ANDBANK
Private Bankers

Flash Note
05/04/2017

Alex Fusté
@AlexfusteAlex
alex.fuste@andbank.com

"Goodbye, goodbye lady reflation"?

If I have learned a lesson in this past year, it is that China can be both the lone exporter of both deflation and inflation globally (as happened in 2016, after the vast stimulus applied by the Chinese authorities in 1H16, leading to the rally in most commodities, which feed through into higher CPI numbers in Western economies).

In my last papers (please see the Flash Note: Back to the quadrant we should never have come out of) I already warned that once these fiscal stimulus were withdrawn (as has happened), we would lose the engine for the global "reflation trade" -that financial markets have been enjoying so enthusiastically since the second half of 2016-.

Now, please look at these figures released in the last few hours:

- Consumer price inflation in China fell from 2.5% y/y in January to 0.8% in February.
- Looking ahead, I expect headline inflation to stay at around 1.5% y/y over the rest of this year as a gradual decline in non-food inflation materializes (with transportation costs likely to ease in the months ahead, dragged down by falling energy prices).
- Although housing prices (and rental costs) can keep robust for a while longer, this is unlikely to last, given the signs we observe that China's property market is cooling somewhat as restrictions on home purchases have started to bite.
- The PBOC has been pushing market interest rates higher since October (remember my warnings a few weeks ago: "Fiscal stimuli were withdrawn in September, while monetary stimuli have been gradually withdrawn this winter"). Well, as long as the PBoC continue to tighten monetary conditions (as I suspect will do for a while) supply and credit growth will moderate, and prices will do the same.

Why all this data does not come as a surprise to me?

In a nutshell. Unless our friend Trump pulls his $1trn worth infrastructure plan out his hat soon, I think that we could start singing the "Goodbye, goodbye lady Reflation" song.

You can easily intuit the consequences (Fed, ECB, Fixed Income instruments, a relaxation in the equity markets, oil, commodities, gold …)

Kind regards

Alex Fusté
Chief Economist
Andbank