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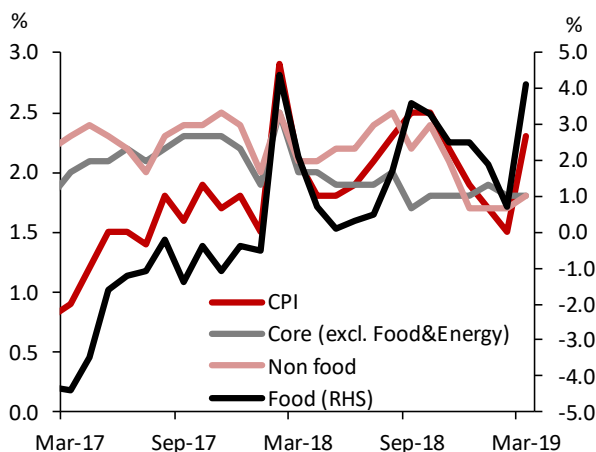


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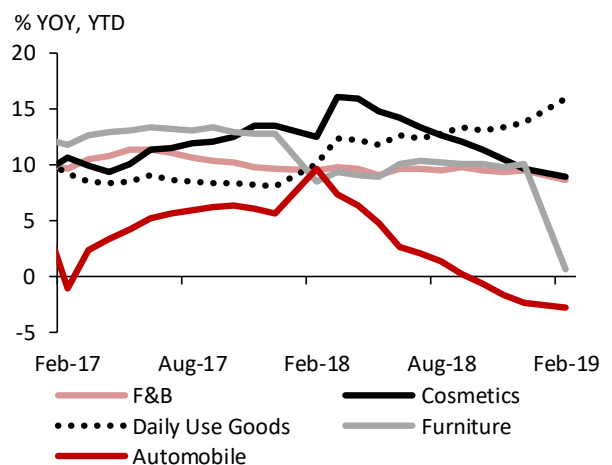
- *March CPI inflation surged by 2.3% YoY due to higher pork prices*
- *The rebound in PPI (Mar: 0.4%; Feb: 0.1%) is unlikely sustainable due to sluggish global demand*
- *Implication for our forecasts: We maintain our inflation forecast of 2.3% for 2019*
- *Implication for investors: We expect PBoC's monetary policy to remain supportive*

**Chart 1: CPI by category**



**Consumer price inflation accelerated to 2.3% YoY in March from 1.5% in February** (Chart 1). Food inflation jumped most in 13 months to 4.1%. Pork prices, which fell by -4.8% in February, surged by 5.1% in March. The swine fever outbreak culled live hog and breeding stock. Live pig stocks fell 23% YoY in February in the Shandong province, one of the country's largest pig farming hubs. The decline in sales of pig feed since October will continue. Pork prices are likely to stay elevated.

**Chart 2: Retail sales by category**



**In contrast, non-food inflation inched up to 1.8% YoY in March from 1.7% in February.** Notably, the -1.2% decline in prices of traffic and communication appliances reversed into a 0.1% increase on higher energy prices. But this was offset by a modest fall in inflation to 2.1% from 2.2% in housing, and to 2.7% from 2.8% in medicines, medical care and personal articles. **Core inflation (excluding energy and food prices) has remained stable around 1.8% in the past seven months.** Consumer sentiment has been dampened by weaker expectation of future income growth. According to the PBoC's Urban Depositor Survey, the proportion of respondents who intended to "save more" has, over a quarter, increased by 0.9% to 45% in 1Q19. This mirrored the recent drop in discretionary spending (Chart 2). Inflation expectation was the third lowest since 2010; only 26.8% of the respondents expected prices to surge (Chart 3). **As such, we maintain our inflation forecast of 2.3% for 2019 (2018: 2.1%).**

Chart 3: Urban Depositor Survey

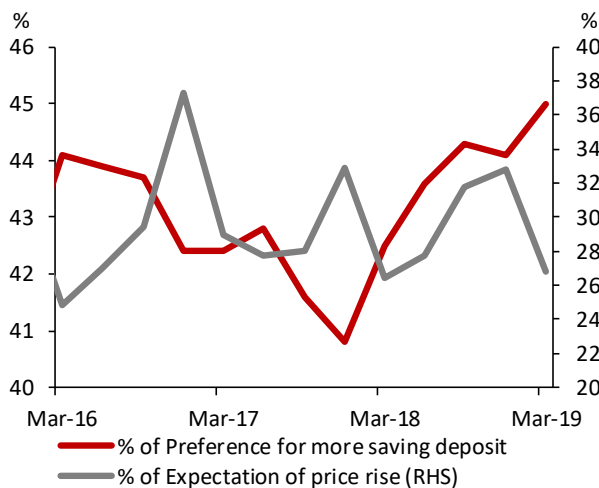
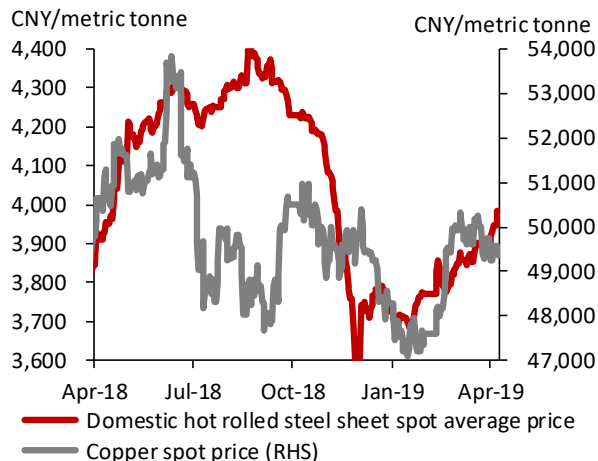


Chart 5: Steel and copper price



Producer price inflation rose to 0.4% YoY in March from 0.1% in February (Chart 4), driven by the mining industry. In month-on-month terms, PPI increased (0.1%) for the first time in five months. The improvement in manufacturers’ pricing power, if sustained, could ease pressure on profit margins. This would provide relief to industrial enterprises where earnings have been depressed by sluggish producer inflation, from oil refineries to steel mills. Profit growth of industrial firms has fallen to 14% YoY in January-February, the weakest since 2011.

Yet the risk of factory deflation still looms due to benign commodity prices. The price of domestic hot rolled steel is trading 9% below its August 2018 peak. Copper prices

remained under pressure with a 3% YoY decline (Chart 5). Sliding factory prices over the past year have eroded corporate profits and weakened the debt repayment ability of indebted companies. By our estimation, the real interest rates shot up to 4.2% in 1Q18 from the trough of 3.1% in 1Q17 (Chart 6). Policymakers have ramped up infrastructure investments alongside tax cuts to support demand. Even so, increased global uncertainty may create headwinds for commodity prices. The IMF has downgraded its global growth forecast for 2019 from 3.5% to 3.3%, the slowest expansion since 2016.

All told, March inflation numbers will not constrain the PBoC’s monetary policy maneuvering this year.

Chart 4: PPI and Manufacturing PMI PPI

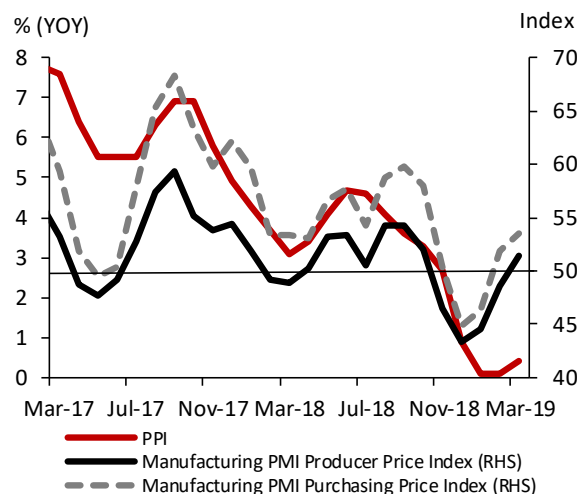
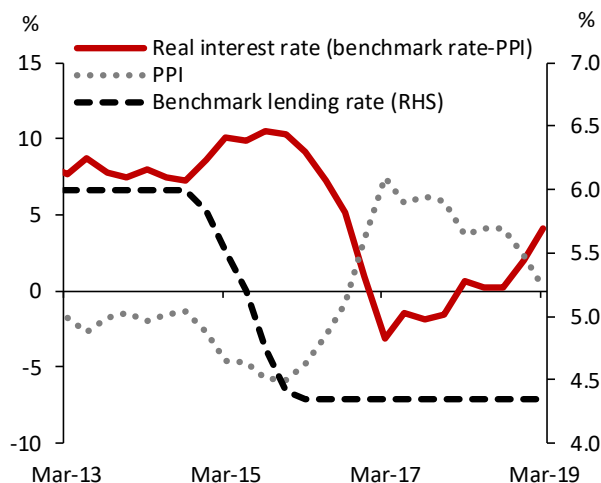


Chart 6: Interest rates and PPI



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**Sources:** Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).

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