

**Summary:** January CPI inflation came in at 4.9% y/y, consistent with our expectations but much lower than the market consensus (BBVA: 4.9% y/y; consensus: 5.4% y/y). The relatively benign inflation outlook—which was anticipated by some analysts yesterday—has been well received in the markets, helping to allay fears of an abrupt policy tightening. That said, both CPI and PPI inflation picked up from December, and remain well above the authorities' comfort level. There was also an official change in weights, but the impact on the CPI inflation outturn appears to have been negligible. We therefore do not anticipate a change in the authorities' monetary tightening campaign, with two additional rate hikes of 25bp in Q2/Q3, along with at least 100bps of additional hikes in reserve requirements. We maintain our growth outlook of 9.2% for 2011, and an average inflation rate of 4.5% (see our latest [China Outlook](#)). Separately, trade data released yesterday came in above expectations, with a narrowing of the trade surplus.

### January inflation eases concerns of an abrupt tightening

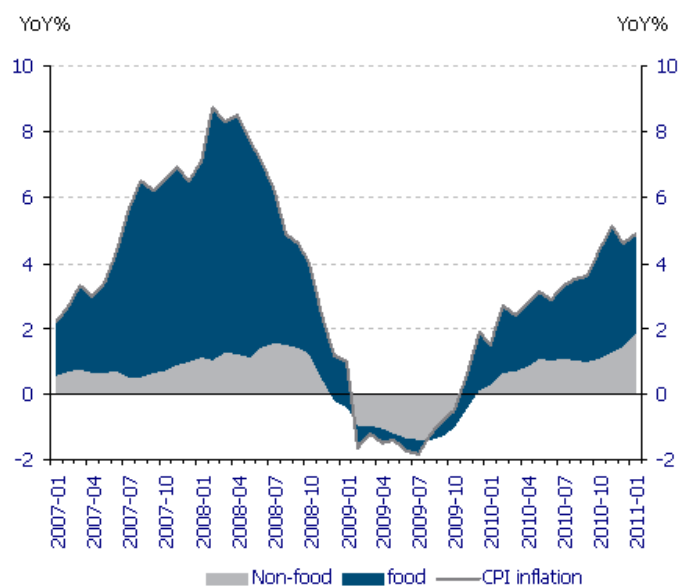
- CPI inflation came in at 4.9% y/y for January, up from 4.6% y/y the previous month (Chart 1). This was in line with our expectations (BBVA: 4.9% y/y), but well below the market consensus (5.4% y/y). The main drivers of inflation continue to be food prices and housing costs (including rents and utilities), which registered increases of 10.3% y/y and 6.8% in January respectively.
- The latest inflation data are based on new weights of the National Bureau of Statistics (NBS) in the CPI basket to better reflect actual spending patterns. According to the NBS, the weight of food has been lowered by 2.21 percentage points (which we believe would bring the overall weight of food down to about 30% in the basket), while the weight of housing costs has been increased by 4.22 percentage points, along with smaller reductions in other components of the basket. According to the NBS, the overall impact of the weighting changes amounted to an increase of 0.024% on January's inflation outturn.
- Despite the benign outturn, inflationary pressures remain present, with January producer prices (PPI) rising by 6.6% y/y from 5.9% y/y in the previous month, exceeding market expectations of 5.9% y/y. As with the CPI, the weightings of the PPI also were revised, resulting in a lower inflation outturn by 0.05 pp according to the NBS. The pickup in PPI inflation bears watch, as it may translate into broader price increases in the period ahead.
- Separately, trade data released yesterday show that both domestic and external demand remain strong. Exports and imports registered much faster-than-expected year-on-year growth rates of 37.7% (BBVA: 24.5%; consensus: 22.5%) and 51.0% (BBVA: 29.5%; consensus: 27.0%), respectively (Chart 2). The January export and import figures likely reflect some front-loading of trade activities ahead of the Lunar New Year holiday, which began on February 3 this year, in comparison to February 14 last year. The trade balance shrank to a much smaller-than-expected USD 6.45 billion (BBVA: USD 12.88 billion; consensus: USD 11.30 billion) in January, and well below December's surplus of USD 13.10 billion. Caution is needed in interpreting the numbers, however, due to the Lunar New Year distortion, as noted above.
- Overall, the relatively benign CPI outturn and strong trade data for January are consistent with our baseline scenario of an economic soft landing in 2011. We maintain our 2011 growth projection of 9.2% and the yearly average CPI at 4.5%, underpinned by a peak in inflation of above 5% through June, before receding to 3.6% y/y at end-year. We anticipate another two 25 bp interest rate hikes and additional hikes in reserve requirements of at least 100 bp. On currency front, we expect RMB to continue its gradual appreciation with 4-5% by end-2011. For details, see our latest [China Outlook](#).
- Additional data is scheduled this week, on new loans and property prices, which we will be monitoring closely.

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**Chart 1:** Inflation continues to rise, albeit by less than anticipated by the market



**Chart 2:** Stronger than expected exports and imports resulted in a decline in the trade surpluses

