CHINA ECONOMIC UPDATE JUNE 2022

Low cost outlier: China's consumer price growth has remained weaker than most international peers

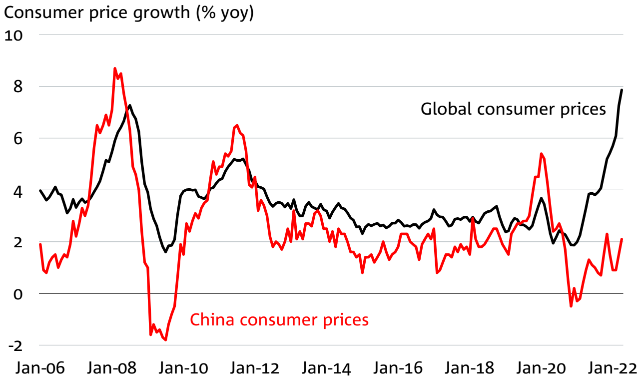
NAB Group Economics

A common theme across the global economy since early 2021 has been the acceleration in consumer prices. While major central banks initially argued that these inflationary pressures were transitory, they have persisted, in part due to supply side constraints that remain unresolved. Globally, we estimate that consumer prices rose by around 7.9% yoy in April 2022, while among the seven largest advanced economies (the G7), prices increased by 6.9% yoy – the largest increase since mid-1982.

That said, prices have not risen uniformly across the globe, with China being a notable outlier. In April, China's consumer price index rose by just 2.1% yoy. There are a broad range of factors that have contributed to this comparative softness, with some being unique characteristics of China's economy, while others point to underlying weakness.

GLOBAL INFLATION

China's consumer prices lag behind the average rate



Source: Refinitiv, NAB Economics

COMPOSITIONAL FACTORS AND THE ROLE OF PORK

In part, some of the relatively weaker consumer price growth has been driven by the differing composition of China's CPI basket (when compared with other major economies). While China does not explicitly reveal the weights of different items, it is possible to back-solve weights from the underlying indices. This approach shows that food and beverages have a much larger weight in China's basket – at around 30% of the total – than in the United States (less than 15%).

While the different weighting methods are not directly analogous, applying US weights to China's CPI would result in a higher level of inflation in recent times – between 15 basis points and 70 basis points between March 2021 and April 2022. Prior to this recent period, US weights would have resulted in lower total inflation – reflecting the elevated food prices between early 2019 and early 2021, which was largely related to shortages of pork.

This highlights a second compositional effect in China's CPI basket – the outsized share of pork in both the food price index and the overall index. Among food products, pork accounts for almost 13% of the price index, which translates into around 2.5% of the overall CPI. In comparison, pork accounts for less than 0.4% of the US CPI.

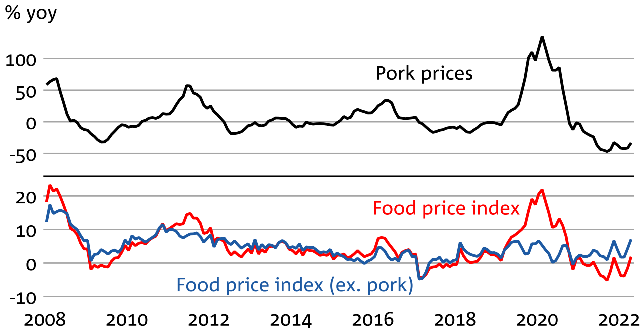
Pork prices have been highly volatile in recent years – largely in response to the outbreak of African Swine Fever that emerged in 2018. According to the US Department of Agriculture, this led to a widespread cull of pigs which, combined with those that died from the virus, reduced the country's herd by around 40%. This reduced pork supply by around one third, leading to a rapid increase in prices.

In year-on-year terms, pork prices started to increase from March 2019, with growth peaking at 135% in February 2020. As domestic pork supply started to recover in the early months of 2021, pork prices fell rapidly – adding downward pressure to overall consumer prices. Overall, China's food price index rose by just 1.9% yoy in April, however excluding pork, we estimate that prices rose by 7.1% yoy.

Date **June 2022** | Author **Gerard Burg** – Senior Economist – International

FOOD PRICE GROWTH MUTED

Steep falls in pork prices have supressed food price growth



Source: Macrobond, NAB Economics

It is also worth noting that pork prices are now back within normal (pre-African swine fever) ranges, meaning that the large downward pressure on the CPI from falling pork prices will dissipate over coming months.

Food prices alone do not explain China's relatively modest consumer price inflation. Growth in non-food prices has also been relatively weak. Again, compositional factors may explain some of this difference – with housing (for example) having around half the share of the CPI basket in China than it does in the United States.

CHINA'S DEMAND SIDE LIMITS PRICE GROWTH

The relative weakness in consumer price growth may also reflect soft domestic demand. In the United States and many other advanced economies, fiscal support allowed households to build considerable savings during major COVID-19 waves, leading to comparatively large rebounds in spending as restrictions eased. This was not the case in China, where fiscal support was directed towards businesses. In addition, the lack of a broad social safety net has meant that those households who were able to build savings during the early stages of the pandemic were less likely to subsequently spend it, particularly given the likelihood of further disruptions in economic activity across China due to ongoing COVID-19 outbreaks.

SUPPLY CHAIN PRESSURES ARE UNEQUAL

China is not the only country where inflation has trended below the global average – in fact it is a common thread across much of East Asia. A broad range of factors have contributed to this trend – including comparatively weaker food price inflation than has been the case in many advanced economies.

The cost of shipping – particularly containerised shipping – has been a contributing factor to the high levels of consumer price inflation (primarily in goods but indirectly for services as well) in advanced economies. However, this trend has not been universal. According to shipping analysts Drewry, the cost of shipping a standard forty-foot container from Shanghai to Rotterdam rose by around 60% yoy in early 2022, but the cost of the opposite route fell marginally over the same period and was only around a tenth of the price in US$ terms. This suggests that imported goods prices are having less of an effect in Asia than in other regions.

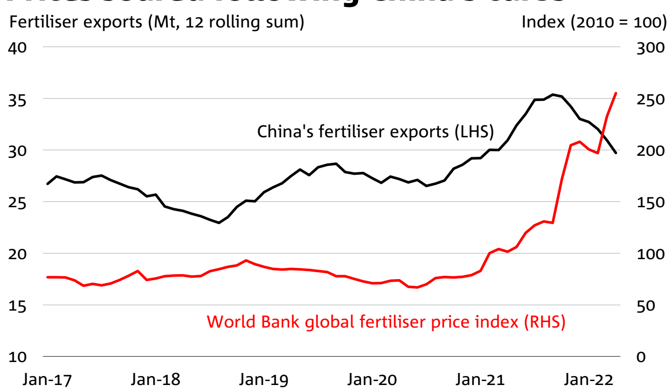
In addition, a range of East Asian economies are highly dependent on international tourism – which has remained comparatively weak in the wake of the pandemic (particularly with regard to Chinese tourism abroad), which has limited demand for tourism-related services and consequently limited price pressure from these sectors.

CHINA'S TRADE POLICY COULD BE HAVING AN EFFECT

According to the Peterson Institute for International Economics, a range of recent trade measures introduced by China's government could be helping to subdue domestic inflation while contributing to price growth internationally. In July 2021, the National Development and Reform Commission instructed fertiliser producers to prioritise domestic supply and limit exports. This was followed by increased inspections by China Customs from October 2021. Together these form unofficial trade barriers that have constrained exports – on a 12 month moving average basis, export volumes of fertiliser peaked in September and have trended lower since, despite Russia's invasion of Ukraine, which has seen global prices surge.

FERTILISER EXPORTS AND PRICES

Prices soared following China's curbs



Source: Macrobond, World Bank, NAB Economics

Similarly, in response to rising domestic steel prices, China imposed export taxes on five steel products in May 2021 while cutting rebates on value added taxes for exports on another 146 steel products, which were increased in August 2021 (PIIE). While this had the effect of reducing domestic prices, global prices climbed higher – reflecting China's outsized role in global steel production (accounting for around half of the total).

CONCLUSIONS

There are a range of factors that have contributed to the relative weakness of China's consumer price inflation when compared with global averages. As the deflationary effects of falling pork prices start to ease, softness in food prices may dissipate, bringing China back closer to the trend. However, uncertainty around future COVID-19 outbreaks – with Chinese authorities appearing committed to zero COVID policies going forward – and a lack of direct financial support to households may mean that demand side factors will remain muted for some time.

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