



China Sourcing Update

February 28, 2018

Energy Costs

1. Crude prices rise and then retreat in January

In line with the movement of global crude prices, China's crude prices trended upward throughout nearly the whole January before retreating in the last few days in the month.¹ For instance, after rising from US\$ 60.0 per barrel on 29 December 2017 to US\$ 63.5 per barrel on 25 January 2018, the Daqing² crude price dropped to US\$ 61.0 per barrel on 31 January 2018 (see exhibit 1).

Two major factors were behind the jump in global oil prices in the month till 25 January. First, concerns over the global oil supply glut continued to ease, thanks to strong oil demand growth underpinned by a healthy global economy, as well as production cuts led by the Organization of the Petroleum Exporting Countries (OPEC) and Russia. Second, the weakening of the US dollar, in which global commodity prices are denominated, also boosted oil prices. The US Dollar Index, a measure of the value of the US dollar relative to a basket of foreign currencies, went down by more than 3% in the period.

The fall in crude prices in late January was triggered by renewed market concerns over the rising crude output in the US. Data from the US Energy Information Administration showed that the US production of crude oil rose to 9.88 million barrels per day in mid-

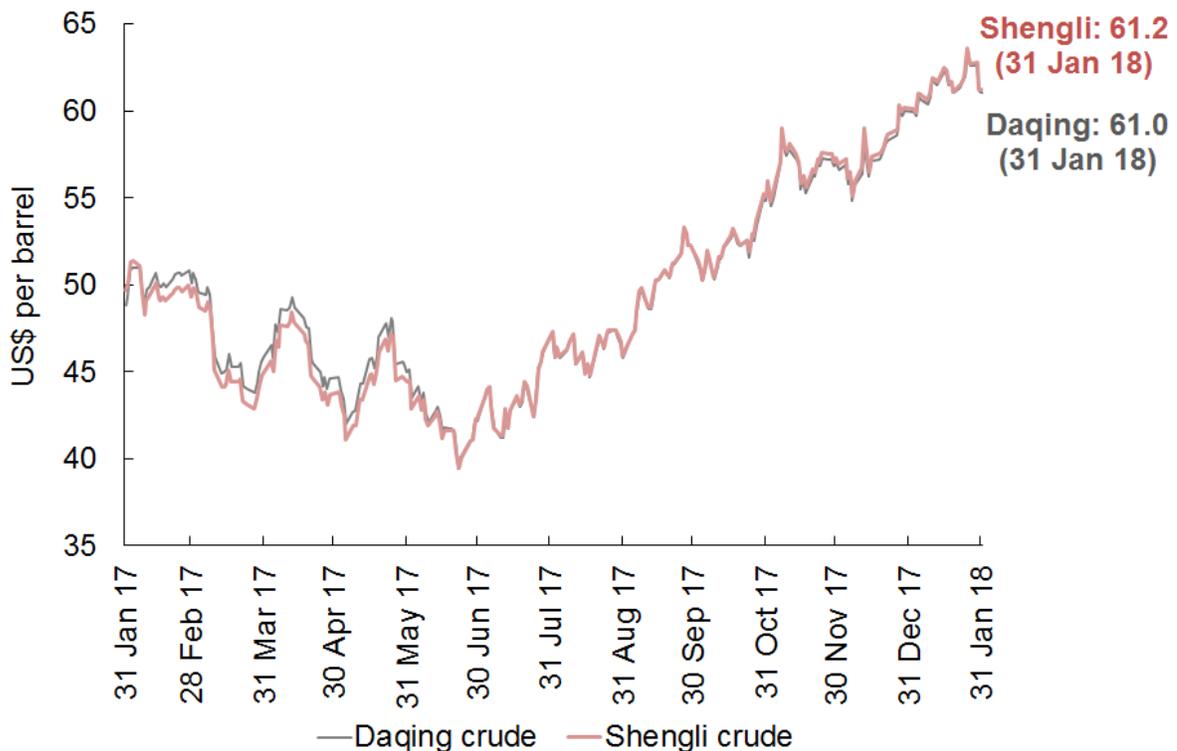
¹ From the year 2000 onwards, China's crude prices were determined with reference to global crude prices.

² Daqing Field is the largest oil field in China.

January and 9.92 million barrels per day in late January, the highest levels in more than 40 years.

Going forward, several bearish factors for global crude prices are in play, including a rising US oil output, which is expected to reach record-high levels in the coming months; and increased volatility in global stock markets lately, which has triggered more risk aversion and thus investment outflow from commodities, including crude oil. All in all, we believe that global oil prices are unlikely to rise further in the near future.

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



Source: ifeng.com

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

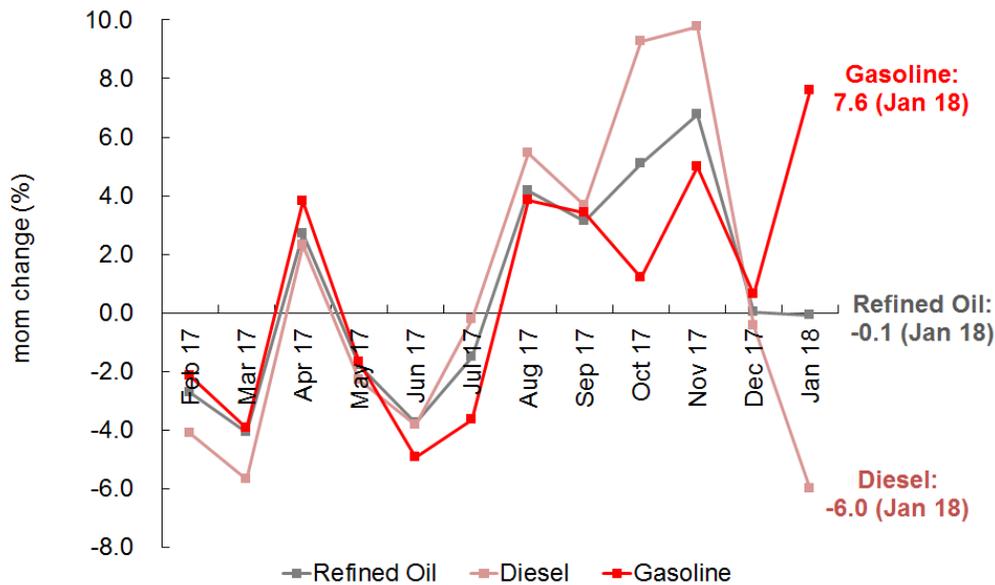
The wholesale price index of refined oil products edged down by 0.1% in January after staying flat in the previous month (see exhibit 2).³ Specifically, the wholesale price index of diesel dropped by 6.0% mom, while that of gasoline jumped by 7.6% mom in January.

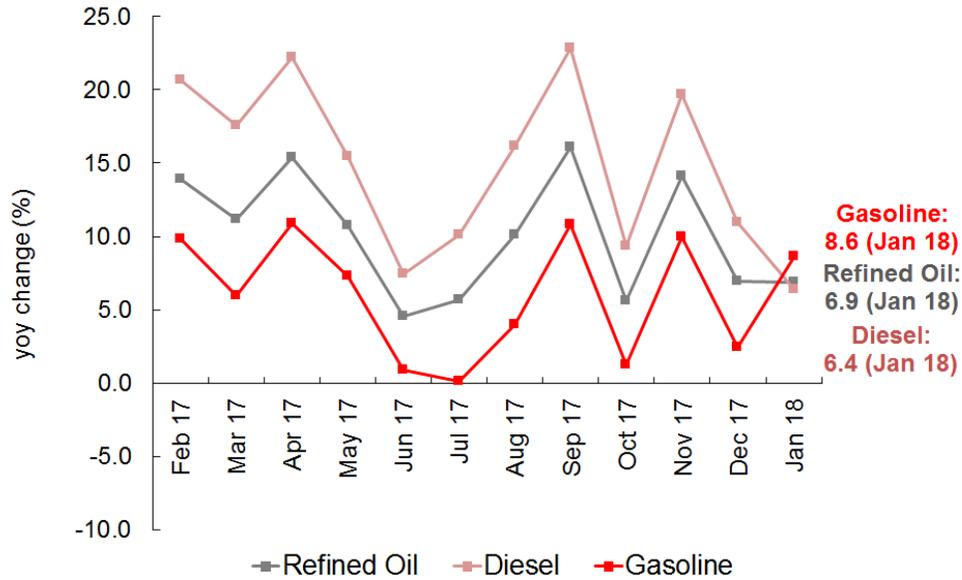
³ The index is compiled by the China Logistics Information Center (CLIC).

The National Development and Reform Commission (NDRC) made upward adjustments to the maximum wholesale prices of refined oil products on 29 December 2017 and 13 January 2018, leading to a rise in gasoline prices in January. Despite this, diesel prices dropped in the month as the consumer demand weakened and the diesel shortage in China eased.

Looking ahead, we expect the wholesale price index of refined oil products to go down in February, as the National Development and Reform Commission (NDRC) lowered the maximum prices of diesel and gasoline on 10 February following a sharp fall in global crude prices during late January to early February. 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, February 2017 to January 2018





Source: China Logistics Information Center

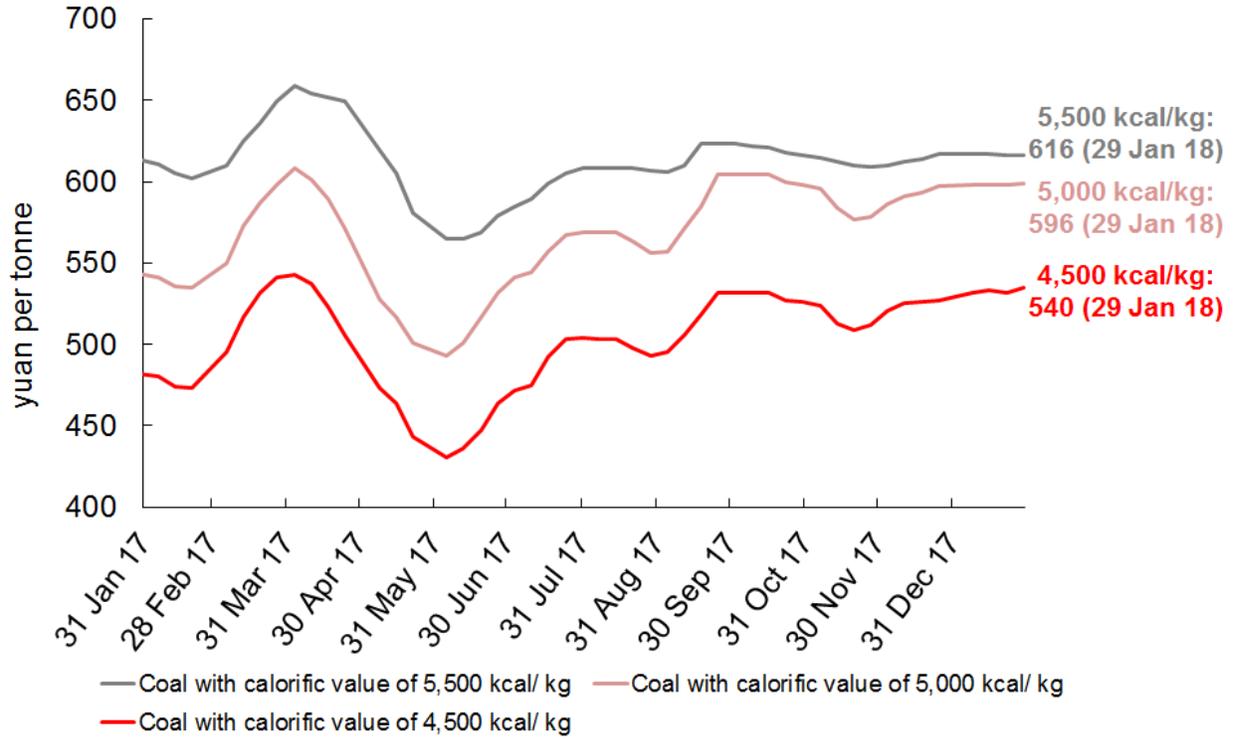
3. Benchmark Qinhuangdao coal prices stay high in January

The benchmark Qinhuangdao coal prices stayed relatively stable at high levels in January (see exhibit 3). For example, the price of coal with calorific value of 5,500 kcal/kg hovered between 616 yuan to 617 yuan per tonne throughout the month, before closing at 616 yuan per tonne on 29 January 2018.

Coal prices stayed high in the month as the restocking demand for coal from power producers remained strong amid high power consumption, in our view.

Going forward, the demand for coal from power producers is likely to slow in February as a lot of factories would suspend their production during and around the Chinese New Year holidays. Therefore, we expect domestic coal prices to trend slightly downward in the near future.

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



Source: ifeng.com, cctd.com.cn

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CONTACT

Helen Chin
Vice President
helenchin@fung1937.com
(852) 2300 2471

William Kong
Research Manager
williamkong@fung1937.com
(852) 2300 2404

Global Sourcing
Fung Business Intelligence
10/F LiFung Tower
888 Cheung Sha Wan Road
Kowloon, Hong Kong

T: (852) 2300 2470
F: (852) 2635 1598
E: fbicgroup@fung1937.com
W: <http://www.fbicgroup.com>



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