced downside risks to growth, continued rise in home prices, and the possibility of capital outflows as a result of Fed tapering would make a benchmark interest rate cut unlikely this year. Instead, PBOC may ensure adequate liquidity in the banking system to prevent an increase in market interest rate, first of all by open market operations, and by RRR cuts if capital outflows consistently outstrip trade surplus.

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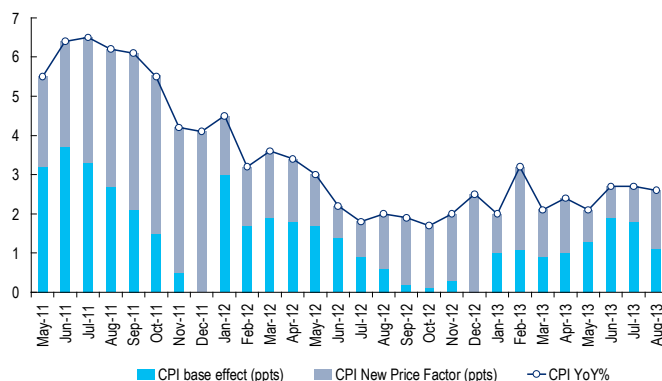
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Figure 1. China Data Release

	Date	For	Actual	Citi Fcst	Mkt Fcst	Prev
CPI (% YoY)	9-Sep	Aug	2.6	2.6	2.6	2.7
CPI Food (% YoY)			4.7	4.3	-	5.0
CPI Non-food (% YoY)			1.5	1.8	-	1.6
PPI (% YoY)			-1.6	-1.7	-1.7	-2.3

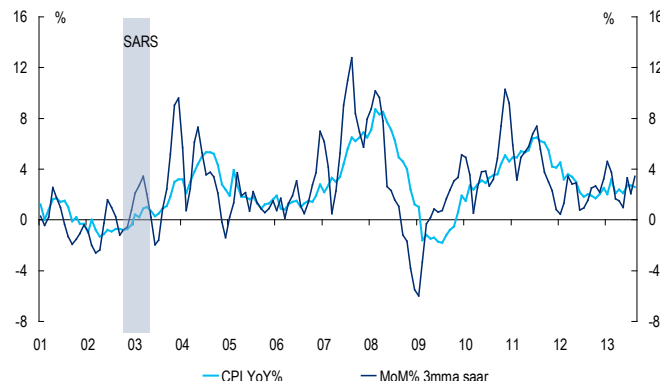
Source: Bloomberg and Citi Research Estimates

Figure 2. CPI eased in Aug thanks to the base effect



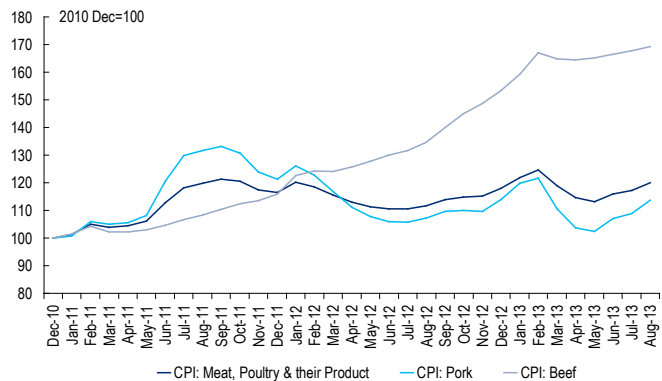
Source: CEIC and Citi Research

Figure 3. Seasonally adjusted CPI indicates rising MoM inflation



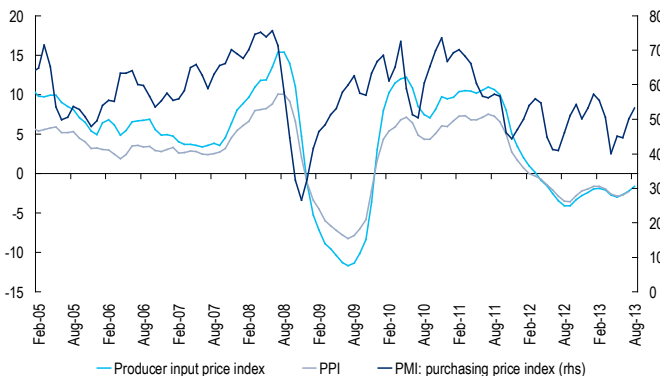
Source: CEIC and Citi Research

Figure 4. Meat prices trended upwards since June



Source: CEIC and Citi Research

Figure 5. PPI deflation alleviated, in line with PMI price index



Source: CEIC and Citi Research

Appendix A-1

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