China's CPI inflation fell more than expected due to drag from vehicles and household appliances

Low inflation offers room for policy easing but RMB stability priority may limit appetite for rate cuts

Source: Shutterstock

0.1% YoY

March CPI inflation

Lower than expected

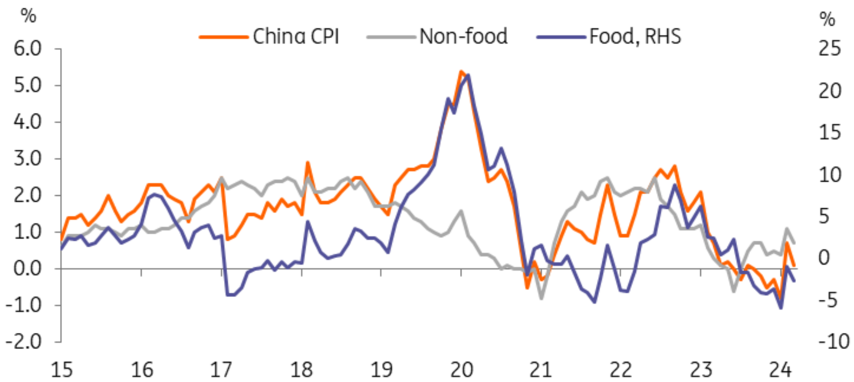
Larger-than-expected slowdown in non-food inflation accounted for CPI forecast miss

China's CPI inflation slowed to 0.1% year-on-year in March, down from 0.7% YoY in February, which was lower than forecasts for 0.4% YoY inflation. While the larger-than-expected decline is likely to stir discussion of deflation once again, it should be noted that non-food inflation remained solidly in positive territory at 0.7% YoY. In month-on-month terms, inflation fell by -1.0%, primarily reflecting a -3.2% decline in food prices, but also a -0.7% drop in non-food prices.

The main reason for the inflation miss was a larger-than-expected moderation of non-food inflation. In particular, sub-categories with negative deflation included household appliances (-0.8% YoY), transportation (-4.6% YoY) and communications devices (-2.4% YoY). With policymakers set to roll out policies to encourage trade-ins of household appliances, this could see a turnaround later in the year. Amid heavy price competition in the NEV sector, transportation prices may remain more subdued.

Food prices turning downward was expected after the Lunar New Year effect passed, with the prices of fresh vegetables (-11% MoM), pork (-6.7% MoM), and fresh fruits (-4.2% MoM) leading the sequential decline. In terms of pork prices, there is some reason for optimism; the YoY decline was a relatively mild -2.4% YoY, versus the double-digit declines seen in the second half of 2023. As the pork cycle continues to turn, food price inflation should begin to abate.

China inflation slowed but avoided falling to negative territory



Sources: CEIC, ING

Low inflation gives ample room for policy easing, but RMB stability priority may limit room for rate cuts in near term

While we believe that data will gradually show that China is not stuck in a deflationary spiral, nonetheless inflation remains well below target, and looking at economic fundamentals alone, we think the economy would benefit from further rate cuts.

However, policy priorities outlined at the Two Sessions included an intention to stabilise the RMB at a reasonable and balanced level this year. Recently the People's Bank of China (PBOC) has already had to ramp up its use of the counter-cyclical factor to push back against RMB depreciation amid hawkish developments in the US.

Given these considerations, the PBOC appears to be favouring utilising reserve requirement ratio (RRR) cuts over interest rate cuts to support the economy, as RRR cuts will not add to RMB depreciation pressure while a rate cut would worsen already unfavourable yield spreads.

As such, next week's medium-term lending facility rate decision is likely to see the PBOC standing pat, maintaining the 1-year MLF rate at 2.5%. We do not expect a rate cut to come until the second half of the year, and are looking for two 10bp rate cuts in 2024.

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