

Asia Economics

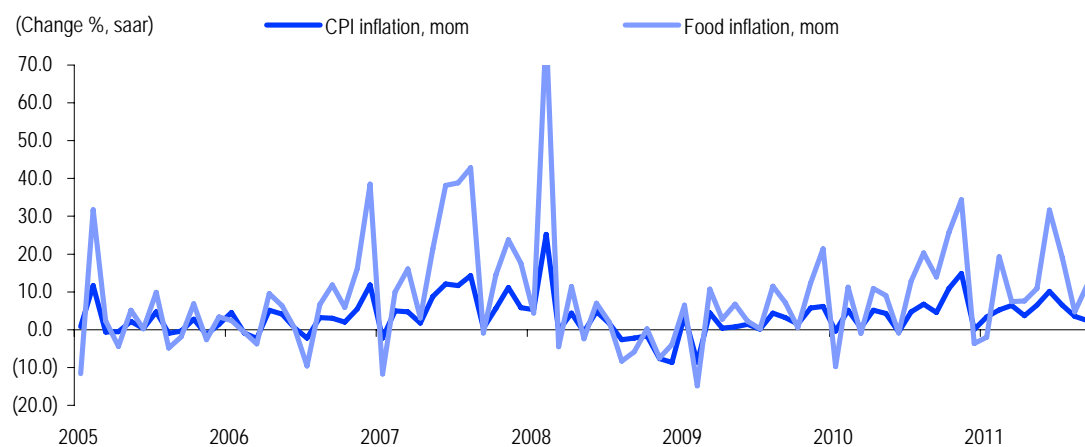
China's inflation should have peaked

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Stubborn increases in food prices have kept headline inflation above 6% since June.

Consumer price inflation was 6.1% in September, after 6.2% in August. The recent rise in food prices, after earlier pressure late in 2010/early 2011, was due to the impact of another pig cycle and a recent pick up in other food prices, notably vegetables and eggs.

Food price increases have remained stubborn

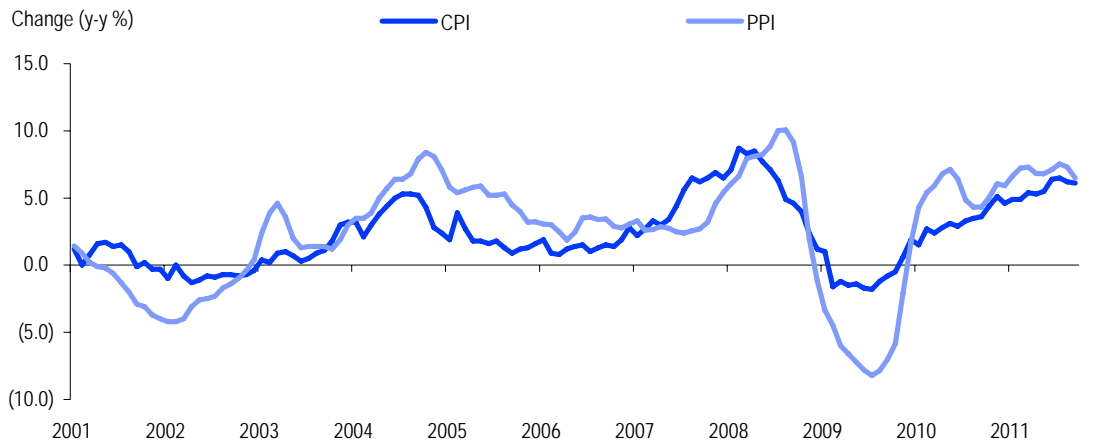


Source: CEIC, MF Global estimates

Nonetheless, food inflation should ease in the coming six months. A substantial part of the increase in food prices in September was a one-off and should reverse. The typical run up in food prices before the mid-autumn festival took place in September, this year. The unwinding of this effect should help reduce inflation in October. Indeed, weekly data on wholesale agricultural prices show food price pressure mitigating in early October. Moreover, because of the “base effects” — food prices started their rise around a year ago — YoY food price inflation should gradually come down in the coming six months.

More generally, inflation pressures are on course to decline. The inflation pressure stemming from commodity prices has started to decline. China's PPI index has remained flat since June, reflecting the impact of developments on the international raw commodity markets. This shows up in a decline in YoY PPI inflation from a peak of 7.5% in July to 6.5% in September. We think this easing of inflationary pressure via commodity prices is likely to continue amid a weak global economic outlook. Meanwhile, core inflation (stripping out food and energy) has remained well behaved, remaining steady at around 2.5% YoY. Therefore, with pressures from food and other commodity prices moderating, we expect headline inflation to decline in the coming six months, to around 5% in December.

Easing price pressure from raw materials shows up in lower PPI inflation



Source: CEIC

The decline in CPI inflation is likely to be gradual, however, and it is unlikely to lead to a drastic change in policy stance any time soon. Fighting inflation and housing price increases have been the priorities of China's macroeconomic policy making so far this year. With worries about global growth intensifying and widespread coverage of SMEs having a hard time, there have been calls for a looser policy stance. The likely decline in inflation, combined with better-contained housing prices, should, over time, allow policymakers to shift their focus to promoting growth. However, the moderation in the inflation trend is likely to remain gradual and subject to upward risks, with little sign of a drastic slowdown in growth so far. These factors mean it may be some time before the government makes decisive changes to its policy stance.

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CE Ref AMB200