

China: PPI inflation has arrived and chip inflation is coming

China's consumer inflation is still modest due to the very high prices of pork last year. In contrast, producer prices jumped in April due to expectations on infrastructure demand. What's more, inflation caused by semiconductor chip shortages is on its way.



Source: Shutterstock

CPI and PPI have diverged

CPI inflation in April was modest at 0.9%YoY after 0.4%YoY in March. There was a short public holiday in April, and this boosted spending and small leisure trips. But the CPI growth rate was capped by pork prices which were very high last year. This high base effect will normalise from 4Q21. So we will see continued modest CPI growth rate for a few months.

In contrast, PPI in April jumped to 6.8%YoY up from 4.4%YoY in March. That was mostly caused by the expectation of infrastructure projects in China and the US. But the market might not yet have taken into account that some transportation projects in China have been stopped as they overlapped with other projects. This has resulted in a reduction in the issuance of local government special bonds.

"Semiconductor chip shortage is going to bring us chip inflation."

Chip inflation will push CPI higher

The semiconductor chip shortage is going to bring us chip inflation.

We may begin to see price increases in many parts and goods such as home appliances, cars, and computers, given the continuing global chip shortage. Even bags that do not have a chip in them, use chips in the process of production. This chip inflation may be passed on to consumers and result in a faster CPI growth rate if the chip shortage persists (estimates range from 2022 to 2023).

We believe that the chip price increase has already pushed up prices of fridges, washing machines, TVs, laptops and car prices in April, which increased 0.6%-1.0%MoM.

I expect that some goods which contain many chips can be charged at higher prices, e.g. goods related to video games. Demand for such goods does not easily fade even if prices increase.

If producers believe that spending power is not going to catch up with the increase in chip prices then producers will produce goods with fewer chips and perhaps fewer advanced functions, e.g. in automobiles. But some producers will absorb some of the increase in chip prices and suffer a squeeze on margins and profits.

Looking forward

There was a long holiday in May in China. Spending and domestic tourism activity were reported to have surpassed pre-pandemic levels. We expect higher CPI inflation in the coming months. On PPI, we expect the market's self-fulfilling behaviour, i.e. buying now rather than later to avoid higher expected future commodity prices will continue, possibly until the Chinese government sends more [warning signals](#) to halt raw material price increase.