



China Consumer Sector

China's CPI and PPI bodes well for consumer sector

- The rebound in China's CPI has mostly been driven by increasing food prices. However, it started to reverse course in Feb-17, with the CPI-food price index falling by 0.8% YoY for Jan-Feb 17. On the other hand, the non-food price index has overtaken the food price index, rising by 2.35% YoY for the same period.
- This suggests that the criticism on the consensus view that the increase in CPI was driven by upstream supply-side reform instead of a recovery in core consumer demand would likely abate in the near term.
- Hence, benefiting from an inflationary environment supported by core demand recovery, we expect China's consumer discretionary sector to surprise on the upside in 2017. On the contrary, we expect consumer staples to hit bottom as margin pressure aggravates given the lagging effect of the CPI versus the PPI.

Positive development for China consumer discretionary: As the PPI is usually regarded as a leading indicator of the CPI, thus with China's PPI having bottomed out around Sept-15 and the CPI picking up gradually since Aug-16, it implies that a higher inflationary environment has emerged since the beginning of the year. Nevertheless, the consensus view that the rebound in China's CPI was driven by upstream supply-side reform instead of a recovery in core consumer demand has been rebuffed by critics. However, the CPI started to reverse course in Jan-Feb period with the food price index falling by 0.8% YoY (Dec-16: +2.4% YoY) and the non-food index increasing by 2.35% (Dec-16: +2.0% YoY) (see *Figure 2-3*). Meanwhile, since the higher raw material prices have been translated into rising ASP suggest a recovery in core demand, we anticipate majority of the consumer discretionary names will report earnings surprises in 1H17.

China consumer staples to hit bottom in 2017: For consumer staples, we expect margin pressure to aggravate in 2017, as a result of the lagging effect of the CPI. Since China's PPI has surged sharply, especially in the past three months, such a problem will become more severe in 2017, in our view. Moreover, the sharp rise in raw material prices would not be translated into higher end product prices immediately. However, as product prices are adjusted upward gradually, margin pressure will alleviate towards the year end of 2017. Hence, we are likely to see consumer staples (i.e. Food & Beverage) to hit bottom in 2017 and pick up gradually in 2018.

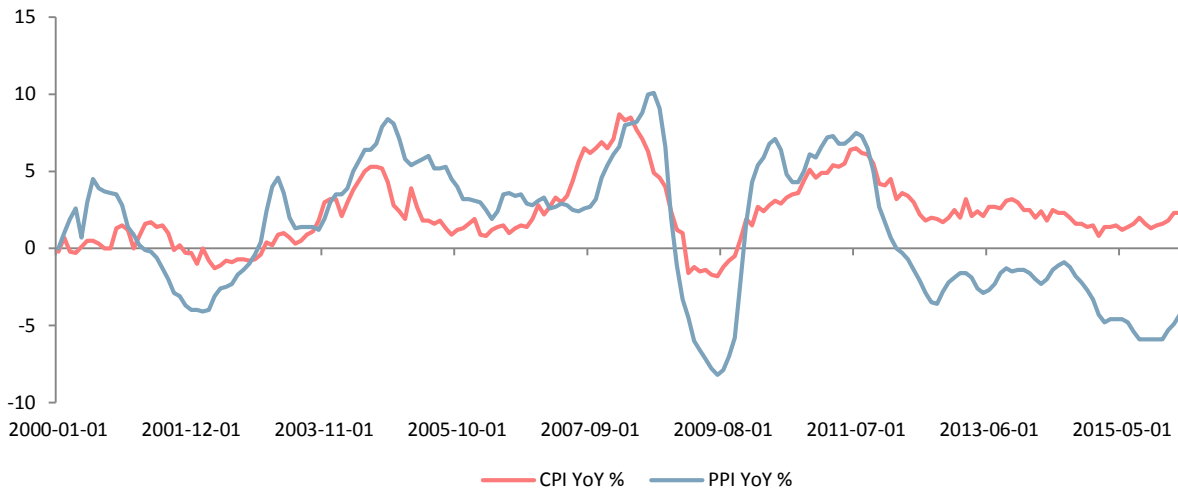
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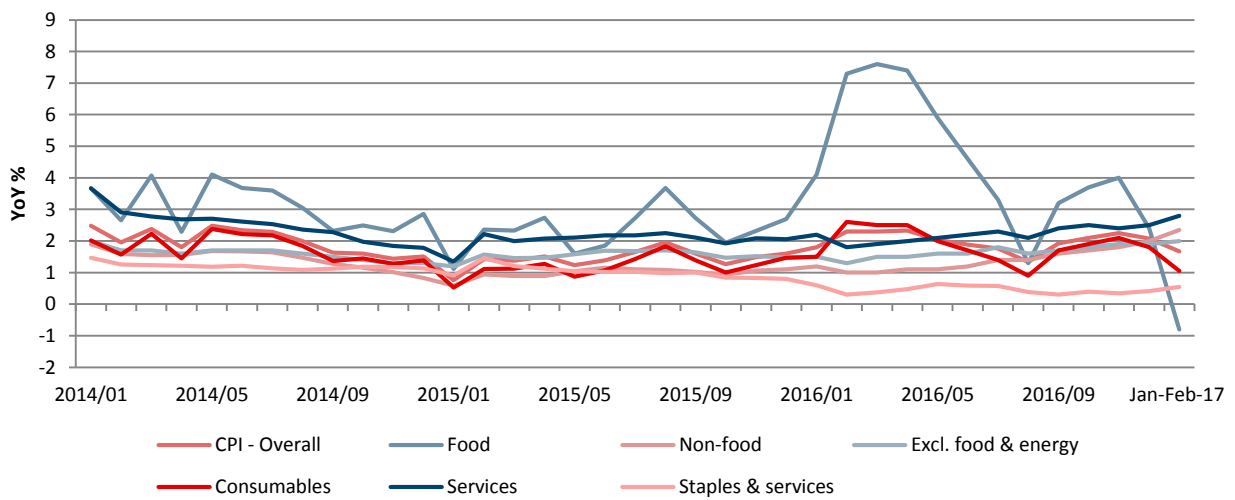
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Figure 1: China's PPI versus CPI



Source: CSCI Research, Bloomberg

Figure 2: Graphical illustration – China CPI breakdown



Source: CSCI Research, WIND

Figure 3: China's CPI breakdown by sub-indices

	YoY % (monthly CPI)						
	CPI - Overall	Food	Non-food	Excl. food & energy	Consumables	Services	Staples & services
2014/01	2.49	3.67	1.89	2.00	2.01	3.67	1.47
2014/02	1.95	2.65	1.59	1.70	1.57	2.91	1.25
2014/03	2.38	4.07	1.55	1.70	2.23	2.78	1.23
2014/04	1.80	2.29	1.56	1.60	1.44	2.69	1.22
2014/05	2.48	4.10	1.68	1.70	2.38	2.71	1.19
2014/06	2.34	3.68	1.67	1.70	2.22	2.62	1.21
2014/07	2.29	3.60	1.64	1.70	2.18	2.54	1.13
2014/08	1.99	3.05	1.47	1.60	1.84	2.36	1.09
2014/09	1.63	2.32	1.28	1.50	1.36	2.27	1.12
2014/10	1.60	2.50	1.16	1.40	1.45	1.97	1.18
2014/11	1.44	2.31	1.01	1.30	1.28	1.84	1.17
2014/12	1.51	2.86	0.83	1.30	1.39	1.79	1.13
2015/01	0.76	1.11	0.59	1.20	0.53	1.35	0.91
2015/02	1.43	2.37	0.95	1.57	1.11	2.22	1.46
2015/03	1.38	2.33	0.89	1.46	1.13	1.99	1.20
2015/04	1.51	2.73	0.89	1.47	1.28	2.08	1.13
2015/05	1.23	1.60	1.05	1.58	0.87	2.11	1.04
2015/06	1.39	1.85	1.16	1.69	1.07	2.18	1.02
2015/07	1.65	2.73	1.11	1.68	1.43	2.18	1.02
2015/08	1.96	3.68	1.09	1.70	1.84	2.24	0.98
2015/09	1.60	2.72	1.02	1.64	1.39	2.11	1.00
2015/10	1.27	1.94	0.93	1.47	1.00	1.92	0.84
2015/11	1.49	2.32	1.06	1.52	1.24	2.09	0.83
2015/12	1.60	2.70	1.10	1.47	1.47	2.05	0.80
2016/01	1.80	4.10	1.20	1.50	1.50	2.20	0.60
2016/02	2.30	7.30	1.00	1.30	2.60	1.80	0.30
2016/03	2.30	7.60	1.00	1.50	2.50	1.90	0.38
2016/04	2.33	7.40	1.10	1.50	2.50	2.00	0.48
2016/05	2.04	5.90	1.10	1.60	2.00	2.10	0.64
2016/06	1.88	4.60	1.20	1.60	1.70	2.20	0.59
2016/07	1.77	3.30	1.40	1.80	1.40	2.30	0.57
2016/08	1.34	1.30	1.40	1.60	0.90	2.10	0.39
2016/09	1.92	3.20	1.60	1.70	1.70	2.40	0.30
2016/10	2.10	3.70	1.70	1.80	1.90	2.50	0.39
2016/11	2.25	4.00	1.80	1.90	2.10	2.40	0.35
2016/12	2.08	2.40	2.00	1.90	1.80	2.50	0.41
Jan-Feb-17	1.67	-0.80	2.35	2.00	1.05	2.80	0.55
2017/01	2.55	2.70	2.50	2.20	2.20	3.20	0.60
2017/02	0.80	-4.30	2.20	1.80	-0.10	2.40	0.50

Source: CSCI Research, WIND



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Company Rating Definition

The Benchmark: Hong Kong Hang Seng Index; Time Horizon: 12 months

Buy	12-month absolute total return: $\geq 10\%$
Hold	12-month absolute total return: $> -10\%$ but $< 10\%$
Sell	12-month absolute total return: $\leq -10\%$

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