



China Sourcing Update

January 13, 2017

Energy Costs

1. Crude prices rise during mid-December to early January

In line with the movement of global crude prices, China's crude prices went up during mid-December to early January.¹ For example, the Daqing² crude price rose from a recent low of US\$ 48.7 per barrel on 16 December to US\$ 51.4 per barrel on 9 January (see exhibit 1).

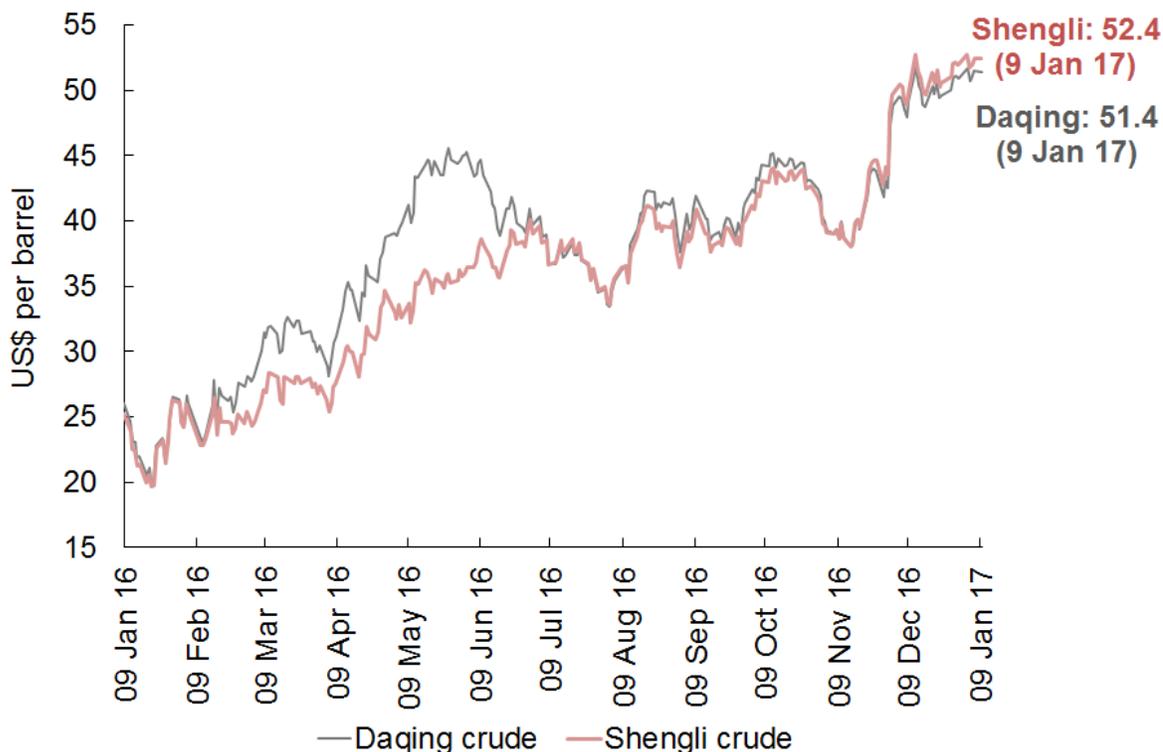
The main reason for the rise in global oil prices during the period was investors' optimism that the crude output cut agreed by major oil producing countries, which kicked in on 1 January, will mitigate the global oversupply of crude oil.

Looking ahead, it is still doubtful as to how closely the oil producing countries will comply with the production quotas and whether the output cut can significantly reduce the global supply glut of crude oil. There are also concerns about a higher oil output in the US, which did not promise to cut output, as the number of operating oil-drilling rigs in the US increased to a one-year high of 529 as of the first week of 2017. Moreover, expectations of a faster pace of interest rate hikes in the US are likely to boost the US dollar and drag down oil prices. In view of these factors, we do not expect oil prices to rise further in the coming months.

¹ From the year 2000 onwards, China's crude prices were determined with reference to global crude prices.

² Daqing Field is the largest oil field in China.

Exhibit 1: China's crude prices, January 2016 to January 2017



Source: ifeng.com

2. Wholesale price index of refined oil products rises in December

The wholesale price index of refined oil products went up by 6.7% mom in December (see exhibit 2).³ Specifically, the wholesale price index of diesel rose by 7.4% mom, while that of gasoline increased by 8.0% mom in the month.

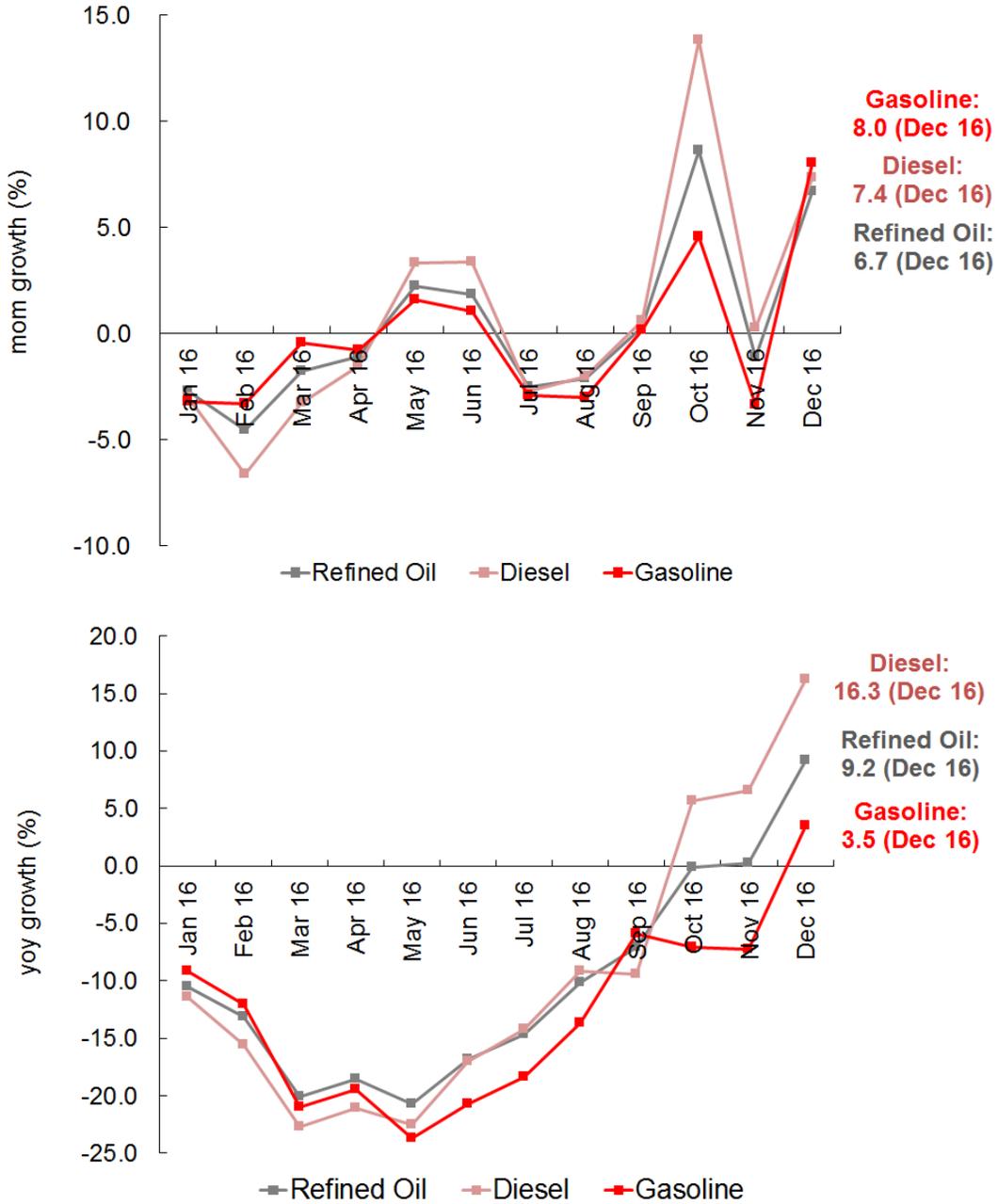
The movement of the price index in the month was mainly driven by the government moves to adjust the wholesale prices of refined oil products. The National Development and Reform Commission (NDRC) made upward adjustments to the maximum wholesale prices of refined oil products on 1 December, 15 December and 29 December, in response to the surge in global crude prices since mid-November.

Looking ahead, we expect the wholesale price index of refined oil products to rise further in January 2017, as the NDRC raised the maximum prices of diesel and gasoline on 13 January again following a further rise in global crude prices. According to the

³ The index is compiled by the China Logistics Information Center (CLIC).

pricing mechanism for refined oil products, the maximum prices of diesel and gasoline are adjusted every 10 working days, based on the change in a basket of global crude prices.

Exhibit 2: China's wholesale price indices of refined oil products, January to December 2016



Source: China Logistics Information Center

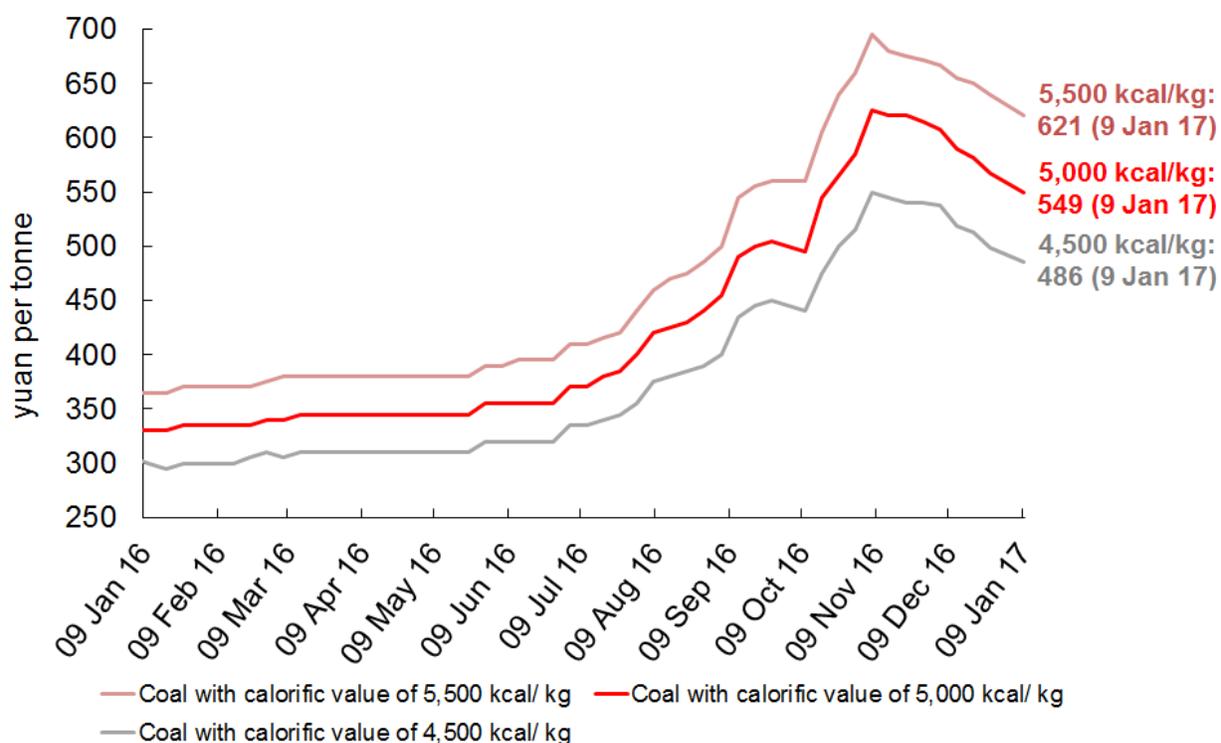
3. Benchmark Qinhuangdao coal prices go down further

The benchmark Qinhuangdao coal prices dropped during mid-December to early January (see exhibit 3). For instance, the price of coal with calorific value of 5,500 kcal/kg fell from 650 yuan per tonne on 19 December to 621 yuan per tonne on 9 January.

The main reason for the decline in domestic coal prices in recent months was a series of government measures to boost the domestic coal supply and cool down the coal market. For example, the Chinese government has allowed all legal coal mines to operate 330 days a year throughout mid-November 2016 to end-March 2017. Besides, at the request of the government, major coal producers also signed 2017 long-term contracts with power producers with the prices of thermal coal markedly lower than the spot prices, thus putting downward pressure on the spot prices of coal.

Looking ahead, the domestic supply of coal is expected to increase further in the near term, and the demand for coal from power producers is likely to fall during mid-January to mid-February, the period around the Chinese New Year when most factories suspend their production. Therefore, we expect the domestic coal prices to drop further in the foreseeable future.

Exhibit 3: Qinhuangdao coal prices, January 2016 to January 2017



Source: ifeng.com, cctd.com.cn

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