Economic Analysis

Subdued inflation and uncertain external demand call for more easing measures

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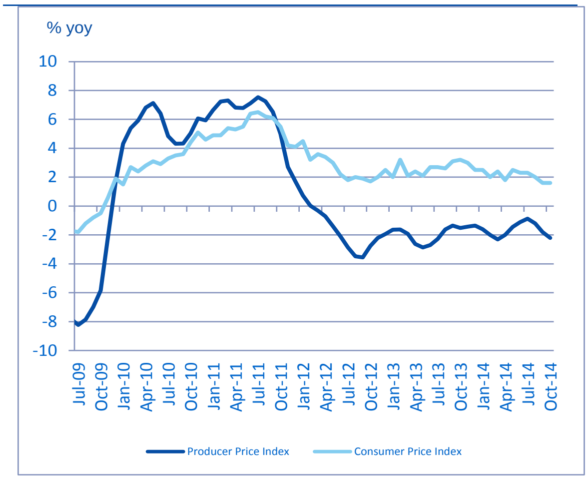
Today, headline CPI inflation came out at 1.6% y/y in October, flat with the outturn in the previous month. In the meantime, PPI dipped further to -2.2% y/y from -1.8% y/y in September, marking the longest disinflation span of 32 months in history. The weak consumer price is mainly due to weak domestic demand and the fall in global commodity prices while the producer price has been afflicted by the overcapacity problems in some upstream industries. Separately, both exports and imports, which were reported last Saturday, significantly moderated from their readings of the last month, pointing to increasing uncertainties of external demand.

A combination of subdue inflation and uncertain external demand suggest that the authorities need to beef up their efforts to easing monetary policies in support of growth. In this respect, we expect that the authorities will stick to its “targeted easing” commitment in the rest of the year while will reinstate the cuts in required reserve ratio by up to four times with 25 bps each time.

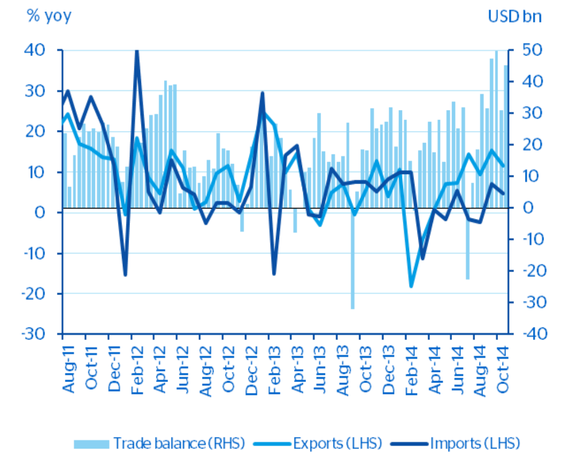
- **Headline CPI remained low while PPI deflation persisted.** CPI inflation in October remained the same as the last month’s reading at 1.6% y/y (Consensus: 1.6% y/y), which was well within the government’s 3.5% tolerance target. By categories, food prices grew by 2.5% y/y while non-food prices increased by 1.2% y/y, showing that the deceleration of consumer prices is broad-based. In particular, price sub-index of tobacco & wine and transportation& communication registered year-on-year decreases in October, which can be explained by the ongoing anti-corruption campaign and sluggish global commodity prices. Meanwhile, PPI inflation further plunged to -2.2% y/y (Consensus: -2.0%) from -1.8% y/y in the previous month, due to the overcapacity problem in some upstream industries. (Figure 1) The subdued inflation outturns will provide room for further policy easing in the following year, which is needed to spur bank lending and buoy domestic demand.
- **Both exports and imports moderated significantly, indicating that the external demand still remained uncertain.** China's exports decreased to 11.6% y/y in October, down from 15.3% in the previous month but still above market expectations (Consensus: 10.6% y/y). On the other hand, imports growth came at 4.6% y/y, lower than both market expectation (Consensus: 5.0% y/y) and September’s outturn of 7.0% y/y. As a result, trade surplus expanded to USD 45.4 bn (Consensus: 42.0 USD bn), from the surplus of USD 40.0 bn in the previous month. (Figure 2) That said, the external demand is still subject to great uncertainties as some major economies in the world (in particular Europe and Japan) are facing substantial growth headwinds. We expect that the net exports may not give a great boost to aggregate output in the fourth quarter as they did in the third quarter (contributed 2.5% out of 7.3% GDP growth).We therefore maintain our growth projection of 7.2% for this year and 7.0% of 2015.

Figure 1
CPI remains low while PPI deflation persists



Source: CEIC and BBVA Research

Figure 2
The trade surplus has continued to expand



Source: CEIC and BBVA Research