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ECONOMY

In China, Deflation Tightens Its Grip

Consumer prices fall at sharpest pace in more than 14 years

By Jason Douglas Follow

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China's economic weakness is throttling consumer spending. PHOTO: QILAI SHEN/BLOOMBERG NEWS

SINGAPORE—Deflation is becoming more entrenched in China, with consumer prices falling in January at their steepest pace in more than 14 years—a stark symptom of deepening economic malaise that spells trouble for the global economy.

The latest data suggest China faces a growing risk of slipping into a longer-term spell of falling prices that becomes harder to reverse the longer it lasts.

That presents a special challenge for the rest of the world. While cheaper goods from China might help ease inflation elsewhere, it means the global economy can also expect a flood of cut-price imports as Chinese factories search out buyers overseas for products they can't sell at home. That risks squeezing other countries' domestic manufacturing, stoking already acute tensions over trade between China and the U.S.-led West.

China's sinking prices add to a litany of economic challenges in the country this year. Growth is projected to slow from last year's underwhelming pace. A drawn-out real-estate crunch is throttling consumer spending, with China Evergrande Group—the poster child for the sector's woes—ordered into liquidation by a Hong Kong court. Exports are struggling and foreign investors are fleeing. Beijing on Wednesday replaced the country's top securities regulator after an epic stock-market rout.

The new consumer-prices data, along with a run of other weak economic signals, "portend a treacherous period ahead for the Chinese economy," said Eswar Prasad, professor of trade policy and economics at Cornell University and a former head of the International Monetary Fund's China division.

"China's deflation could also impinge on the world economy if it means that China, rather than serving as an engine of global growth, counts on demand from the rest of the world to revive its economy," he said.

Consumer prices fell 0.8% in January compared with a year earlier, China's National Bureau of Statistics said Thursday, the biggest annual decline since September 2009.

Producer prices, which fell every single month last year, declined 2.5% in January as companies further slashed prices to find buyers.

Signs of deflationary pressure are everywhere. Prices for fruit, vegetables and meat all tumbled in January. Prices for pork—a staple of the Chinese diet—were down 17.3% year-over-year.

Core consumer-price inflation, which excludes volatile prices for food and energy, slowed to a 0.4% annual rate from 0.6%.

It isn't just goods. Services prices are also weakening, rising just 0.5% on the year, half the rate notched a month earlier.

"Normally people are willing to spend big on hair ahead of the Spring Festival as a new and good hairstyle bodes well for the new year. But this year more people were asking for lower prices," said Song Jiaqi, a hairdresser in Beijing, referring to the traditional period of celebration around the Lunar New Year that falls this year on Feb. 10.

The run-up to Lunar New Year is typically a period of intense activity for hairdressers and barbers, as a common belief in China is that getting a haircut early in the first month of the lunar calendar brings bad luck, especially for one's uncles.

Song said that this year some of her competitors are offering a wash, cut and dry for just under 20 yuan, around $2.80, or around half the typical price. People who would usually get their hair cut once every two months are now visiting her salon once every three or four months, she said.

"Consumers are more cautious in spending in the economic downturn," Song said.

Prices for fruit, vegetables and meat in China tumbled in January. PHOTO: STR/AGENCE FRANCE-PRESSE/GETTY IMAGES

Foreign firms operating in China are also feeling the heat.

"China—I think we should not expect too much when it comes to price increases," Bjorn Rosengren, chief executive of European engineering giant ABB, said on a Feb. 1 earnings call with analysts. ABB, which makes power transformers, transmission systems, robotics and other industrial hardware, increased prices in China by around 2% in 2023, Rosengren said. This year, "it is more really around 1%-ish that we are expecting," he said.

Deflation is a pernicious economic problem. Falling prices eat into corporate profits and prompt consumers to delay spending in anticipation of bigger bargains tomorrow. That leads companies to cut prices and put off hiring and investment, further depressing spending and worsening the deflationary cycle.

Some economists say they don't think China is really in danger of such a deflationary spiral. They say inflation should return as the year progresses thanks to government spending on infrastructure and other modest stimulus efforts.

Pressure from falling food prices caused by abundant supplies of pork and other foods should also start to ebb, they say, and some say January's data were distorted by volatility in food and tourism prices around the Lunar New Year holiday.

"We think consumer price inflation will return to positive territory over the coming months," said Julian Evans-Pritchard, head of China economics at Capital Economics, in a research note Thursday, though he added he expects core inflation to remain subdued for the foreseeable future, citing structural problems such as the housing bust and worsening demographics.

For other economists, however, China is displaying some of the hallmarks of a deeper and more lasting problem.

Income growth has slowed, making it harder for consumers to service their debts while maintaining spending. Workers are settling for lower-paid jobs in a tight labor market, and some data suggest salaries for new hires are falling.

Corporate profits are sliding, so companies with millions of yuan in debt are wary of investment and hiring.

Economists sometimes use the term balance-sheet recession to describe a situation in which the burden of debt rises and households and businesses focus on reducing their borrowings from a dwindling pile of earnings. The worrying parallel is Japan, which entered its "lost decades" of weak growth and persistent deflation after twin real-estate and stock-market bubbles burst in the early 1990s.

"Poor sentiment among businesses and households is not coming out of nowhere," said Arthur Budaghyan, chief emerging-markets and China strategist at BCA Research. "It is the result of debt deflation and a balance-sheet recession."

China has experienced periods of falling consumer prices before, notably in 1998 when a financial crisis ripped through Asia and in 2009 in the aftermath of the subprime mortgage bust in the U.S. that triggered bank bailouts worldwide.

In both those instances, China's policymakers responded forcefully, flooding the economy with easy money by cutting interest rates and dishing out cheap loans. Growth and inflation soon returned.

But in juicing growth, they created a housing bubble that leader Xi Jinping is now determined to deflate. The result is a policy response that has been far more muted than in the past, with modest cuts to borrowing costs, smaller injections of cash into the financial system, and a jumble of piecemeal housing policies such as loosening restrictions on second home purchases in some big cities.

That means, according to many economists, that this spell of subdued growth and flat or falling prices will persist for a while, possibly for years, either until officials abandon their aversion to bigger stimulus or debts are finally worked off.

"The People's Bank of China really ought to deliver stronger policy support," said Carlos Casanova, senior Asia economist at Union Bancaire Privée.

Chinese exports are struggling. PHOTO: CFOTO/ZUMA PRESS

—Grace Zhu in Beijing contributed to this article.

Write to Jason Douglas at jason.douglas@wsj.com

Corrections & Amplifications

Core consumer-price inflation slowed to a 0.4% annual rate in January. An earlier version of this article incorrectly said the number was 0.3%. (Corrected on Feb. 8)

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