

China Flash

Easing inflation provides policy room to support growth

In line with expectations, China's headline inflation eased to 4.1% y/y in December (BBVA: 4.1%; Consensus: 4.0%) from 4.2% y/y in November (Chart 1). The overall decline in year-on-year inflation occurred despite an uptick in food prices (9.1% y/y) as non-food components eased to 1.9% y/y. In sequential, seasonally adjusted terms we estimate that headline inflation was broadly flat. The moderating trend is in line with our expectations of a further decline in inflation to around 3% by mid-year, although in the near term we anticipate an upturn in January due to the forthcoming Chinese New Year holiday during the week of January 23. The December outturn is encouraging as it provides room for further policy easing which the authorities are implementing due to slowing growth momentum. We expect additional 150-200bp cuts in the RRR in H1 2012, with the next cut likely in the coming month or two. If the external environment deteriorates further, we would also expect up to 50bp cuts in interest rates in the second or third quarter of the year.

- **Headline CPI inflation eased to 4.1% y/y in December from 4.2% in November, in line with expectations (Consensus: 4.0%; BBVA: 4.1%).** In year-on-year terms, the outturn reflects an uptick in food prices to 9.1% y/y and a moderation in non-food prices to 1.9% y/y. Interpreting the month-on-month trends is difficult due to timing effects of the forthcoming Chinese New Year holiday, which occurs in January this year rather than in February as was the case last year. That said, food prices rose by 1.2% m/m, up from a decline of -0.8% m/m in November; however, this was most likely due to seasonal effects associated with demand from the Chinese New Year. Meanwhile, non-food prices declined by -0.1%, from +0.1% in November. Seasonally adjusted, the overall CPI index was broadly flat in December.
- **Producer price inflation (PPI) in December slowed noticeably**, to 1.7% y/y (Chart 2), in line with expectations (Consensus: 1.7% y/y; BBVA: 1.5%), down from 2.7% y/y in November. Month on month, the PPI declined by -0.3% in December, or by -0.2% m/m in seasonally adjusted terms. The decline in producer price inflation reflects falling commodity prices by -0.4% m/m in December. The decline in producer prices should help reduce headline inflation pressures in the months ahead.
- **Monetary aggregates released earlier this week accelerated in December, consistent with the authorities' shift to a more growth supportive policy stance.** Specifically, M2 growth (Chart 3) in December increased by 13.6% (consensus: 12.6%). New loans also increased to RMB 640.5 billion (consensus: 560.0 billion), up from RMB 562.2 billion in November.
- **The December trade figures, also released earlier this week, show a widening of the trade surplus due to weak imports** (Chart 4). Export growth remained buoyant at 13.4% y/y in December, slightly down from 13.8% in the previous month. However, import growth decelerated to just 11.8% y/y from 22.1% in November (consensus: 18.0%). The December trade surplus thus rose to a larger-than-expected \$16.5 billion (consensus: \$8.8 billion) from \$14.5 billion in November. For the year as a whole, the trade surplus narrowed to \$155.1 billion from \$181.5 billion in 2010. While the weaker import growth could be a sign of declining domestic demand, price and seasonality effects were at play, and other recent production and demand indicators have been robust.

Chart 1
CPI eases further in December

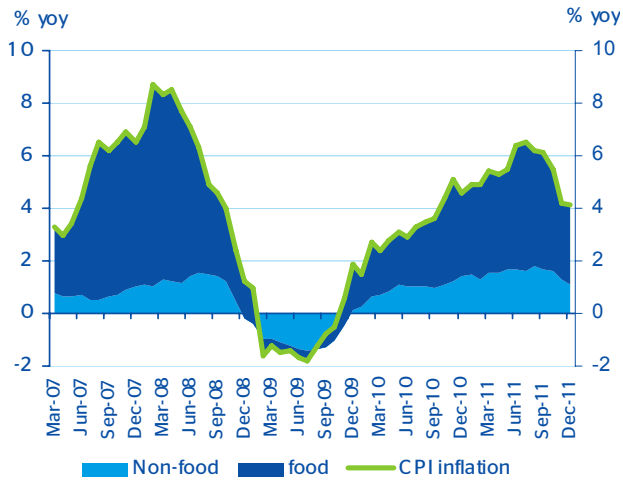


Chart 2
Falling PPI reduces inflationary pressure ahead

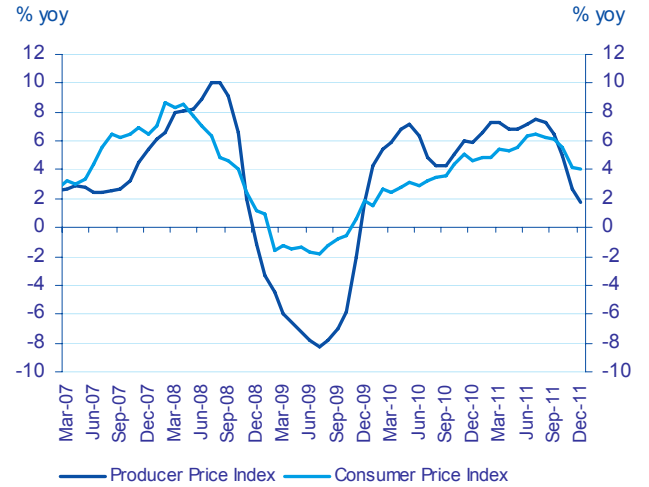


Chart 3
Money supply growth is rebounding

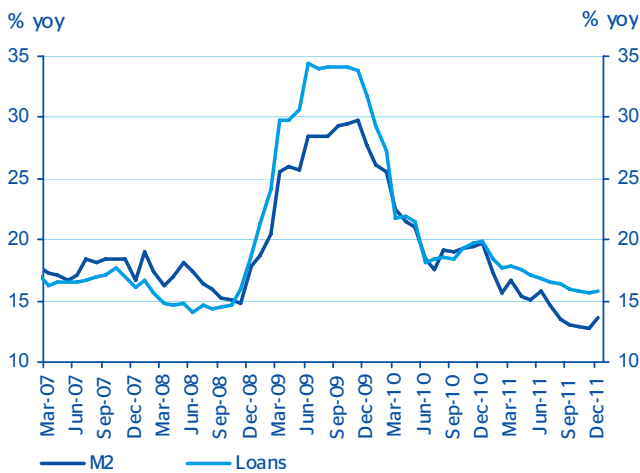


Chart 4
Weak imports resulted in a wider December trade surplus

