



CCBI SECURITIES | RESEARCH

China Economics Update: PPI reflation rises further 中国经济评论: PPI 继续走高

China's PPI reflation accelerated further while core CPI remained contained.

PPI increased 9.0% YoY in May, surprising on the upside as global commodity prices remained elevated. Food prices helped to contain headline CPI; sequential growth on core inflation also stayed muted. PPI inflation pressure is likely to remain high in coming months, adding upward pressure to our annual PPI forecast of 5%. The limited feedthrough from PPI to CPI points to margin pressure on downstream industries.

PBoC remains patient but watch for a turning point. Elevated commodity prices led to a series of administrative measures from top authorities over the past weeks. Liquidity conditions remained steady. There has been a marginal increase in interbank rates amid high producer price pressure. Local government bond issuance could also pick up momentum. The expected rise in CPI in 4Q may add to the pressure on the PBoC to tighten its stance and raise rates.

中国 PPI 通胀进一步加速，核心 CPI 保持可控。5 月 PPI 同比增长 9.0%，高于市场预期，因全球大宗商品价格持续高企。食品价格帮助抑制了国内 CPI，核心通胀的环比增长也保持温和。未来几个月 PPI 通胀压力可能会保持高位，这给我们 5% 的年度 PPI 预测增添了上行压力。PPI 对 CPI 的有限影响表明下游行业面临利润率压力。

央行仍然保持耐心，但需关注货币政策的转折点。过去几周中央采取了一系列行政措施抑制大宗商品价格的快速上涨。流动性状况依然保持稳定。同业拆借利率小幅上升，由于生产者价格压力居高不下，同时地方政府债券发行势头有可能回升，增加债市供给压力。预计四季度 CPI 同比上行更加明显，会增加央行收紧货币政策和提高利率的压力。

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PPI accelerated in May; CPI pressure contained

May PPI inflation data came in higher than market expectation. PPI grew 9.0% YoY in May (cons: 8.5% YoY), its highest level since Oct 2018. On a sequential basis, May PPI rose 1.6% MoM after easing to 0.9% MoM in Apr, consistent with the global commodity price trend, which saw sequential growth pick up further in May (4.3% MoM vs. 3.9% MoM in Apr). In addition, the base effect has been in play since Mar. In May, the carryover effect of last year contributed 3.0% ppt to headline PPI inflation, higher than in Apr (Fig 2). Since 2Q was the trough of last year's PPI inflation (average of -3.2% YoY), the base effect is expected to fade in 2H while PPI YoY remains strong in the near-term.

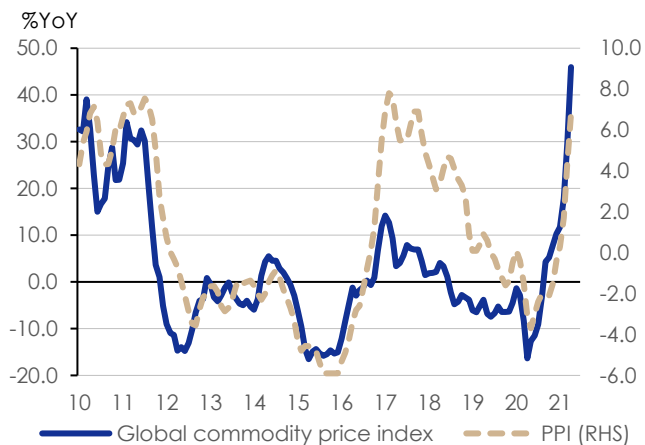
Core CPI inflation pressure well contained. May CPI rose 1.3% YoY, lower than the market expectation (cons: 1.6% YoY). The base effect from last year resulted in a higher contribution to the headline figure than in the previous month (+0.7% ppt vs. +0.1% ppt in Apr). On a sequential basis, CPI continued to decline albeit at a slower pace (-0.2% MoM in May vs. an average of -0.4% MoM in Mar-Apr). Food prices continued to lead the contraction with a decline of 1.7% MoM, while non-food and service prices both increased moderately, by 0.2% MoM. Core CPI inflation, excluding food and energy, remained well contained, edging up only 0.1% MoM, from 0.3% MoM the previous month. Overall, despite substantial price increases on the PPI front, China's CPI price pressure remained limited.

Our view

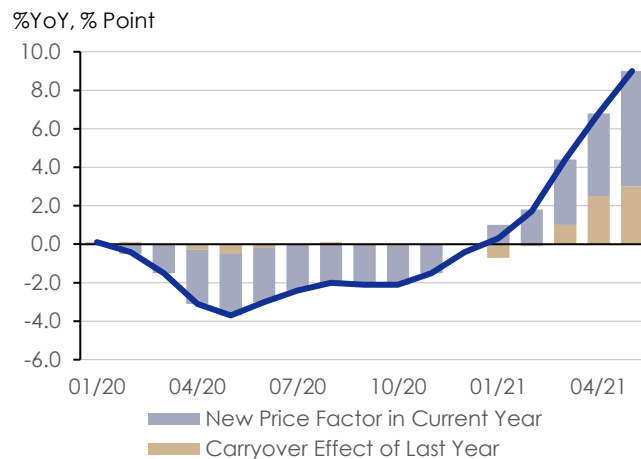
PPI inflation pressure to persist. PPI pressure so far has concentrated on producer input and output prices for mining, raw materials, and upstream manufacturing goods. Pass-through to the downstream, including consumer products, has been limited (Fig 3). Nonetheless, elevated commodity prices led to a series of administrative measures from China's top authorities over the past weeks, from raising transaction fees, changing tax rules, urging producers to sell inventory, and clamping down on speculative trades. As a result, prices for rebar and coal fell more than 20% from their highs in May. However, with stronger global recovery momentum and supply constraints, it is likely that commodity prices will tick higher, at least in the near-term: in the first week of Jun, global commodity prices (S&P GSCI Index) rose 3.5% from the average in May. We expect PPI inflation to reach over 8% YoY in 2Q, adding more upside risk to our current full-year forecast of 5%.

China's CPI inflation to pick up in 2H. Headline CPI inflation is still benefiting from declining food prices. Pressure on core CPI inflation appears to be well under control, as the sequential growth eased again from the previous month. Limited feedthrough from PPI to CPI so far suggests margin pressure on downstream industries. However, with the recovery in services and cost pressure, core CPI is likely to see more upward pressure. The fading base effect will also add to the headline YoY numbers in the latter part of the year. Our forecast suggests CPI inflation of around 3% by 4Q.

A turning point in monetary policy to be watched. PBoC has kept the liquidity environment tightly balanced. Weekly funds injected through open market operations (OMO) remained steady at around RMB50b since Mar, just enough to balance out the matured reverse repo, with the operating interest rate unchanged at 2.2%. Nonetheless, interbank interest rates edged up lately and benchmark 10-year yields also crept higher to 3.12% from as low as 3.05% in previous weeks. Persistent price pressure and the anticipation of more debt issuance from local governments may be the reasons behind rising rates in recent weeks. On the latter: new local government bond issuance of RMB946.5b during the first five months of the year was only 22% of the RMB4.27t annual quota assigned by the MOF, compared with a share of 50-60% in the past. This has raised expectations of higher debt issuance in the remainder of the year. While CPI inflation pressure remains muted as the economy recovers, we have yet to see whether and when the central bank will tighten its liquidity stance.

Fig 1: PPI rose along with surging commodity prices

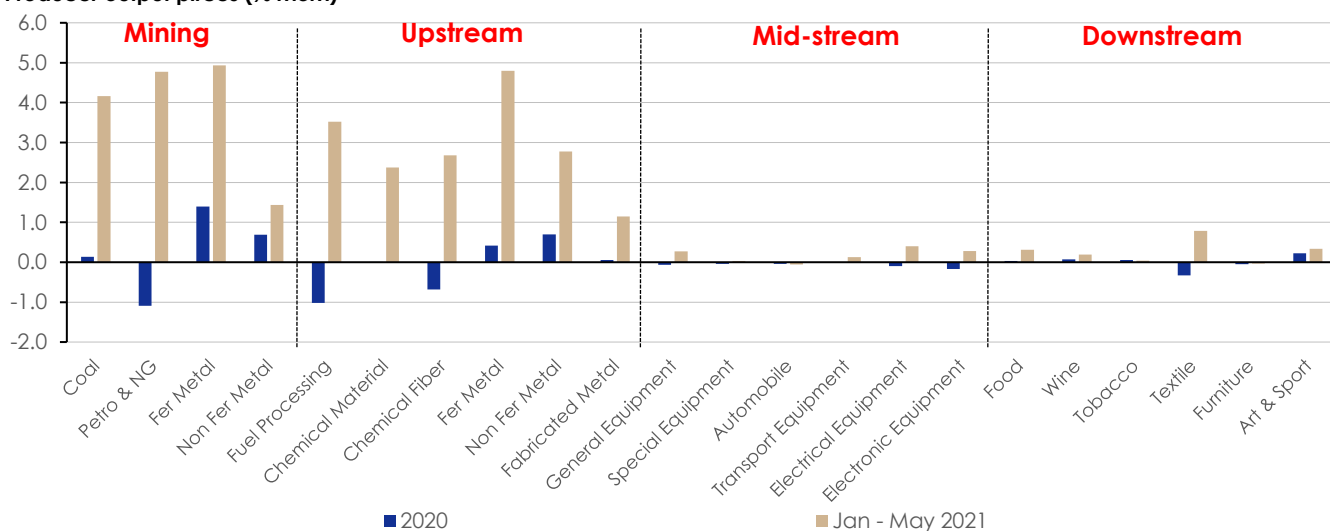
Source: CEIC, CCBI

Fig 2: Low base in 2Q last year also contributed to PPI YoY

Source: CEIC, CCBI

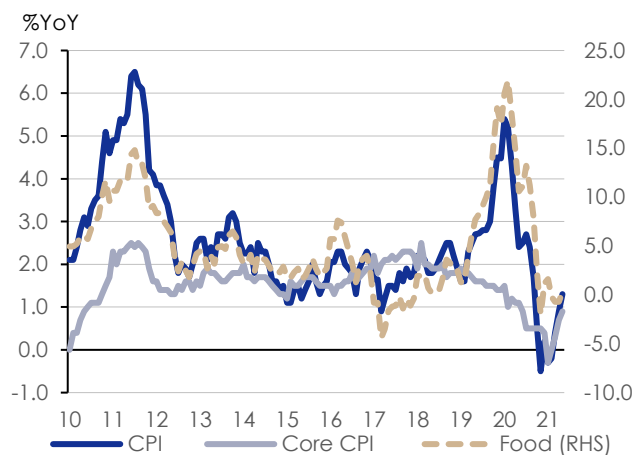
Fig 3: Upturn in producer output prices is so far concentrated in the mining and upstream sectors

Producer output prices (% MoM)



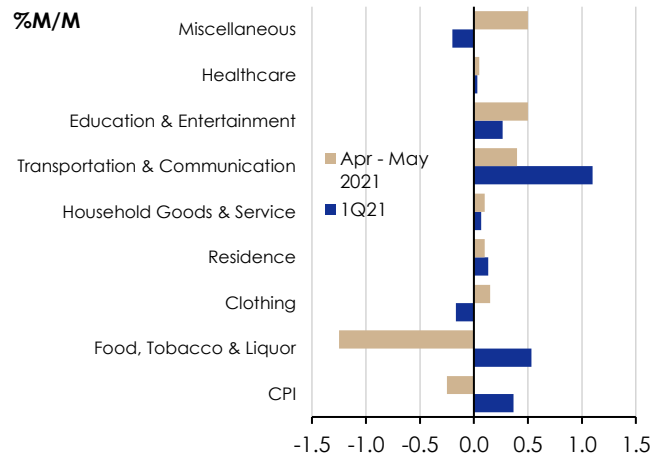
Source: CEIC, CCBI

Fig 4: CPI headline and core inflation increased 1.3% and 0.9% YoY in May



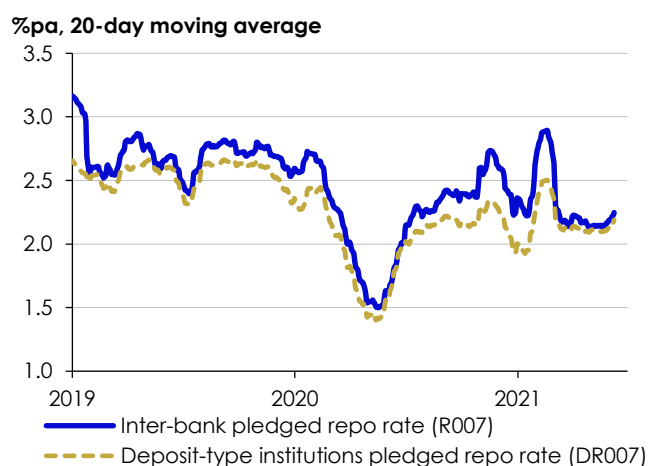
Source: CEIC, CCB

Fig 5: CPI price momentum remained well under control as food prices continued to decline



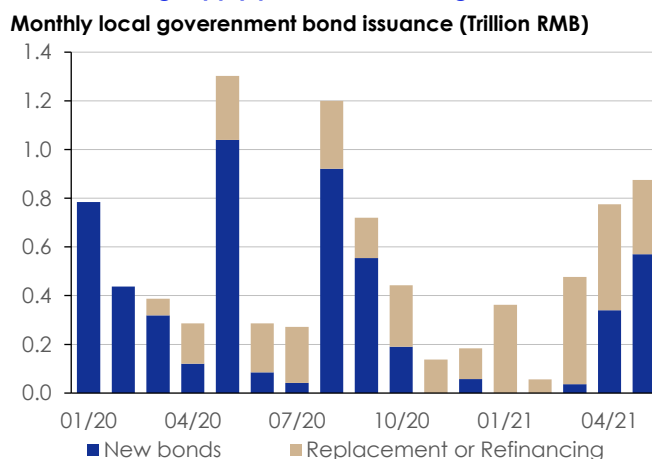
Source: CEIC, CCB

Fig 6: Interbank rates turned up marginally since late-May



Source: CEIC, CCB

Fig 7: New LGB issuance fell short of annual quota; there could be rising supply pressure in coming months



Source: CEIC, CCB

Rating definitions:**Outperform (O) – expected return > 10% over the next twelve months****Neutral (N) – expected return between -10% and 10% over the next twelve months****Underperform (U) – expected return < -10% over the next twelve months****Analyst certification:**

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