



China Sourcing Update

January 23, 2019

Energy Costs

1. Crude prices plunge in mid- to late December and rebound afterwards

In line with the movement of global crude prices, China's crude prices showed slight fluctuations in the first half of December, but then plunged in the following weeks, before showing a rebound in late December.¹ For instance, after fluctuating within a narrow range of US\$ 51.6 per barrel to US\$ 54.2 per barrel throughout 3 to 14 December, the Daqing² crude price dropped markedly to US\$ 41.8 per barrel on 26 December, but then rebounded to US\$ 45.1 per barrel on 28 December (*see exhibit 1*).

Two major factors were behind the plunge in the global oil prices in mid- to late December. First, there were growing market concerns about a glut of crude on the world market. The US Energy Information Administration (EIA) reported on 19 December that the US's production of crude oil stayed high at 11.60 million barrels per days in the week ending 14 December, slightly lower than its record high of 11.70 million barrels per days in the week ending 30 November. Second, the shutdown of the US federal government from 22 December onwards triggered a sell-off of risky assets, thereby putting downward pressure on the global crude prices.

The global crude prices have rebounded since late December as there have been signs that the OPEC and some other major oil producing countries are determined to reduce

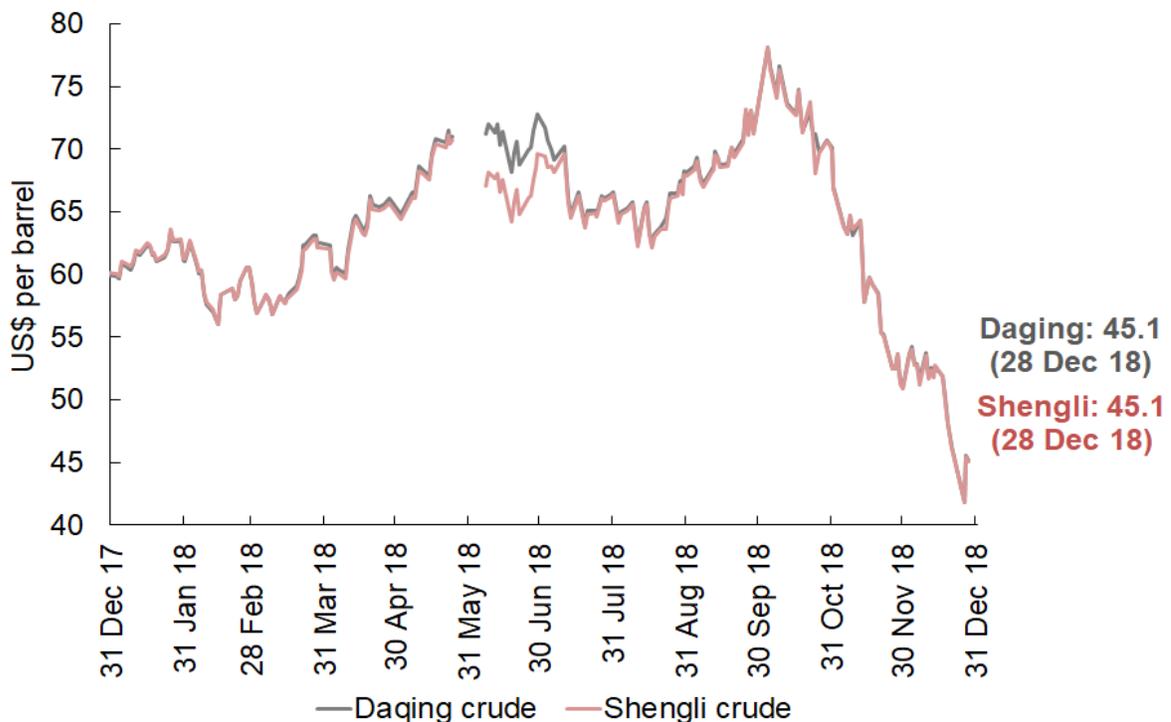
¹ From the year 2000 onwards, China's crude prices were determined with reference to global crude prices.

² Daqing Field is the largest oil field in China.

their crude oil output after making an agreement of production cuts on 7 December.³ For example, Russian Energy Minister Alexander Novak said on 25 December that the global crude prices would become more stable in 1H19 due to the production cuts. Besides, a survey conducted by Bloomberg estimated that Saudi Arabia's crude output dropped markedly by 420,000 barrels from the previous month to 10.65 million barrels in December.⁴ Moreover, Saudi Arabia's Energy Minister Khalid al-Fali said on 10 January that his country would further reduce its crude output in February.⁵

Looking ahead, we do not expect the global crude prices to rise much in the near future as the global demand for the crude is likely to moderate amid weaker growth of the global economy this year. According to the latest forecasts by the International Monetary Fund (IMF) on 21 January, the world's economic growth is projected to decelerate to 3.5% in 2019 from 3.7% in 2018.⁶

Exhibit 1: China's crude prices, December 2017 to December 2018



Source: ifeng.com, gcec.com.cn

³ On 7 December, OPEC members and some non-OPEC oil producing countries agreed to cut their crude output by 1.2 million barrels per day in the first six months of 2019.

⁴ <https://www.bloomberg.com/news/articles/2019-01-02/opec-output-falls-most-in-almost-two-years-as-saudis-begin-cuts>

⁵ <https://www.reuters.com/article/us-saudi-oil-cuts-idUSKBN14W1Y5?il=0>

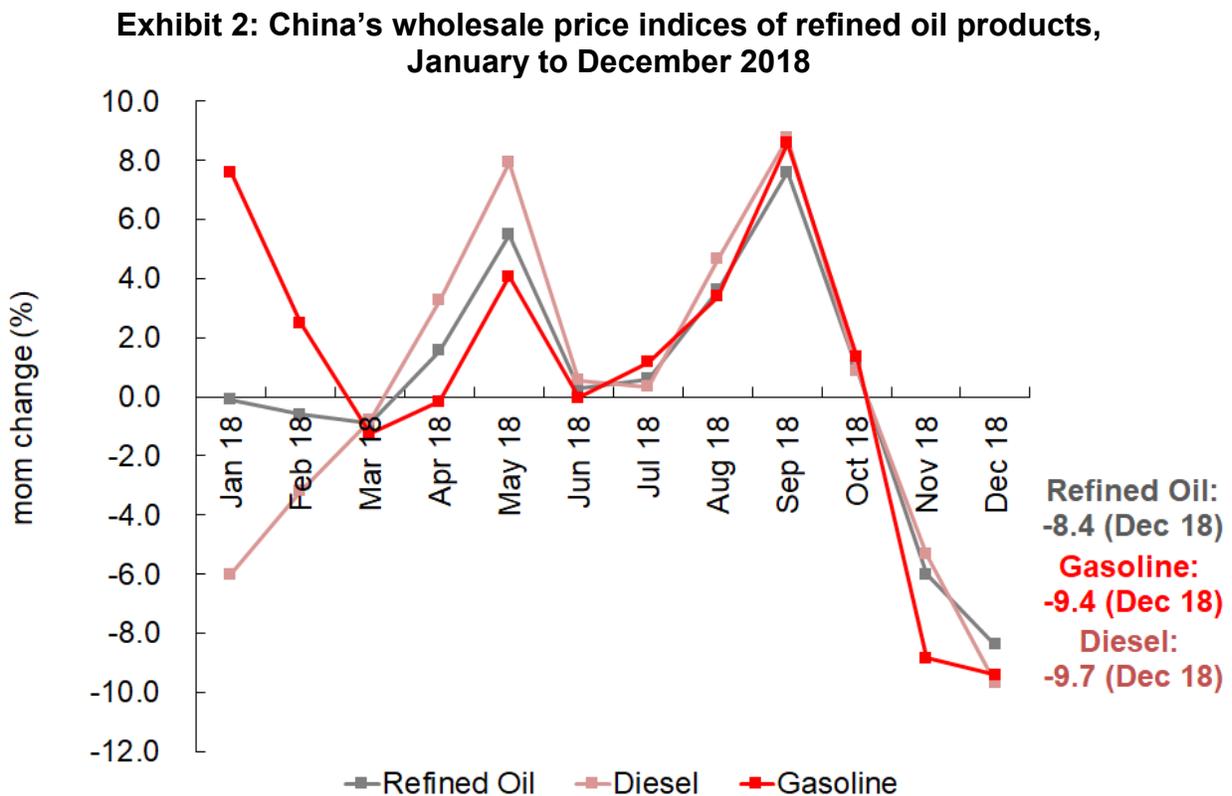
⁶ IMF, *World Economic Outlook Update*, January 2019

2. Wholesale price index of refined oil products drops markedly in December

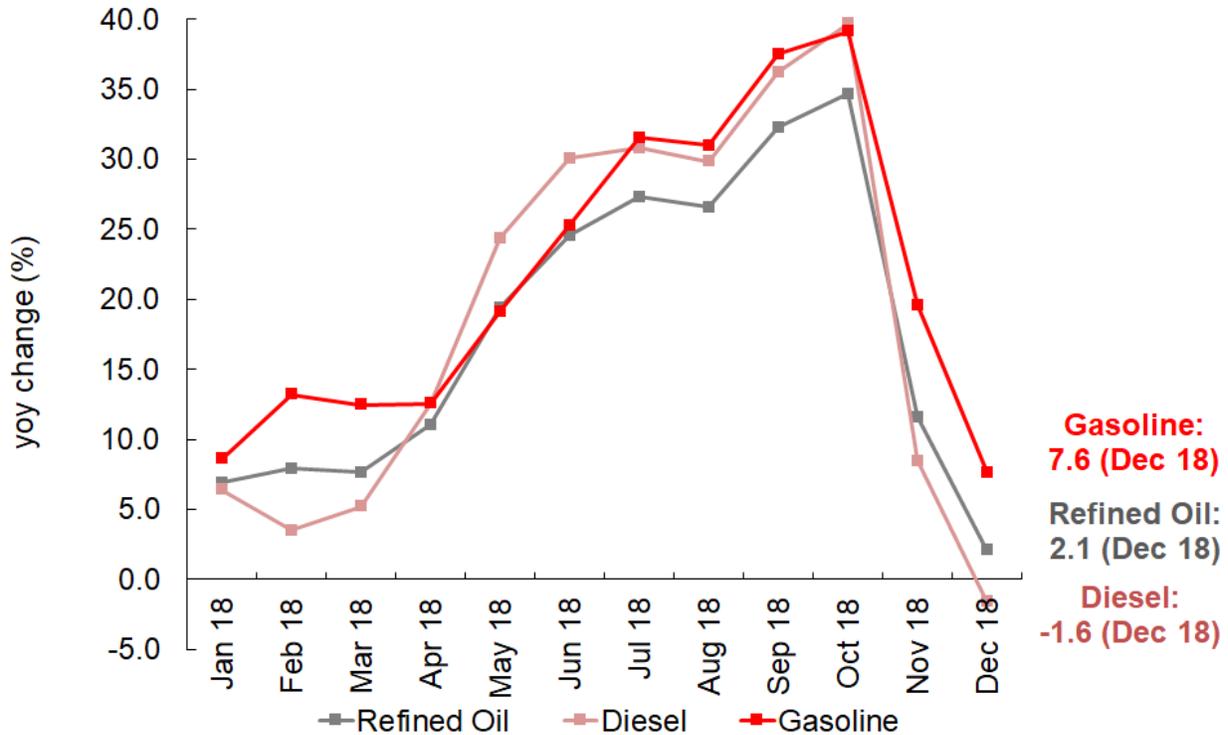
The wholesale price index of refined oil products fell markedly by 8.4% mom in December (see exhibit 2).⁷ Specifically, the wholesale price index of diesel dropped by 9.7% mom, while that of gasoline decreased by 9.4% mom.

In response to a fall in global crude prices during mid-November to late December, the National Development and Reform Commission (NDRC) made downward adjustments to the maximum wholesale prices of refined oil products on 1 December, 15 December and 29 December. According to the 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.

Looking ahead, we expect the wholesale price index of refined oil products to rebound in January, as the NDRC raised the maximum wholesale prices of diesel and gasoline on 15 January due to a rise in global crude prices from late December onwards.



⁷ The index is compiled by the China Logistics Information Center (CLIC).



Source: China Logistics Information Center

3. Benchmark Qinhuangdao coal prices fall in December

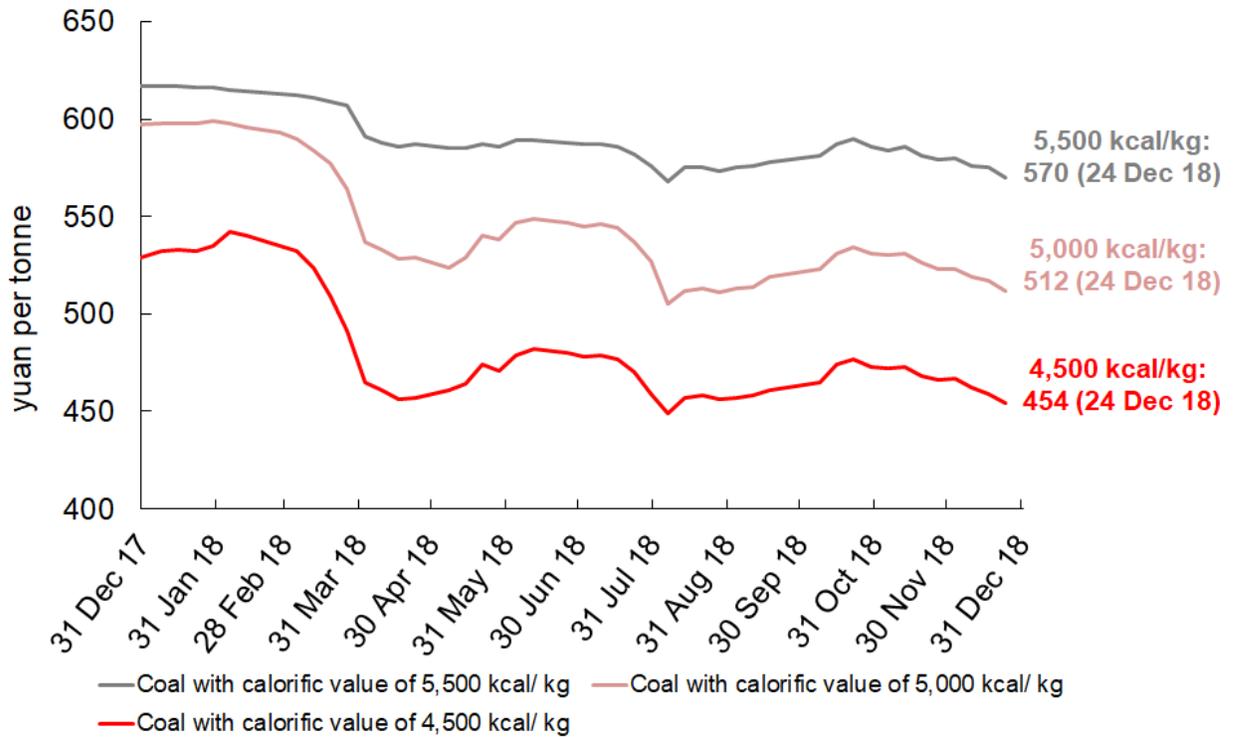
The benchmark Qinhuangdao coal prices fell in December (see exhibit 3). For example, the price of coal with calorific value of 5,000 kcal/ kg went down to 512 yuan per tonne on 24 December, compared to 523 yuan per tonne on 26 November.

The fall in the domestic coal prices in December was attributable to destocking activities and a weak downstream demand for coal. One of the reasons behind the weak demand was that the downtrend of coal prices in recent months built up market expectations of a further fall in coal prices, according to media reports.

On 12 January, a coal mine in Shenmu county in Shaanxi province collapsed and 21 people were killed due to the accident. Afterwards, the Chinese government ordered a number of coal mines in several provinces to shut down their operations for safety checks, according to media reports.⁸ As the supply of coal has tightened, we predict that the coal prices will show a rebound in the near future.

⁸ <https://www.hellenicshippingnews.com/chinas-domestic-thermal-coal-prices-under-close-watch-ahead-of-key-political-meetings-sources/>

Exhibit 3: Qinhuangdao coal prices, December 2017 to December 2018



Source: ifeng.com, cctd.com.cn

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