CAPITAL ECONOMICS 凯投宏观

CHINA RAPID RESPONSE

Consumer & Producer Prices (Oct.)

Deflationary returns but is unlikely to persist

- **CPI slipped back into deflationary territory last month. This was mostly due to a drop in food inflation. But core inflation declined too, adding to evidence of renewed economic weakness. Nonetheless, the divergence between goods and services inflation continues to suggest that the primary disinflationary pressure is not domestic. And with policy support still on course to drive a modest recovery in growth over the coming quarters, an extended period of deflation is unlikely.**

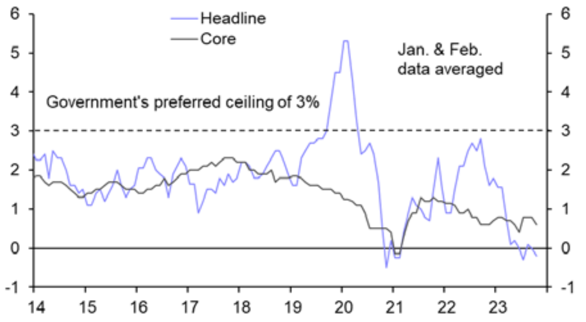
- CPI fell 0.2% y/y in October, after holding steady in September (the Bloomberg median was -0.1% and our forecast was -0.2%). (See Chart 1.) The main culprit was a deepening of food price deflation, from -3.2% y/y to -4.0%. This largely reflects a much higher base for comparison – pork prices rose 9.4% m/m in October 2022. But pork prices also fell 2.0% m/m last month. This more than offset a rise in energy prices, which pushed energy price inflation back into positive territory for the first time since March.

- **Core inflation dropped for the first time in four months, from 0.8% y/y to 0.6%. This adds to wider signs, including from the latest PMIs, of a renewed loss of economic momentum recently**. That said, China's low inflation rate is not primarily due to domestic weakness. Instead, it appears to be related to price cutting by Chinese manufacturers in a bid to defend market share as the pandemic boom in global goods demand peters out. Core goods inflation dropped last month, from 0.3% y/y to a record low of 0.0%. (See Chart 2.) In contrast, services inflation, which more narrowly reflects domestic conditions, has held up much better, edging down only slightly from a 19-month high of 1.3% y/y to 1.2%.

- Meanwhile, producer price deflation deepened for the first time in four months, falling from -2.5% y/y to -2.6% (Bloomberg and CE: -2.7%). (See Chart 3.) This reflects a stronger base for comparison from a year ago – **factory-gate prices were unchanged m/m from September.** Increases in the price of energy and chemical products offset declines in metal prices. (See Chart 4.)

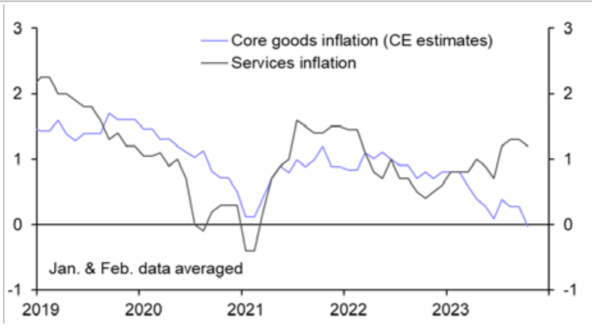
- **Chinese inflation looks set to remain low for the foreseeable future. But we don't think the country is about to enter a deflationary spiral.** Core inflation is likely to return above 1.0% in the first half of 2024, as policy support holds a hand under domestic demand and supports a further increase in services inflation. It may also nudge up core goods inflation. Meanwhile, the base effects weighing on food and producer price inflation will ease before long. In all, we think headline CPI will rise over the coming months and average around 1.0% in 2024, while factory-gate deflation should also ease next year.

Chart 1: Consumer Prices (% y/y)



Sources: CEIC, Capital Economics

Chart 2: Core CPI (% y/y)



Sources: CEIC, Capital Economics

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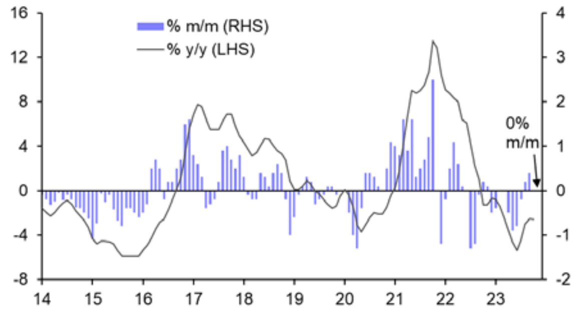
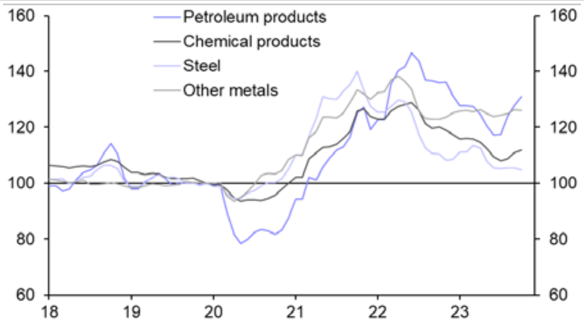
Chart 3: Producer Prices



Sources: CEIC, Capital Economics

Chart 4: Producer Prices (Dec. 19 = 100, seas. adj.)



Sources: CEIC, Capital Economics

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