

## China: CPI and PPI divergence result in smaller profits

CPI and PPI continued to diverge in May. This will hurt producers' profits if they cannot pass all the rising material costs to consumers.



An aluminium alloy products factory in Tangshan City, China

### Divergence between CPI and PPI

CPI rose to 1.3%YoY from 0.9%YoY, and PPI increased to 9.0%YoY from 6.8%YoY in May. The rise in PPI was mainly driven by ferrous metals.

Consumer prices continued to be affected by last year's high pork prices, which started to come down in May last year. As such the high base effect from now will dissipate, and therefore we will see CPI edging higher from now on. **This higher CPI induced by base effects should not be labelled as "inflation" in any meaningful sense.**

We have seen a general fall in metals prices since the last week of May. That has followed the authority's administrative measures. This could have a lasting effect for several months in the domestic market. But if global commodity prices continue to rise due to US infrastructure stimulus measures and re-opening economies elsewhere, then it will be difficult for the domestic market not to follow.

## Impact of CPI-PPI divergence

As the gap between CPI and PPI growth rate widens, profits of producers are going to fall as they cannot pass rising costs on to consumers.

This is especially true at the moment when there are small lockdowns in Guangdong province. Some residents are not allowed to leave their home, which means demand for goods in the domestic market is affected. Producers can look to the global market for a price increase. But overseas markets have only recently started to recover, and it is uncertain if producers can pass the extra costs on to export markets.

**We believe the net effect of all this will be slower profit growth for producers until consumer power recovers further.**