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China Struggles to Kick Deflationary Concerns

Manufacturing-led recovery has sparked trade frictions abroad, but weak price growth shows consumption lags behind at home

By Jason Douglas Follow

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Price growth for services, food and consumer goods all slowed in March, data showed. PHOTO: ALEX PLAVEVSKI/SHUTTERSTOCK

SINGAPORE—Inflation in China retreated sharply, reigniting concerns over deflation even as its economy starts to feel the benefit of a manufacturing-led revival that is fueling trade tensions overseas.

Consumer prices rose just 0.1% in March compared with a year earlier, according to official data released Thursday, a weaker-than-expected reading that highlights ongoing strains in China's economy from a drawn-out property crunch and restrained consumer spending.

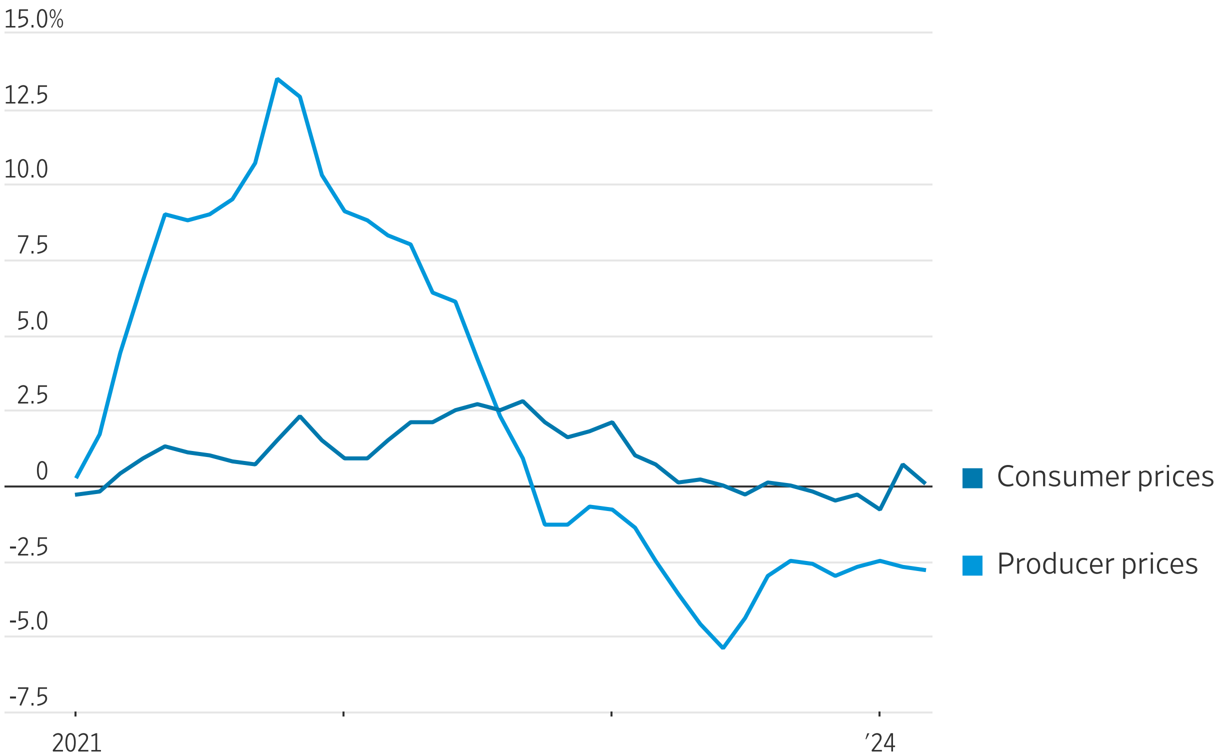
Beijing's response to the economy's weaknesses has been to double down on its strength as the world's factory floor. Investment is pouring into manufacturing, especially in sectors such as electric vehicles and green energy equipment. As a result, industrial production is picking up.

Economists at Goldman Sachs, Morgan Stanley and the Asian Development Bank this week nudged up their forecasts for economic growth in China this year in response. All three now expect growth to be close to the government's official target of around 5% for the full year.

Deflation Risk

Deflation worries have persisted in China amid a lopsided recovery.

Price indexes, change on a year earlier



Source: CEIC

Still, Thursday's inflation data point to the lopsided nature of China's recovery. While Beijing is having some success in driving growth by supporting manufacturing, many economists say officials need to do more to boost consumer spending, too.

China's preference for stimulating the supply side of its economy is already causing ripples overseas. Thursday's data showed the prices for goods leaving Chinese factories fell for a 18th straight month in March, tumbling 2.8% in year-over-year terms, as ballooning capacity outstripped demand.

While falling prices for Chinese-made products such as cars and electronics are a potential boon for consumers after years of high inflation, governments worry that generous support from Beijing is allowing Chinese competitors to undercut homegrown rivals, threatening jobs and industries.

Treasury Secretary Janet Yellen, in meetings with senior officials in China this week, urged Beijing to stop relying on exports and instead take steps to boost consumer spending to achieve more balanced economic growth. She warned that plowing investment into hot sectors such EVs, battery technology and solar power was creating gluts in global markets.

“China is now simply too large for the rest of the world to absorb this enormous capacity,” Yellen said Monday in Beijing. “When the global market is flooded by artificially cheap Chinese products, the viability of American and other foreign firms is put into question.”

The retreat in consumer-price inflation in China contrasts with the U.S., where price-growth last month surprised to the upside, upsetting expectations for interest-rate cuts from the Federal Reserve. U.S. consumer prices advanced 3.5% in March from a year earlier, according to figures published Wednesday.

A man works at Changsha Boda Technology Industry, a manufacturer and supplier of automobile parts, in Liuyang, China. PHOTO: CHEN SIHAN/ZUMA PRESS

Weakness in inflation in China was broad-based in March. Price growth for services, food and consumer goods all slowed, data showed. Core consumer-price inflation, which strips out more volatile prices such as food and energy, slowed to 0.6% from 1.2% previously.

The world's second-largest economy expanded 5.2% last year after notching just 3% growth in 2022, when activity was hit by lockdowns in major cities to contain the Covid-19 pandemic.

Forecasters including the International Monetary Fund expect growth in China to hover around 4% in the next few years, down from 6% to 7% in the years before the pandemic. The economy is grappling with difficult challenges such as a deflating property bubble and an aging and shrinking workforce.

"The Chinese economy's ongoing flirtation with deflation highlights both short-term weaknesses and structural fragilities," said Eswar Prasad, a professor at Cornell University and former head of the IMF's China division.

Deflation is a pernicious economic problem. Falling prices tend to reinforce weak consumer spending as people delay purchases in anticipation of a better deal. Weaker spending means weaker corporate profits, with potential knock-on effects on jobs and earnings. Debts become harder to bear as incomes shrink.

China's central bank has cut interest rates, and the government has promised greater fiscal support this year to underpin growth and prevent deflation from becoming entrenched. Many economists say officials could still take more forceful action, perhaps by cutting borrowing costs even further or boosting consumer spending with tax cuts or handouts.

Economists at Capital Economics said they expected inflation to recover somewhat but remain around 0.5% on average over the next couple of years, as Beijing's preference for boosting supply over spending weighs on prices. "Policy support is unlikely to resolve the investment-consumption imbalance behind China's low inflation, which we think will be a long-term phenomenon," they wrote in a note to clients.

—Grace Zhu and Xiao Xiao in Beijing contributed to this article.

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