17 May, 2021

China and US's CPI and PPI strengthens and all eyes on inflation

Inflation speeds up in April as consumer prices in the U.S. and producer prices in China and the U.S. leap. Investors globally are increasingly worried that pandemic-driven stimulus measures could spark a rapid rise in inflation and force central banks to start tapering, such as reducing bond purchases, raising interest rates or taking other tightening measures, potentially holding back the pace of economic recovery.

On May 11, the National Bureau of Statistics of China reported,

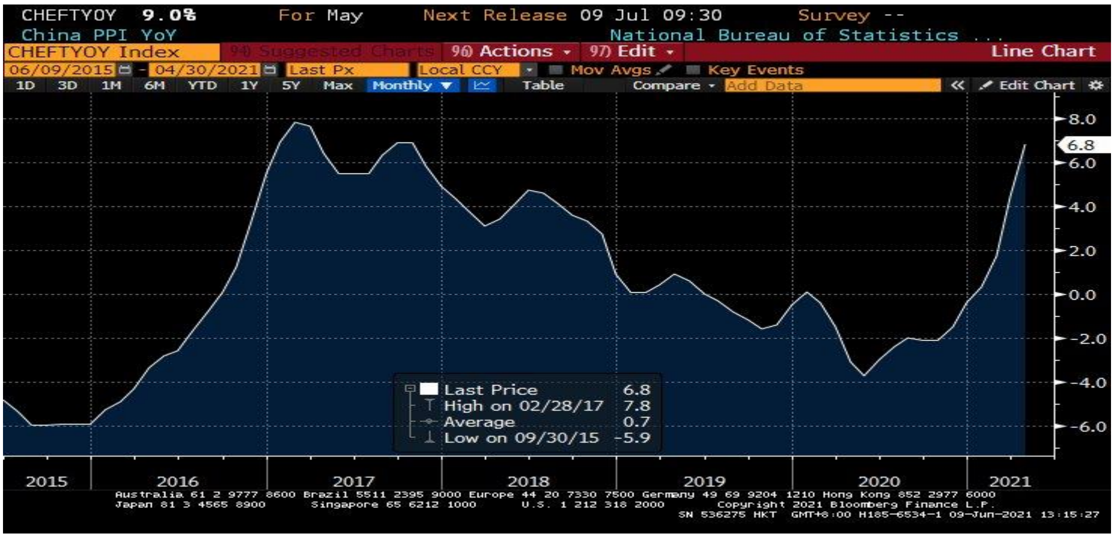
- China Consumer Price Index (CPI): rose by 0.9% in April year on year (vs. 0.4% rise in March, below the analysts' expectations of 1% rise);
- China Producer Price Index (PPI): rose 6.8% in April year on year (vs. 4.4% increase in March, ahead of a 6.5% rise tipped by Reuters poll of analysts).

China CPI YOY

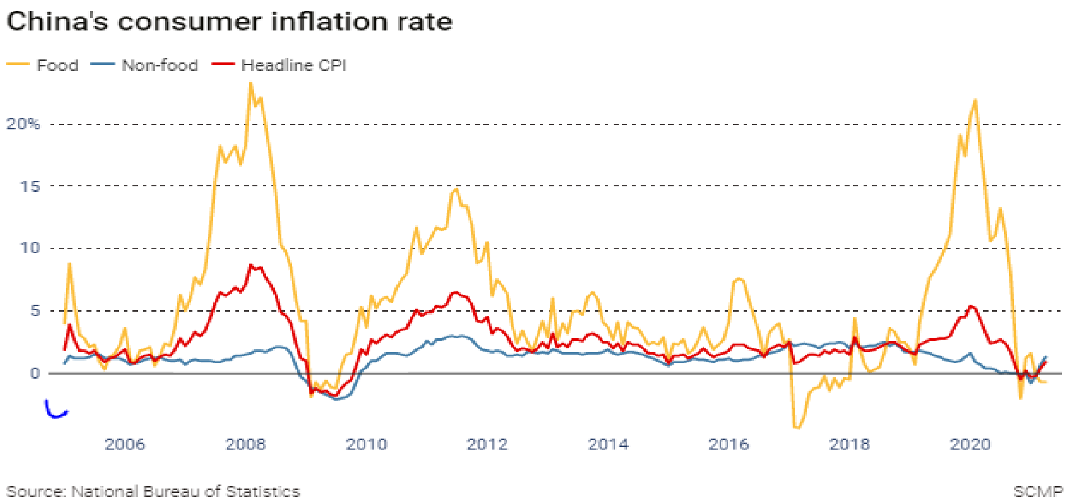
Source: Bloomberg

The rise is mostly driven by gains in transportation and communication, which was 4.9% compare to 2.7% in March. It is most likely boosted by the spending and small leisure trips during Easter holiday. The domestic consumption momentum is stronger than pre-pandemic level. It is expected CPI will be higher in the coming months along the economic recovery. Although China's CPI has only recorded 0.9% a year-on-year growth, it does not mean China does not have an inflationary pressure. One of the reasons for the low gain is being dragged down by food prices which fell by 0.7% year-on-year. Besides, the relatively high base recorded in the last year also dragged down the YOY figure, as the CPI figure was 3.3% in Apr 2020.

China PPI YOY



Source: Bloomberg



In addition, the surge in producer costs is highly likely will pose cost increase in consumers in China and even throughout the world as China being the world biggest exporter. Thus, a recorded PPI in China adds another risk to global inflation. Due to a substantially high PPI figures, CPI is expected to have the further upward pressure in the coming months amid economic recovery.

On May 12 and 13, the U.S. Bureau of Labour Statistics reported,

- US Consumer Price Index (CPI): rose by 4.2% in April year on year (vs. 2.6% rise in March, far ahead 3.6% forecast in Reuters poll);
- US Producer Price Index (PPI): rose by 6.2% in April year on year (vs. 4.2% increase in March, ahead of a 5.8% rise tipped by Reuters poll of analysts).

US CPI rose by 4.2%, the sharpest since September 2008

Source: Bloomberg

US PPI rose by 6.2%, the highest at least since 2010

Source: Bloomberg

The U.S. Consumer Price Index rose to 4.2% at the fastest rate since September 2008. Energy commodities (up 47% YOY), including gasoline (up 49% YOY), used cars and trucks (up 21% YOY) are the major contributors for the sharp price rise in April. Besides, the prices for food, food away from home, household furnishings and supplies, rent of shelter, motor vehicle maintenance and insurance and airline fares have increased over 2% in the past 12 months, which are also seen as inflation contributors.

Central banks' responses

Both China and the U.S. new released data have pointed to worries inflation may pick up faster than expected. But central banks have so far played down the risks.

Chinese authorities have repeatedly stated that they would avoid sharp policy shifts that could derail the recovery, but are slowly normalizing policy and clamping down on property speculation in particular. However, the monetary policy had been started shifting to a steadier stance since late 2020 as the economic recovery solidified. The purpose is to prevent excessive money supply will bring about economic overheating and asset bubbles after the economic recovery. Secondly, China's CPI only recorded a 0.9% increase which is still at a reasonable level and thus no hard brake is needed.

Federal Reserve officials tried to calm down the market and stated that the current rise as temporary and not likely to influence its current monetary policy. Fed has repeatedly emphasized that the Fed is nowhere close to raise interest rate, any price increases would be transitory. The Fed pledged not to change the current monetary policy, nor reduce the current scale of debt purchasing. But that if one occurred the central bank has the tools to deal with it. The economy appears a "long way" from its goals of maximum employment and inflation "moderately" its 2% target.

The reasons behind the recent prices surge

Base effects

One of the reasons for the surge was base effects, the economy is hardly hit by COVID-19 caused a widespread shutdown at this time a year ago and inflation was unusually low, while factory-gate price picked up on the back buoyant economic activities.

Pent-up demand

The recent sharp price gain should be significantly driven by the pent-up demands as restrictions ease. Most of the economic activities were unavailable during the height of pandemic, as restrictions are widely lifted and resuming to normal, the pent-up demand which had pushed up the demands and lead to short term excess demand and jumps in prices. The demands have been building up for months which pushed up the raw materials prices, fueled by rapid gains in commodities.

Number of new housing construction in the U.S. increased significantly in the past few months, at least 17% more than the construction number before the outbreak, we believe it is due to pent-up demand more than a long-term uptrend.

Source: Bloomberg

Timber price: One of the examples showing the power of lagged demand is timber price. Along with the surge in new housing construction, the timber price has jumped more than 200% compared to the beginning of 2020 and more than 80% in 2021.

Source: Bloomberg

Stimulus fiscal plan

Trillion dollars have plumped into economy has led to a build-up of savings and consumptions, also driving prices higher. Given continued momentum from global economic recovery, as well as stimulation from expansionary fiscal policies around the world. Inflation in US hit 2.6% in March and 4.2% in April, continued breaching the Federal Reserve's target of 2% and raising fears it might eventually force the Fed shift the policy to cool off the economy.

Not necessary to fret about- for now?

Although we do not expect the price surge is structural and will last for years, and we expect most Central Banks in the near term will be likely to stand still, but the underlying risk of rising inflationary may again lead pressure to the stock market. Signs have already arrived showing that inflation will tilt higher, at least in the coming months. It may again push up the long-dated Treasury bond yield. If so, stocks, especially growth and tech stocks may be under pressure again due to market devaluation.

Source: Bloomberg, WSJ, Reuters, CNBC, Yahoo Finance, Investors.com

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