



# China Sourcing Update

August 18, 2017

## Energy Costs

### 1. Crude prices soar during mid-July to early August

In line with the movement of global crude prices, China's crude prices rose sharply during mid-July to early August.<sup>1</sup> For example, the Daqing<sup>2</sup> crude price jumped from US\$ 41.2 per barrel on 11 July to a three-month high of US\$ 47.2 per barrel on 1 August, before retreating to US\$ 45.4 per barrel on 11 August (*see exhibit 1*).

There are several reasons for the surge in global oil prices during mid-July to early August. First, US crude and gasoline inventories fell more than expected in consecutive weeks ending 14 July and 21 July, according to data from the US Energy Information Administration. Some investors regarded the inventory drawdown as a signal that the over-supply in the oil market was easing. Second, the number of oil rigs operating in the US has shown signs of plateauing in recent weeks, indicating that the growth in US production of crude oil is likely to decelerate in the coming months.

Lastly, oil prices were also supported by a further agreement reached between the Organization of the Petroleum Exporting Countries (OPEC) and some non-OPEC countries to boost compliance with their pledged production cuts; and a voluntary agreement by Nigeria, which was previously exempted from the output reductions, to limit its oil output to 1.8 million barrels per day. Saudi Arabia also said it planned to cap

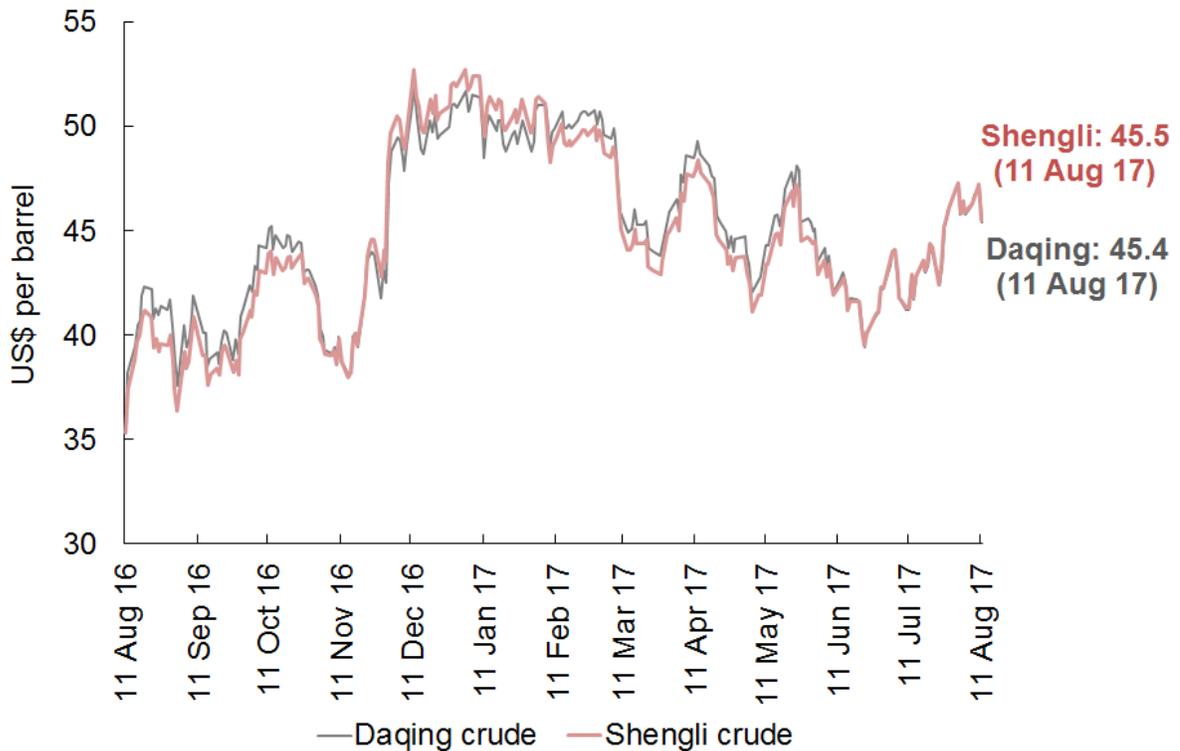
<sup>1</sup> From the year 2000 onwards, China's crude prices were determined with reference to global crude prices.

<sup>2</sup> Daqing Field is the largest oil field in China.

crude exports to 6.6 million barrels per day in August, about 1 million barrels per day below the level last year.

Looking ahead, we believe that global oil prices are unlikely to rise further in the near future as it is still doubtful as to how closely the oil producing countries will comply with the production quotas and whether the output cuts can significantly mitigate the global oil supply glut amid a rising oil production in the US.

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



Source: ifeng.com

**2. Wholesale price index of refined oil products drops in July**

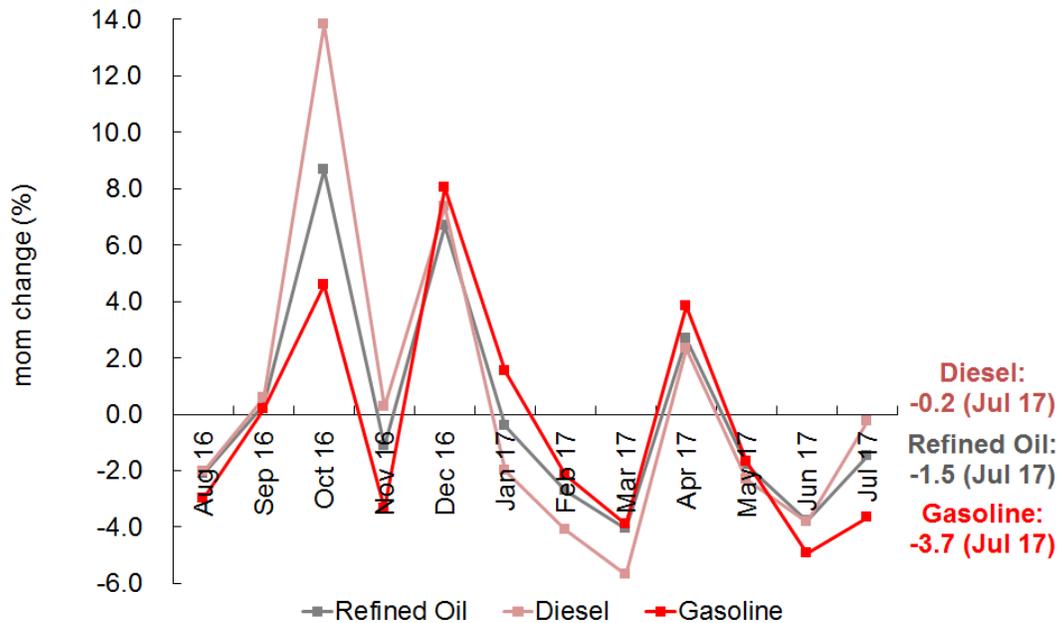
The wholesale price index of refined oil products went down by 1.5% mom in July (see exhibit 2).<sup>3</sup> Specifically, the wholesale price index of diesel fell by 0.2% mom, while that of gasoline declined by 3.7% mom in the month.

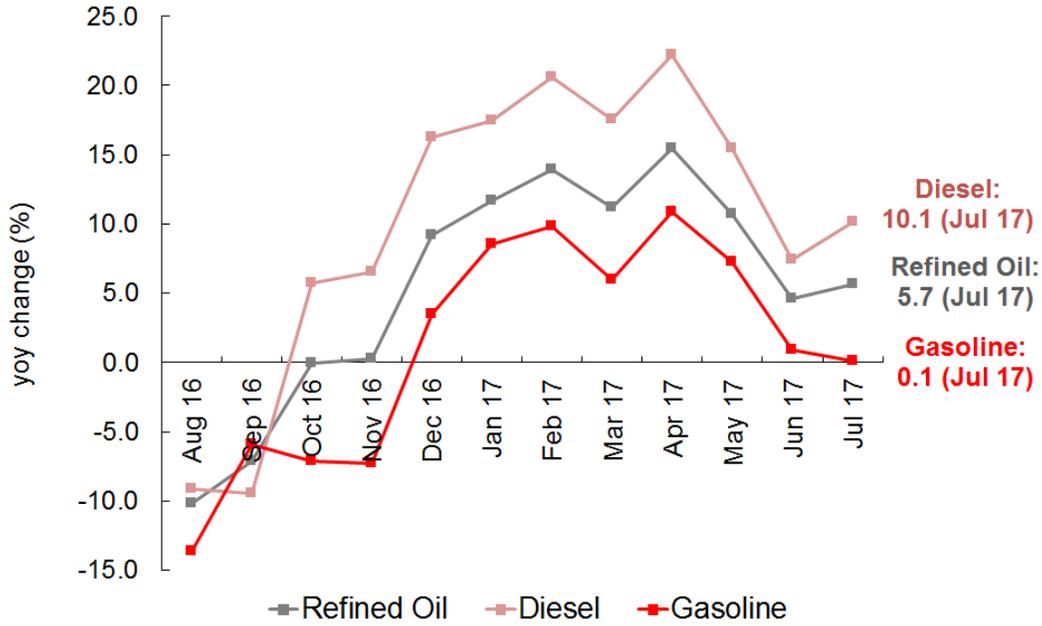
<sup>3</sup> The index is compiled by the China Logistics Information Center (CLIC).

The movement of the price index in July was mainly driven by the government moves to adjust the wholesale prices of refined oil products. The National Development and Reform Commission (NDRC) made a downward adjustment to the maximum wholesale prices of refined oil products on 24 June, and an upward adjustment on 22 July, resulting in slightly lower average prices of refined oil products in July than in June.

Looking ahead, we expect the wholesale price index of refined oil products to rise in August, as the NDRC raised the maximum prices of diesel and gasoline again on 5 August following a surge in global crude prices in late July. 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, August 2016 to July 2017**





Source: China Logistics Information Center

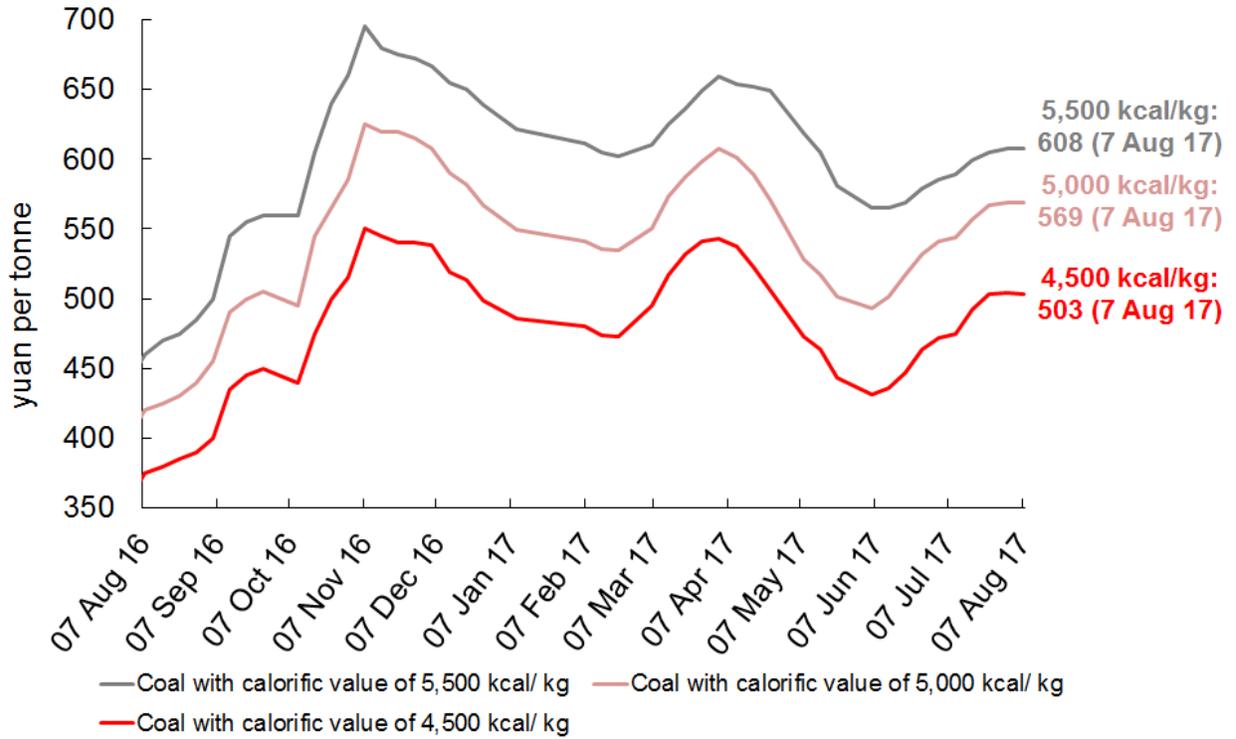
### 3. Benchmark Qinhuangdao coal prices rise during mid-July to early August

The benchmark Qinhuangdao coal prices went up during mid-July to early August (see exhibit 3). For instance, the price of coal with calorific value of 5,500 kcal/ kg climbed from 599 yuan per tonne on 17 July to 608 yuan per tonne on 7 August.

In our view, the increase in domestic coal prices in the period was due largely to a stronger demand for coal from power producers, boosted by the hot weather in various parts of China; and a tightened supply of coal due to ongoing safety checks on domestic coal mines and rainstorms in major coal producing provinces.

Looking ahead, the demand for coal from power producers is likely to stay stable in the current high season for power consumption. Therefore, we believe that the domestic coal prices will stay around the current high levels in the foreseeable future.

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



Source: ifeng.com, cctd.com.cn

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