

China inflation softened from warmer spring

The weather factor could hardly change the course of monetary policy



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Warm spring has put downward pressure on both PPI and CPI

Thanks to the warmer weather in March 2018, there was less demand for heating and more supply of vegetables that stabilised producer and consumer inflation.

PPI inflation fell to 3.1% YoY in March from 3.7% in February, which was mainly caused by lower demand for heating and led to lower energy prices. For example, petroleum refinery prices went down by 2.0% MoM and gasoline production prices went down by 1.7% MoM.

CPI inflation dropped to 2.1% YoY in March from 2.9% in February. This was also a result of a warmer spring that increased the supply of vegetables, and consumers enjoyed lower vegetable prices of 14% MoM in March.

In addition, tourism-related prices also fell more than 10% on a monthly basis after the Chinese New Year holiday.

All in all, softer inflation in March is largely weather and seasonal driven.

Monetary policy is still tight

As we do not think that the lower inflation is a reflection of lower economic activities, we do not believe that these softer inflation numbers will have any impact on monetary policy.

Tightening of liquidity will continue as the central bank continues financial deleveraging reform. The result of tighter liquidity would be higher short-term interest rates. 1Q's lower short-end rates were a result of cautious and pre-emptive actions by the central bank to prevent spikes during long holidays. But 2Q liquidity management should return to a tighter situation to facilitate deleveraging reforms.

PBoC to continue to follow Fed rate hikes but at a lesser extent

Apart from daily liquidity management that pushes up interest rates, we continue to believe that to keep the interest rate spread stable between China and the US, the PBoC will follow the Fed's future rate hikes. But the PBoC's rate hikes are expected to be only 5 basis points each because short-end rates should have already moved up by the tighter liquidity management via daily open market operations.