# China: disappointing inflation data point to weakness in the economy

China's March CPI data were worse than expected and weaker compared to February. This is not the right sign for a full economic recovery. We expect next week's GDP report to show a partial recovery. The government needs to add more stimulus to the economy

China's economy is showing signs of weakness

0.7%YoY

China's March CPI

Weaker CPI hints that China is not in full recovery mode yet

## Weaker inflation

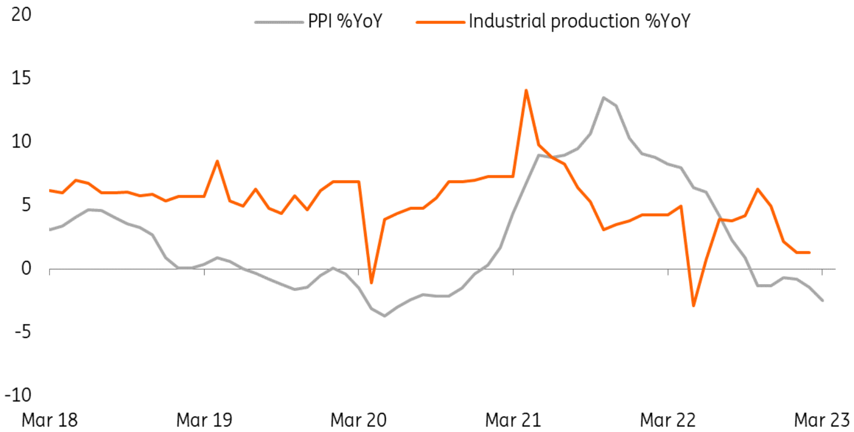
China's CPI only increased by 0.7% year-on-year in March compared to 1% in February. And PPI fell deeper too at -2.5%YoY from -1.4%YoY in February.

Both point to a slower recovery in March. But CPI is mainly affected by food prices. Higher egg prices caused by a bird flu outbreak were offset by lower vegetable prices due to warmer weather.

Clothing, a reliable gauge of average consumer behaviour, increased by 0.8%YoY and 0.5% month-on-month, which means that the average consumer is still spending. Competition among retailers during recovery should have limited price increases and squeezed profits.

A weaker PPI could be an indicator of weaker industrial production data for March, which will be released next week. This should be a result of the weakening export demand.

## Weaker PPI could signal slower growth in industrial production




Source: CEIC, ING

## Implication for macro policies

**Fiscal stimulus**

Data released so far do not point to a recovery that could lead to 5%YoY GDP growth for the first quarter. As such, we think the government will announce fiscal stimulus measures after the GDP report is released next week. There is no need to maintain a wait-and-see approach anymore. So far, the economic data show that the weakness in external demand has affected China's manufacturing activities and the labour market in the manufacturing sector. This could affect consumption growth later in the year if stimulus is not put in place.

There should be more infrastructure investment and some consumption stimulus. One such stimulus could be the resumption of subsidies for electric vehicles (EVs). However, this would increase the risk of overexpansion of the EV industry. Another option would be to provide a stimulus for the consumption of electronics, which would increase domestic demand for semiconductors.

**Interest rate cuts**

An interest rate cut by the People's Bank of China, China's central bank, could support infrastructure and business investments by lowering borrowing costs. The PBoC can cut 10bp on both the 1Y Medium Lending Facility rate and the 7D reverse repo rate. This could then be followed by a 5bp cut in the 1Y Loan Prime rate and a 15bp cut in the 5Y Loan Prime rate by banks, which is the same pattern we saw in August 2022. This should create faster loan growth year-on-year in the second quarter and bring forward more infrastructure and company investments from the second half of this year to the second quarter.

The negative side of an interest rate cut is that it would lead to a wider interest rate differential with most major economies, and that could induce portfolio capital outflows from China. This is not ideal if the market reads the rate cut as a sign of weak economic recovery.

## CNY and CNH reacted to the weak inflation data

USDCNY and USDCNH reacted higher to the inflation data, resulting in a softer yuan. USDCNY and USDCNH were as high as 6.89 when the data were released, and were 6.8847 and 6.8927 on 10 April 2023.

The weakness in the currency is likely to continue until we see some good data in next week's GDP report (which we don't expect) or the government announces more stimulus measures.

### Author

**Iris Pang**
Chief Economist, Greater China
iris.pang@asia.ing.com