GLOBAL MARKETS RESEARCH

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China CPI: last negative reading for 2024?

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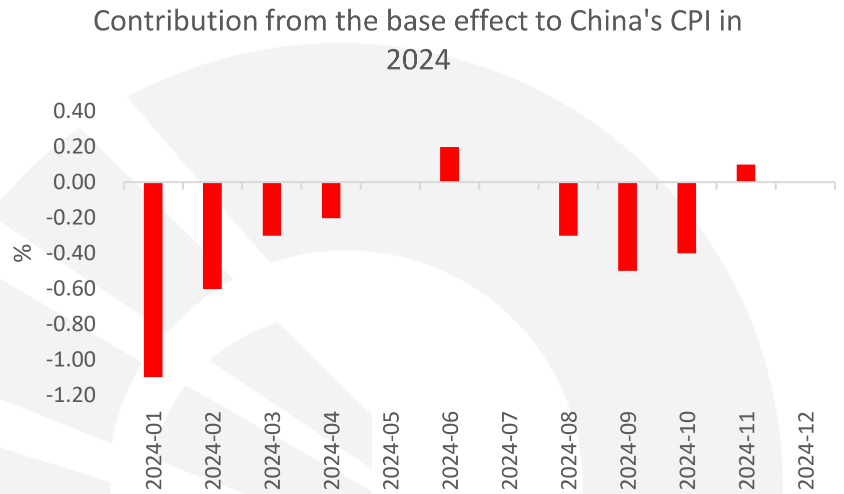
- The negative base effect alone dragged the CPI down by 1.1% in January.
- Chinese New Year effect in February is likely to offset the base effect drag.
- As the base effect diminishes in the second quarter and with the implementation of appropriate policy support, the barrier for CPI to return to negative territory is expected to increase.

In January, China's Consumer Price Index (CPI) experienced a significant year-on-year contraction of 0.8%, marking the largest decline since 2009. This contraction was primarily attributed to the negative base effect resulting from the Chinese New Year falling in February this year, which alone dragged the CPI down by 1.1%. However, on a sequential basis, the CPI showed a modest increase of 0.3% month-on-month, driven by both food and non-food price rises. Food prices, buoyed by cold weather, rose by 0.4% month-on-month, with vegetable prices notably increasing by 3.8%. Additionally, non-food prices also edged up by 0.2% month-on-month.

Looking ahead, the impact of the base effect is expected to continue exerting a considerable drag, amounting to approximately 0.6% in February. However, with the Chinese New Year approaching, recent high frequency data indicate that food prices have surged by over 3% in the first week of February, which is likely to offset the base effect drag. Consequently, it is anticipated that China's CPI will grow by more than 0.5% year-on-year in February.

<u>Chart1:</u> Estimated contribution from the base effect to China's CPI in 2024.



Source: Wind, OCBC

As the base effect diminishes in the second quarter and with the implementation of appropriate policy support, the barrier for CPI to return to negative territory is expected to increase.

Notably, China has already implemented a 50 basis points cut in the reserve requirement ratio effective from February 5th, with expectations of further cuts in the loan prime rate post the Chinese New Year holiday.

Moreover, a significant portion of the funds from government bonds issued in the fourth quarter of 2023 remains unspent, likely to be carried over into fiscal year 2024. Additionally, surplus funds available for carry-over from government-managed funds exceed 1.1 trillion yuan, bolstering the potential for proactive fiscal policies to mitigate deflationary pressures and support economic recovery.

Despite the hopeful prospect that January's negative CPI reading may be the last for 2024, the pace of reflation hinges on the magnitude of China's policy interventions. In the medium term, the success of China's reform efforts, policy consistency, and strategies to address structural challenges will be pivotal in steering the country away from the downward spiral of prices.

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