



China Sourcing Update

March 21, 2017

Energy Costs

1. Crude prices fall in early to mid-March

In line with the movement of global crude prices, China's crude prices plummeted during early to mid-March after fluctuating within a narrow range during early January to early March.¹ For example, the Daqing² crude price hovered between US\$ 48.5 per barrel and US\$ 52.0 per barrel during early January to early March, before slumping to US\$ 44.9 per barrel on 13 March (see *exhibit 1*).

The main reason for the plunge in global oil prices during early to mid-March was investors' concerns that a global supply glut would persist despite efforts by the member countries of the Organization of the Petroleum Exporting Countries (OPEC) to curb crude production. The OPEC-led crude output cut kicked in on 1 January; however, production and stockpiles of oil continued to rise in the US. Data from the US Energy Information Administration (EIA) showed that the US's production of crude oil expanded by more than 500,000 barrels per day from October 2016 to February 2017. The US's production of crude oil is expected to increase further in the coming months. Moreover, the commercial crude oil inventories (excluding those in the Strategic Petroleum Reserve) in the US rose for nine consecutive weeks, reaching a record high of 528.4 million barrels as at 3 March, according to the EIA.

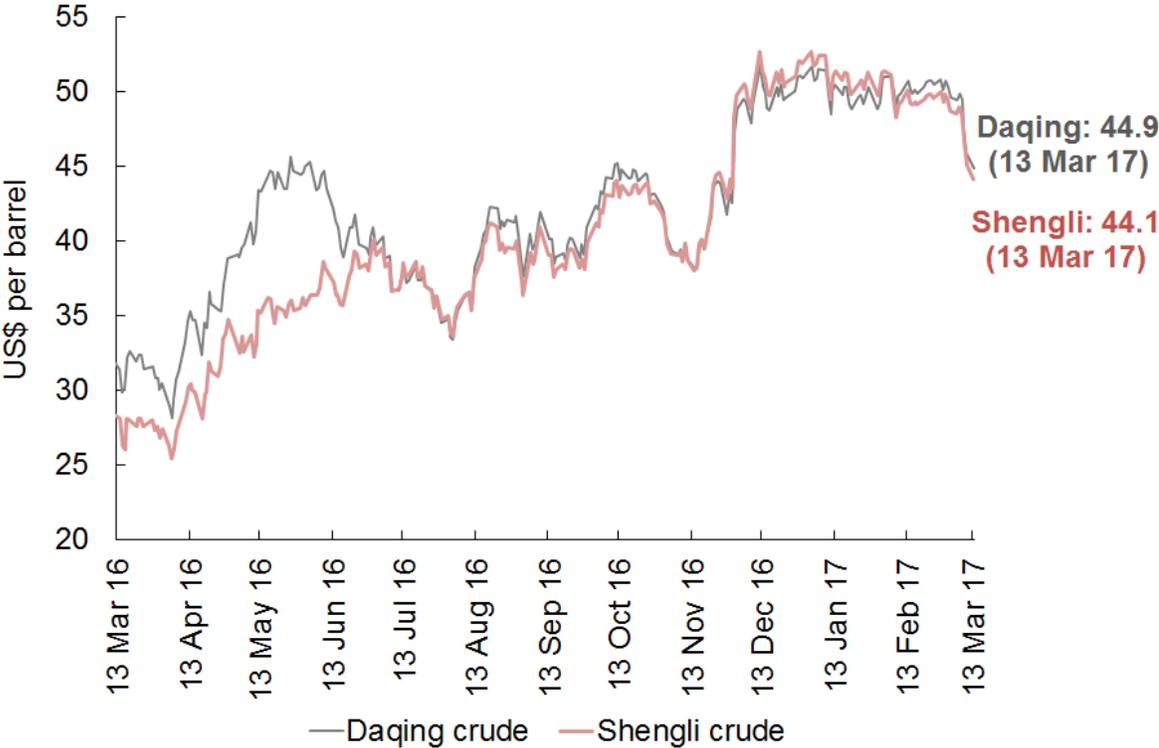
Looking ahead, it is expected that the rising US oil output will continue to undermine the positive impacts of the OPEC-led crude output cut on global crude prices. Moreover,

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.

there are concerns as to whether the OPEC-led output cut will be extended beyond June. In view of these factors, we believe that global oil prices are unlikely to start an upward trend in the near future.

Exhibit 1: China’s crude prices, March 2016 to March 2017



Source: ifeng.com

2. Wholesale price index of refined oil products falls in January and February

The wholesale price index of refined oil products edged down by 0.4% mom in January and dropped further by 2.7% mom in February (see exhibit 2).³ Specifically, the wholesale price index of diesel fell by 2.0% mom in January and dropped by 4.1% mom in February, while that of gasoline went up by 1.5% mom in January and declined by 2.1% mom in February.

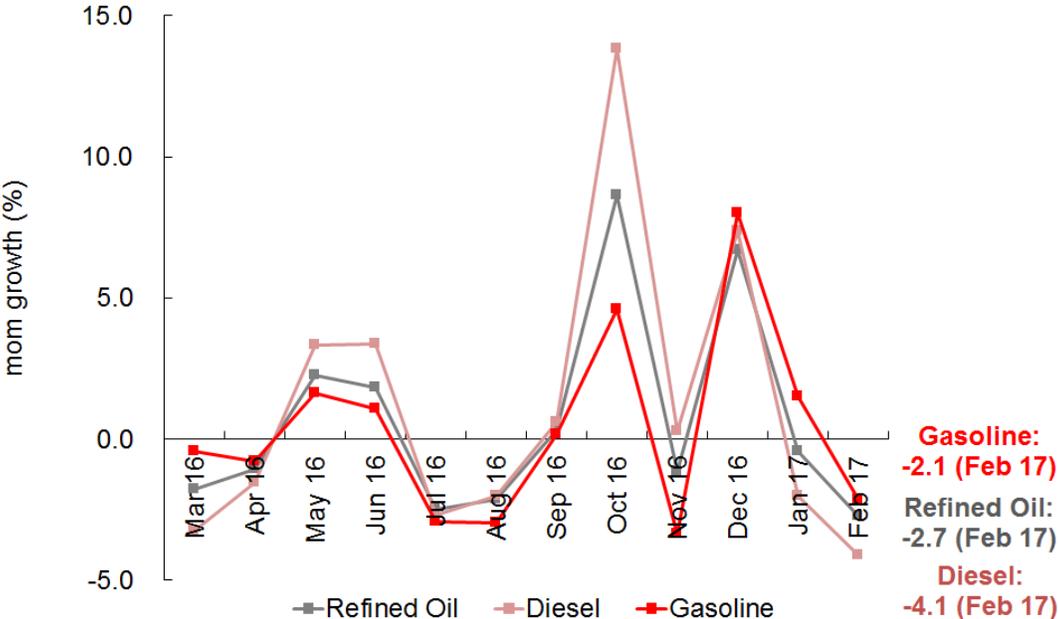
The movement of the price index in the two-month period was mainly driven by the government move to adjust the wholesale prices of refined oil products. The National

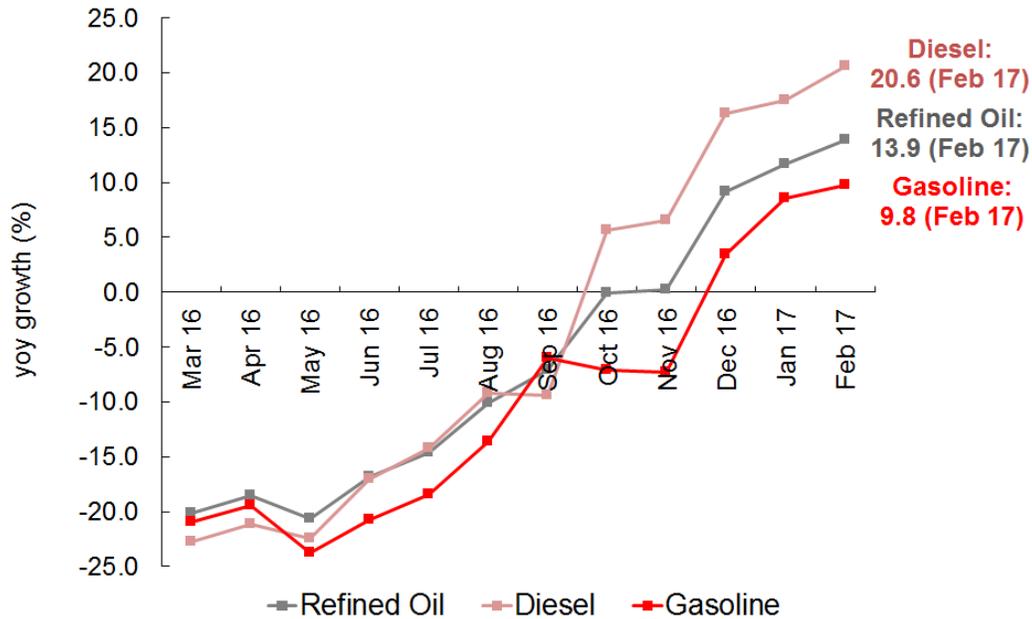
³ The index is compiled by the China Logistics Information Center (CLIC).

Development and Reform Commission (NDRC) made a downward adjustment to the maximum wholesale prices of refined oil products on 26 January, resulting in a fall in the price index in the period.

Looking ahead, we expect the wholesale price index of refined oil products to fall further in March, as the NDRC lowered the maximum prices of diesel and gasoline again on 15 March following a plunge in global crude prices since early March. 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.

Exhibit 2: China’s wholesale price indices of refined oil products, March 2016 to February 2017





Source: China Logistics Information Center

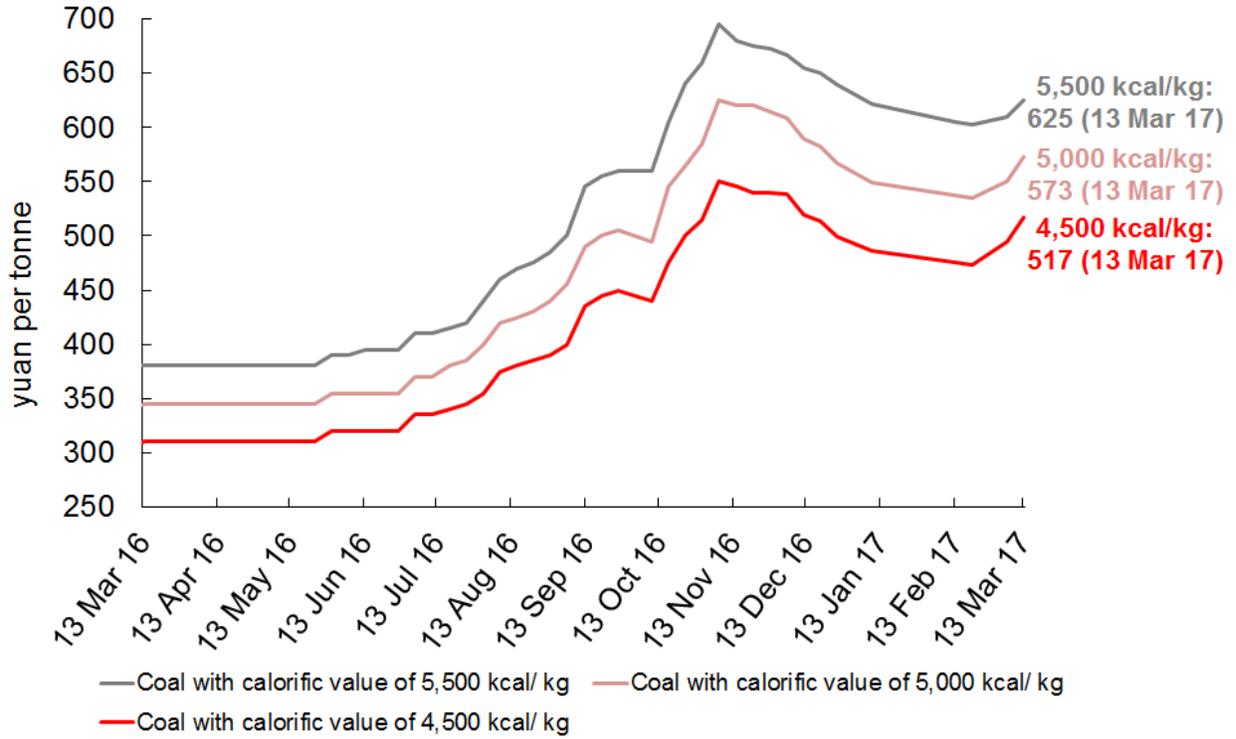
3. Benchmark Qinhuangdao coal prices rebound

The benchmark Qinhuangdao coal prices went up during late February to mid-March (see exhibit 3). For instance, the price of coal with calorific value of 5,500 kcal/ kg rose from 602 yuan per tonne on 20 February to 625 yuan per tonne on 13 March.

In our view, the main reasons for the increase in domestic coal prices in the period were a fall in the supply of coal as domestic coal mines saw output slide due to ongoing safety checks, and a strong restocking demand from power producers.

Looking ahead, the domestic supply of coal is expected to remain tight in the rest of the year, as the Chinese government announced on 5 March its plan to cut at least 150 million tonnes of coal production capacity in 2017. Therefore, we expect the domestic coal prices to stay high in the coming months.

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



Source: ifeng.com, cctd.com.cn

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