

China’s Consumer Prices Rebound Amid Festive Spending

- Consumer prices rose 1.0% MoM and 0.7% YoY
- Core inflation increased to 1.0% YoY
- Factory gate deflation deepens
- Deflationary pressures remained considerable

China's consumer prices rose for the first time in six months due to spending linked to the Lunar New Year, while factory-gate prices fell again.

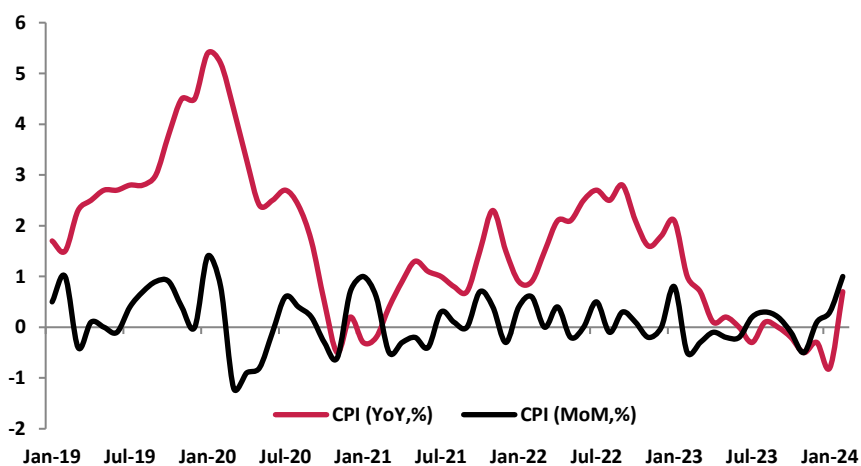
China’s consumer prices rise for first time since August

China’s Consumer Price Index (CPI) rose in February for the first time since August, bucking a months-long stretch of deflation that compounded the country's myriad economic woes. The CPI rose 0.7% YoY, breaking a four-month streak of declines. That followed a 0.8% drop in January. On month-on-month basis, the CPI climbed 1.0%, outpacing the 0.3% uptick in January. Slower food-price deflation was the main factor behind the CPI’s rise. The drop in food prices narrowed to -0.9% YoY from -5.9% in January. Demand related to the Chinese New Year holiday likely gave a boost. Higher travel prices, likely buoyed by holiday demand, were another key reason. These prices surged 23.1% YoY, accelerating from a 1.8% rise in January.

Meanwhile, core CPI, which excludes volatile energy and food prices, grew by 1.2% YoY per cent year on year last month. On a monthly basis, this translated into a 0.5% growth in February from January.

Consumer prices traditionally see a boost during the Chinese New Year period, which fell in February this year. The National Bureau of Statistics (NBS) said rising demand during Lunar New Year was the reason for the uptick in the CPI in February. According to the NBS, during the Chinese New Year period, consumer demand for food products grew, in addition to rainy and snowy weather in some regions affecting supply. The boost to food prices from the Chinese New Year was clear, with that gauge rising 3.3% MoM in February, much more than a 0.4% rise in January. The picture for travel prices was similar, with that component jumping 13.1% MoM after a 4.2% rise in January.

Chart 1: China Headline Inflation (%)



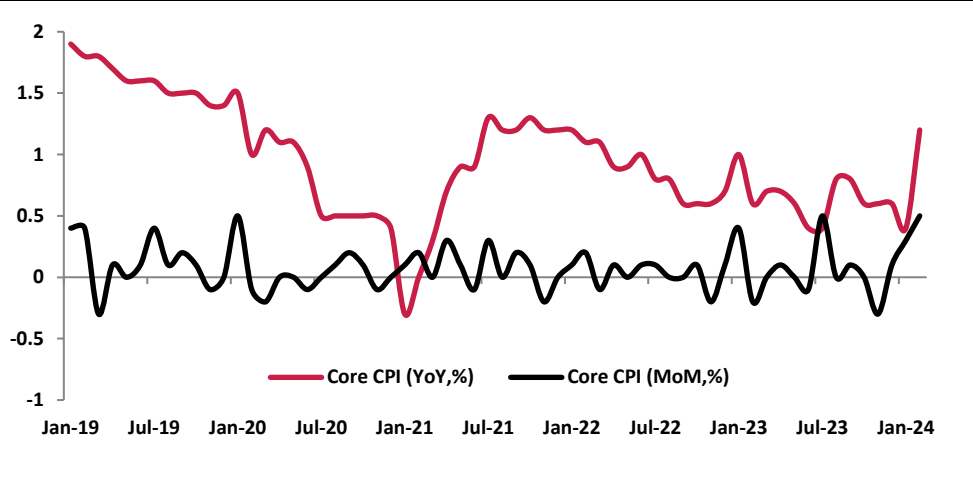
Source: Bloomberg, BIMB Securities

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Chart 2: China Core Inflation (%)



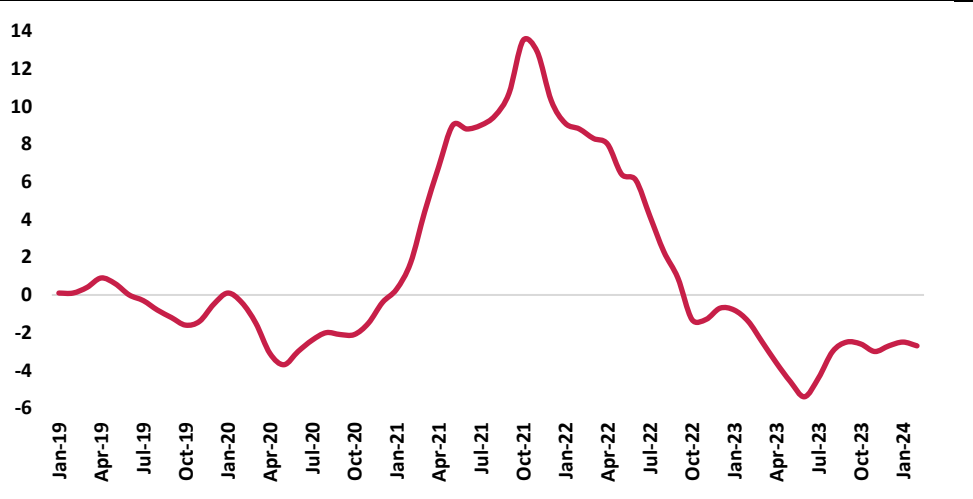
Source: Bloomberg, BIMB Securities

Factory-gate deflation deepens

The producer price index (PPI), which measures the cost of goods at the factory gate, tends to be much less affected by Chinese New Year holidays than the CPI, fell 2.7% YoY, more than January’s 2.5% decline. It was the 17th straight month of contraction in factory gate prices, underscoring that the economy continued to grapple with numerous headwinds as various support measures from Beijing to speed up recovery since last year apparently had little effect. On a month-on-month basis, the PPI dropped for a fourth consecutive month, falling 0.2% from January. Consumer-goods prices in the PPI basket dropped 0.9% YoY, dragged down by costs of food and durable consumer goods. Prices of producer goods in the PPI dropped 3.4% YoY, deeper than January’s 3.0% decline.

The National Bureau of Statistics attributed the PPI decline in part due to slower industrial activities during the holiday period.

Chart 3: China PPI (%)



Source: Bloomberg, BIMB Securities

Deflationary pressures remained considerable

China’s consumer prices rebounded in February thanks to a holiday-driven consumption boom, but deflationary pressure still looms as domestic demand has yet to really recover. Data for January and February show the CPI was unchanged from the same period last year, while the PPI dropped by 2.6% in the first two months compared to the same period last year. Officials combine data for the first two months of the year as it can be affected by the timing of Chinese New Year, the country’s biggest public holiday, which fell in February this

year but was celebrated in January last year. February's jump in the CPI to 0.7% YoY came after a 0.8% YoY decrease in January, which marked the sharpest drop in inflation since September 2009. The domestic inflation rate has been on a negative trajectory after a slight uptick in August and falling flat in September. However, the main reason for last month's CPI increase was Lunar New Year, as the holiday season tended to see greater spending and rising prices. The PPI meanwhile was down by 2.7% YoY last month, following a drop of 2.5% in January. While the CPI figure was good news, PPI data remained underwhelming. PPI gives a warning signal that the problem is not over with PPI is still negative month on month, so the deflation pressure continues on the upstream sector.

Overall, it is too early to conclude that deflation in China is over. Domestic demand is still quite weak. It takes time for the fiscal boost to be transmitted to the economy and help domestic demand to recover. The price rebound, while welcome news for the country's deflationary trend, was helped by the Lunar New Year holiday temporarily boosting demand. China has been desperate to perk up price growth as consumers and investors pull back. Considering the potential for a pullback in food and travel prices and the drop in prices of consumer goods in the PPI basket, we see deflation in the CPI returning, possibly as soon as April. Therefore, we expect the People's Bank of China (PBoC) to cut rates to try to bolster demand and confidence and fight deflationary pressures.

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