

Greater China – Week in Review

Highlights: Supply driven reflation

I had a meaningful discussion with clients and counterparties last week during my trip to Shanghai and Shenzhen, and two key concerns stood out.

First, the normalization of oil prices may prove much slower than the market currently expects. Even though the war has de-escalated, the extent of damage to energy infrastructure suggests that supply disruptions could persist for longer. In my view, commodity traders' concerns about structurally elevated oil prices are well-founded.

Second, China's reflation process appears to be accelerating, but largely driven by a supply shock rather than a recovery in underlying demand. This raises an important question: is this good or bad news for China's equity market?

China's PPI rose 1.0% MoM in March, marking the sixth consecutive monthly increase and the strongest gain in nearly four years. On a YoY basis, PPI accelerated by 1.4ppts to 0.5%, ending a 41-month contraction streak.

The faster rebound in March PPI was driven by four main factors. First, the sharp rise in global oil prices lifted domestic producer prices in upstream energy-related sectors. Second, prices along the crude oil–petrochemical chain increased significantly. Third, the non-ferrous metals sector remained an important source of support. Fourth, prices in communications and electronics extended their upward trend.

Nevertheless, CPI fell 0.7% MoM in March, weaker than the typical post-Lunar New Year seasonal pattern. On a YoY basis, CPI eased to 1.0% from 1.3% in February. Core CPI also moderated to 1.1% YoY from 1.8% YoY. Structurally, amid the pullback in international gold prices, domestic gold jewelry prices declined in March for the first time in eight months.

Looking ahead, if oil prices remain above USD100/bbl, we think PPI inflation could rise to around 2.0% YoY in the coming months. As for CPI, the recent oil price surge is likely to feed through via two channels: first, the direct pass-through from higher crude prices to transportation; and second, the indirect transmission from PPI to core goods CPI. As a result, CPI inflation is likely to re-accelerate in 2Q to about 1.5% YoY.

On reflation, the historically tight correlation between PPI and industrial profits implies that headline industrial profit growth is likely to improve further in the near term. However, the nature of this reflation matters. Rising oil prices tend to widen the divergence in corporate profitability rather than lift all boats — upstream sectors benefit, while downstream industries face margin compression from higher input costs.

The bottom line, in our view, is that we should not be overly "optimistic" about oil-driven PPI reflation, but neither should we dismiss it entirely. I personally lean to the argument that it provides cyclical support to parts of the market.

Tommy Xie Dongming
Head of Asia Macro Research

Keung Ching (Cindy)
Hong Kong & Macau Economist

Ultimately, policy matters more than prices. The People's Bank of China will be the key anchor for equity market direction.

The Hong Kong Monetary Authority announced to grant issuer licences to Anchorpoint Financial Limited (joint venture between Standard Chartered Hong Kong, HKT and Animoca Brands) and the HSBC for issuing stablecoins in Hong Kong. The issuers are said to launch Hong Kong dollar–linked stablecoin in the second half of this year, focusing on retail payment (P2P and P2M payment) and investment of tokenized products.

Given Hong Kong's advanced and efficient electronic payment landscape (such as the Faster Payment System, FPS), public adoption of stablecoin may remain limited in the near-term horizon. Future success of stablecoin push will likely depend on enhancing its interoperability, as well as building sizable pools of high-quality tokenized assets and growing the Web3 economy which leverage stablecoins as mediums of exchange. In that connection, Hong Kong authorities are actively exploring stablecoin applications in payments, decentralized finance (DeFi), and RWA tokenization, alongside collaboration with industry stakeholders.

Separately, Hong Kong PMI fell sharply from 53.3 in February to 49.3 in March, dragged by declines in new order (47.3 vs. 54.9 in Feb) and output sub-indices (48.6 vs. 55.5 in Feb). The deterioration in business conditions was partly due to the geopolitical conflict in the Middle East which is expected to strain market demand. Business confidence, which had shown signs of recovery previously, slipped deeper into contraction territory in March, as firms expected demand to remain weak in the months ahead.

Key Events	
Facts	OCBC Opinions
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Key Economic News	
Facts	OCBC Opinions
<ul style="list-style-type: none"> In March, China's PPI rose 1.0% MoM, marking the sixth consecutive monthly increase and the strongest gain in nearly four years. On a YoY basis, PPI accelerated by 1.4ppts to +0.5%, ending a 41-month contraction streak. 	<ul style="list-style-type: none"> The faster rebound in March PPI was driven by four main factors. First, the sharp rise in global oil prices lifted domestic producer prices in upstream energy-related sectors, especially oil and gas extraction. Among upstream industries, price gains were particularly pronounced, with oil extraction and petroleum refining prices rising 15.8% and 5.8% MoM, respectively. Second, prices along the crude oil-petrochemical chain increased significantly, as upstream cost pressures were gradually passed down the supply chain, pushing up prices in chemicals and chemical fibers by 3.6% and 3.4% MoM, respectively. Third, the non-ferrous metals sector remained an important source of support. Although copper prices softened somewhat, stronger gains in rare earths, aluminum, and other non-ferrous metals continued to provide an additional boost to PPI. Fourth, prices in communications and electronics extended their upward trend for a third consecutive month. In March, producer prices for computers, communications, and other electronic equipment rose 0.7% MoM and 0.4% YoY. Meanwhile, CPI fell 0.7% MoM in March, weaker than the typical post-Lunar New Year seasonal pattern. This softer reading mainly reflected two factors. First, warmer weather and improved supply conditions drove food CPI down 2.7% MoM. Second, the post-holiday moderation in services demand was more pronounced than usual, weighing on service CPI. For example, prices for air tickets, vehicle rentals, and travel agency services fell 29.5%, 18.9%, and 14.2% MoM, respectively. On a YoY basis, CPI eased to 1.0% from 1.3% in February. Core CPI also moderated to 1.1% YoY from 1.8% YoY. Structurally, amid the pullback in international gold prices, domestic gold jewelry prices declined in March for the first time in eight months. Looking ahead, if oil prices remain above USD100/bbl, we think PPI inflation could rise to around 2.0% YoY in the coming months.

	<p>As for CPI, the recent oil price surge is likely to feed through via two channels: first, the direct pass-through from higher crude prices to transportation; and second, the indirect transmission from PPI to core goods CPI. As a result, CPI inflation is likely to re-accelerate in 2Q to about 1.5% YoY.</p>
<ul style="list-style-type: none"> Hong Kong PMI fell sharply from 53.3 in February to 49.3 in March, dragged by declines in new order (47.3 vs. 54.9 in Feb) and output sub-indices (48.6 vs. 55.5 in Feb). The deterioration in business conditions was partly due to the geopolitical conflict in the Middle East which is expected to strain market demand. Business confidence, which had shown signs of recovery previously, slipped deeper into contraction territory in March, as firms expected demand to remain weak in the months ahead. 	<ul style="list-style-type: none"> However, purchasing activity was more active in March than in the previous month, with the rate of expansion at the fastest in three years. This was partly linked to consecutive months of order growth. Many firms also reported buying additional inputs due to expectations of sharp price increases from suppliers. Inflationary pressures cooled, with overall input costs (52.6 vs. 53.6 in Feb) and output charges (51.7 vs. 53.1 in Feb) both rising at slower rates. Meanwhile, employment sub-index improved to 51.2 in March (vs. 50.4 in February), as firms increase hiring in response to backlog.



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