

# CHINA ECONOMICS RAPID RESPONSE

China Consumer & Producer Prices (Feb.)

 9th March 2023

## Drop in inflation suggests reopening effects remain small

Factory gate prices stopped falling last month, as China's reopening helped to put a floor under global commodity prices. Meanwhile, consumer price inflation dropped back sharply due to a fall in food prices and some residual seasonality. Looking through this volatility, the big picture is still that China's reopening is nudging up core inflation. But the impact has so far been marginal and, while we expect a bigger impact from reopening before long, we doubt it will push up inflation as much as it did in other economies.

CPI inflation dropped from 2.1% y/y in January to 1.0% last month, well below market expectations (the Bloomberg median was 1.9% and our forecast was 2.2%). The key driver was lower food inflation, resulting from a 11.4% m/m drop in pork prices. Core inflation also fell from 1.0% y/y to 0.6% but this was largely due to residual seasonality caused by the earlier timing of Lunar New Year in 2023 compared with 2022. To account for this, it makes sense to average January and February's data. On that basis, core inflation edged up from 0.7% y/y in December to 0.8% at the start of this year. This reflects a surge in demand for travel and other in-person services following reopening, pushing up their cost. These reopening effects now appear smaller than previously thought but are still present in the latest data.

Producer price deflation deepened from -0.8% y/y in January to -1.4% last month, consistent with market expectations (Bloomberg and CE: -1.4%). But this was due to a stronger base for comparison. In month-on-month terms, factory-gate prices stabilised in February, following falls in December and January. Consumer durable prices continued to drop back, as supply chain disruption caused by the reopening wave of infections eased. But this was offset by higher metal and energy prices, which were buoyed by the rebound in domestic demand.

We think consumer price inflation will rebound in the coming months on the back of reopening effects. But it is **unlikely** to reach the levels seen in other economies when they opened up. We forecast inflation to average 2.5% this year, up from 2.0% in 2022 but still below the government ceiling of "around 3.0%". Consistent with our view, the reports presented at the National People's Congress (NPC) struck a sanguine tone on inflation, noting that China has an "ample supply of agricultural and industrial products" and "a solid foundation for stable prices". Nonetheless, officials did acknowledge that the country will "continue to face upward pressure on CPI in 2023" and are therefore likely to err on the side of caution when it comes to the inflationary risks from monetary and

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fiscal support. While we don't anticipate formal policy tightening this year, the NPC did signal that further broad-based easing is unlikely.