



China Sourcing Update

December 22, 2016

Energy Costs

1. Crude prices surge during mid-November to mid-December

In line with the movement of global crude prices, China's crude prices went up sharply during mid-November to mid-December, and gave up some of the gains afterwards.¹ For example, the Daqing² crude price soared from a recent low of US\$ 38.1 per barrel on 14 November to US\$ 51.8 per barrel on 12 December, the highest level since July 2015, before retreating to US\$ 48.7 per barrel on 16 December (*see exhibit 1*).

The rise in global oil prices during mid- to late November was mainly triggered by Donald Trump's victory in the US presidential election, which fuelled a risk-on sentiment among investors and pushed up the prices of commodities; and investors betting on a possible output cut agreement by the Organization of the Petroleum Exporting Countries (OPEC).

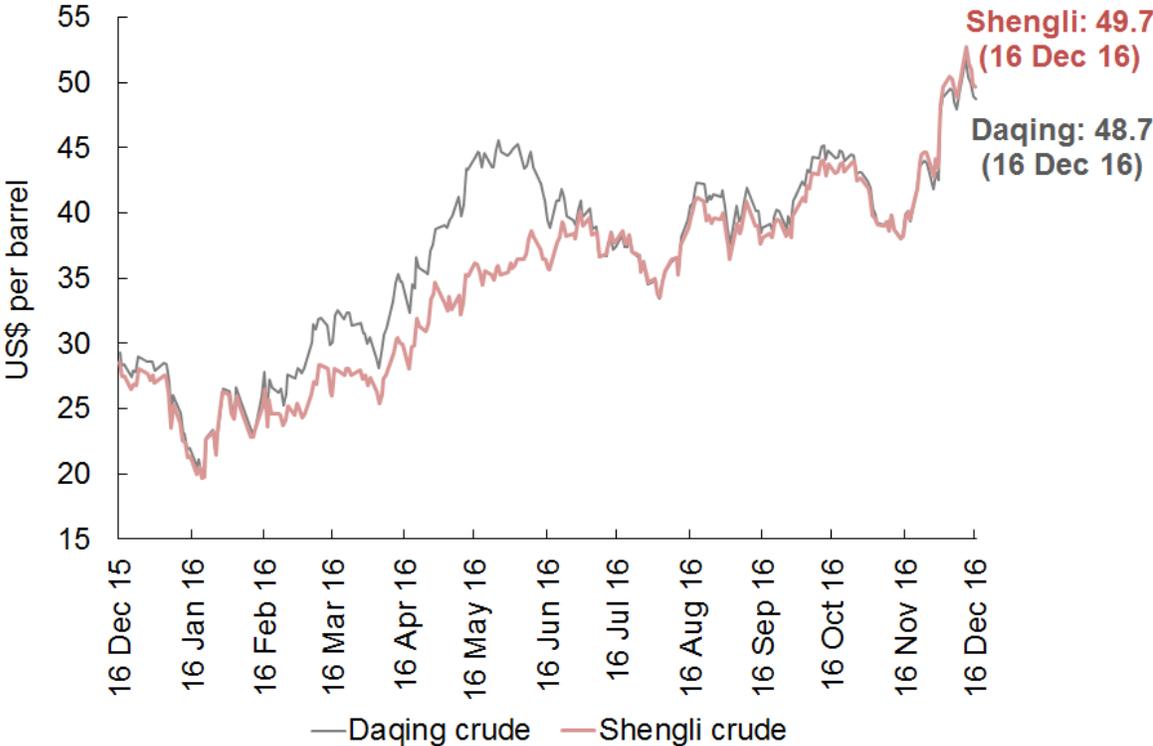
After the OPEC announced on 30 November that it would cut oil production by around 1.2 million barrels per day to 32.5 million barrels per day from January 2017 onwards, oil prices jumped further in the following days. However, since the US Federal Reserve raised its benchmark interest rate by 0.25% and signalled three possible interest rate hikes in 2017 on 14 December, oil prices have fallen on a stronger US dollar.

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.

Looking ahead, it is still doubtful as to how closely the OPEC’s production caps will be adhered to and whether the output cut can significantly mitigate the global oversupply of crude oil. Moreover, expectations of a faster pace of interest rate hikes in the US is likely to boost the US dollar and drag down oil prices. Therefore, we do not expect oil prices to start an upward trend in the near future.

Exhibit 1: China’s crude prices, December 2015 to December 2016



Source: ifeng.com

2. Wholesale price index of refined oil products drops in November

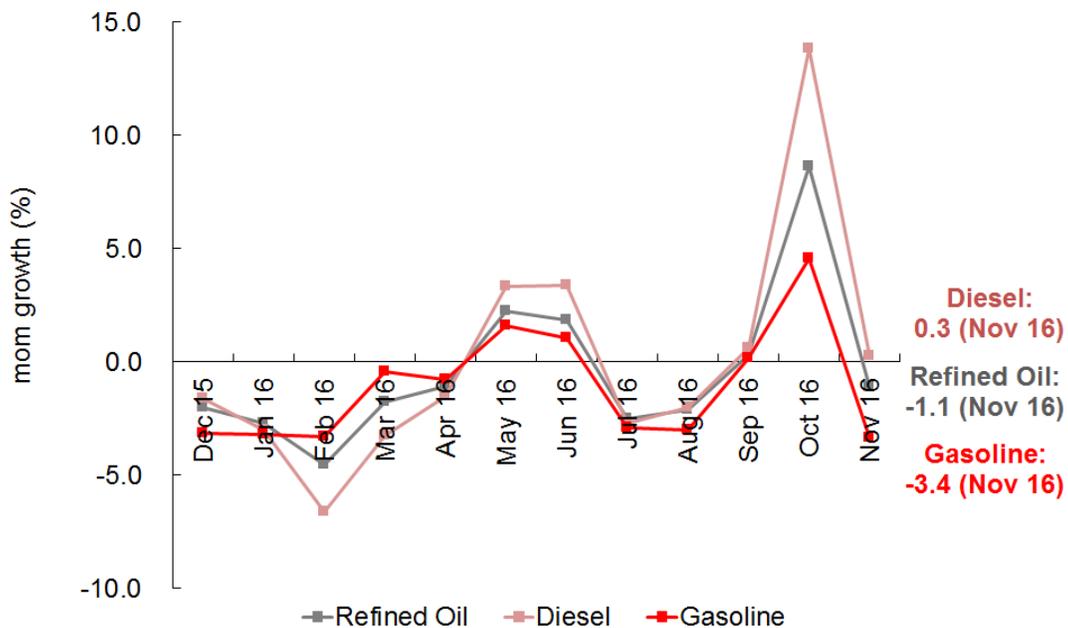
The wholesale price index of refined oil products went down by 1.1% mom in November (see exhibit 2).³ Specifically, the wholesale price index of diesel rose by 0.3% mom, while that of gasoline fell by 3.4% mom in the month.

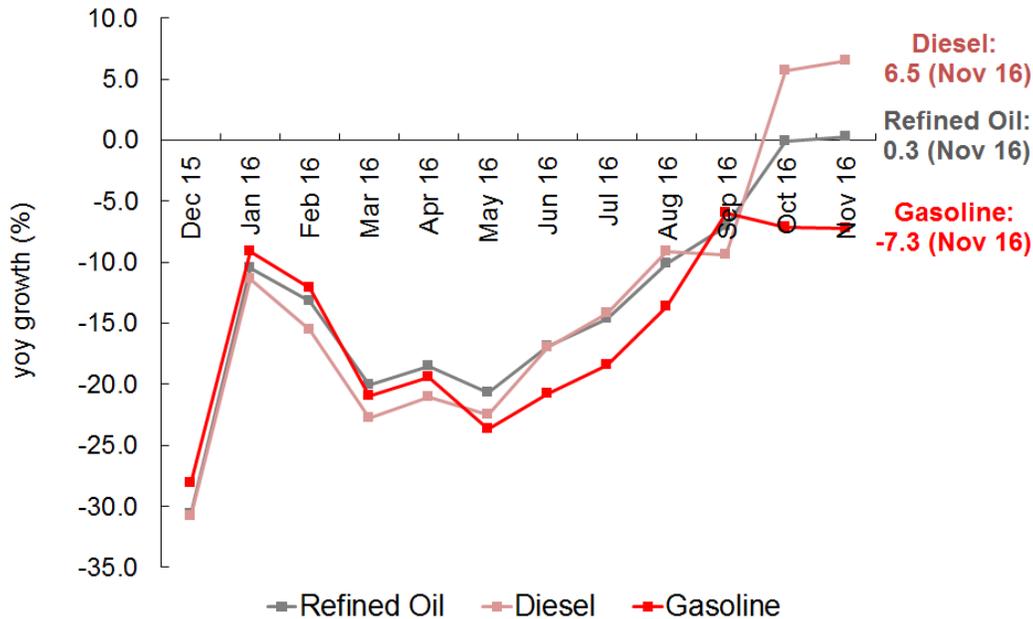
³ The index is compiled by the China Logistics Information Center (CLIC).

The movement of the price index in the month was mainly driven by the government move 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 17 November, in response to the drop in global crude prices in late October and early November.

Looking ahead, we expect the wholesale price index of refined oil products to rebound in December, as the NDRC raised the maximum prices of diesel and gasoline on 1 December and on 15 December again following the recent surge in global crude prices. 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, December 2015 to November 2016





Source: China Logistics Information Center

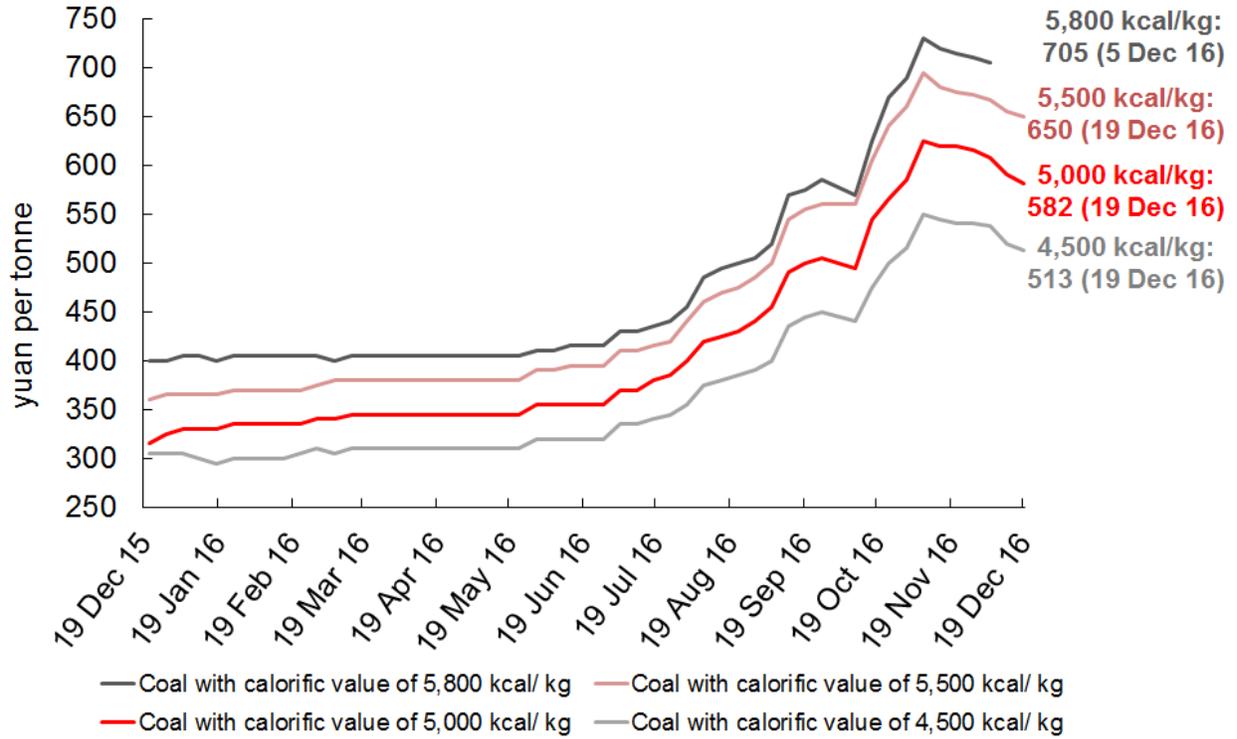
3. Benchmark Qinhuangdao coal prices drop in early November to mid-December

The benchmark Qinhuangdao coal prices went down during early November to mid-December (see exhibit 3). For instance, the price of coal with calorific value of 5,500 kcal/ kg dropped from a four-year high of 695 yuan per tonne on 7 November to 650 yuan per tonne on 19 December.

The fall in domestic coal prices was mainly triggered by a series of government measures to boost the domestic coal supply and cool down the coal market. For example, the Chinese government urged rail authorities to increase coal shipment on 9 November, and announced that all legal coal mines are allowed to operate 330 days a year till the end of March 2017 on 17 November. Major coal producers, in response to the government's earlier call to cap the coal prices for 2017 long-term supply contracts, also inked contracts with power producers with the base price of coal with calorific value of 5,500 kcal/ kg set at 535 yuan per tonne, which is significantly lower than the spot prices and has thus put downward pressure on the spot prices of coal.

Looking ahead, the domestic supply of coal is expected to increase following a bunch of government measures, and the restocking demand for coal from power producers is likely to fall in the near term. Thus, we expect the domestic coal prices to drop further in the foreseeable future.

Exhibit 3: Qinhuangdao coal prices, December 2015 to December 2016



Source: Cqcoal.com, Cctd.com.cn

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