



CHINA RAPID RESPONSE

Consumer & Producer Prices (Jul.)

Services inflation hits 17-month high

- **CPI joined PPI in deflationary territory last month. But this was due to a sharp drop in food inflation caused by base effects. More importantly, core inflation rose to its highest since January and we remain sceptical that China is slipping into an extended period of deflation.**
- CPI fell 0.3% y/y in July, after holding steady in June. (See Chart 1.) The main culprit was a sharp decline in food price inflation, from 2.3% y/y to -1.7%, reflecting a much higher base for comparison – pork prices jumped a record 25.6% m/m in July 2022 but were flat last month. **Core inflation, which is a better guide to underlying price pressures, rose from 0.4% y/y to 0.8%**, its highest since January and broadly in line with its 2022 average. Core goods inflation picked up but, at just 0.4% y/y last month, remains well below where it started the year. In contrast, **services inflation hit a 17-month high of 1.2% y/y.** (See Chart 2.)
- The lack of a stronger rebound in services inflation following reopening underscores how underwhelming the domestic recovery has been. But the fact that inflation in the tradeable sector has slumped this year, while inflation in the non-tradeable sector has picked up slightly, implies that **the main factor weighing on core inflation has been the recent pullback in foreign demand rather than domestic weakness.**
- **Producer price deflation eased last month, from -5.4% y/y to -4.4%.** As usual, the main driver was commodity prices which, due to their volatility, have an outsized impact on headline PPI. In particular, higher oil and gas prices meant PPI only declined 0.2% m/m last month, compared to a 0.8% fall in June. (See Chart 3.) But **what stands out most to us is the slight rise in the output prices of consumer durables, following six months of declines.** (See Chart 4.)
- **We doubt that CPI and PPI will still be in deflationary territory by year-end.** Core inflation suggests that underlying inflation is low but still positive. And we think it may pick up somewhat in the coming months as policy support results in a slight reacceleration in economic growth. The base effects currently weighing on food inflation and producer price inflation will also turn more favourable before long. **Low inflation is still a concern. But China doesn't appear to be on the brink of an economy-wide deflationary spiral.**

Chart 1: Consumer Prices (% y/y)

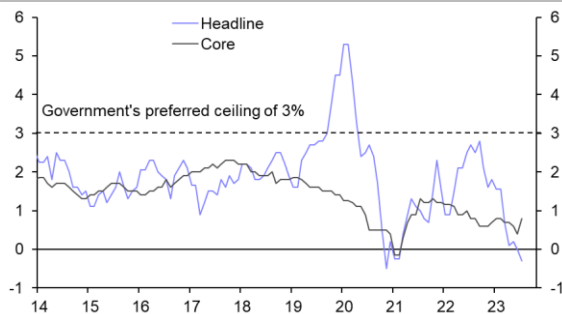


Chart 2: Core CPI (% y/y)

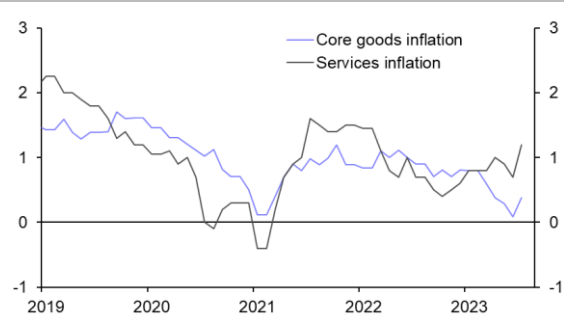


Chart 3: Producer Prices

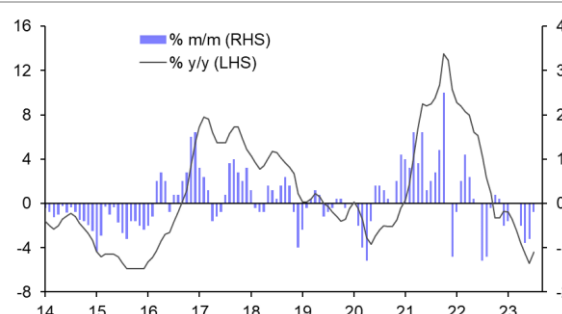
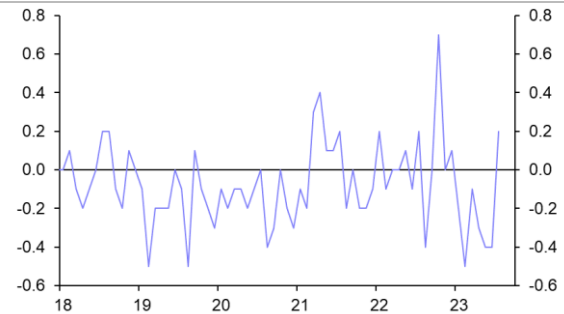
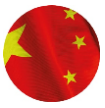


Chart 4: PPI – Durable Consumer Goods (% m/m)



Sources: CEIC, Capital Economics



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