



China Sourcing Update

November 22, 2016

Energy Costs

1. Crude prices rise during early to mid-October and have dropped since then

In line with the movement of global crude prices, China's crude prices went up during early to mid-October, and have fallen since then.¹ For example, the Daqing² crude price trended upward from US\$ 41.3 per barrel on 30 September to US\$ 45.2 per barrel on 12 October, and then fell to US\$ 39.1 per barrel on 7 November (see exhibit 1).

The main reason for the rise in global oil prices during early to mid-October was the announcement of a proposed output cut by the Organization of the Petroleum Exporting Countries (OPEC) in late September.

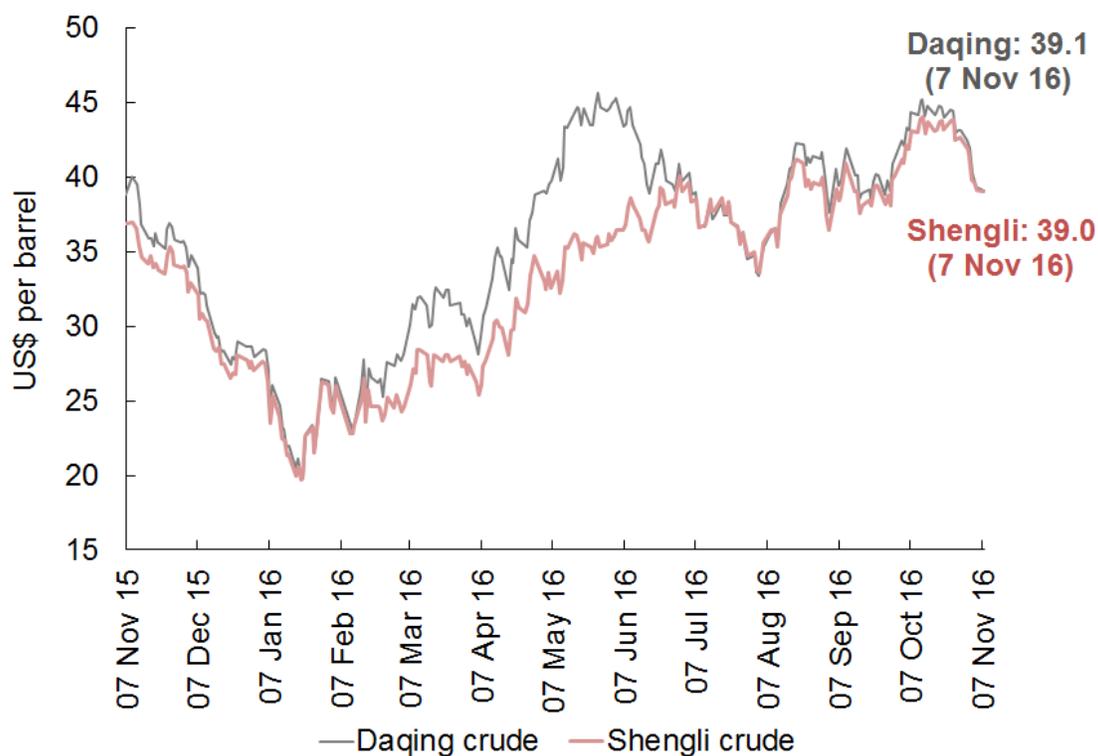
However, global oil prices started to trend downward in mid-October, after the International Energy Agency reported on 11 October that the OPEC had boosted its crude output by 160,000 barrels per day to a record 33.64 million barrels per day in September. Doubts about the OPEC's ability to coordinate a production cut drove down oil prices further in late October, as members of the OPEC reached an impasse during technical talks aimed at preparing a more detailed plan to cut crude output.

Looking ahead, it is still doubtful as to whether the OPEC can finalise the output cut agreement in late November and, if successful, whether the output cut can significantly mitigate the global oversupply of crude oil. All in all, we expect the oil prices to fluctuate around the current levels in the foreseeable future.

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.

Exhibit 1: China's crude prices, November 2015 to November 2016



Source: ifeng.com

2. Wholesale price index of refined oil products rises in September and October

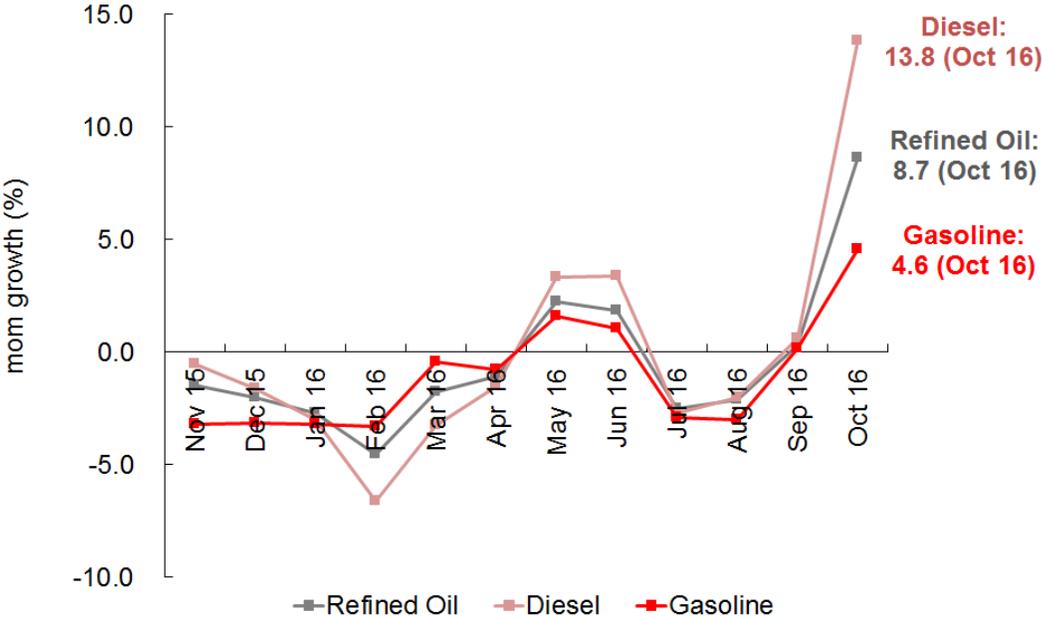
The wholesale price index of refined oil products went up by 0.3% mom in September and surged 8.7% mom in October (see exhibit 2).³ Specifically, the wholesale price index of diesel rose by 0.6% mom in September and by 13.8% mom in October, while that of gasoline increased by 0.2% mom in September and by 4.6% mom in October.

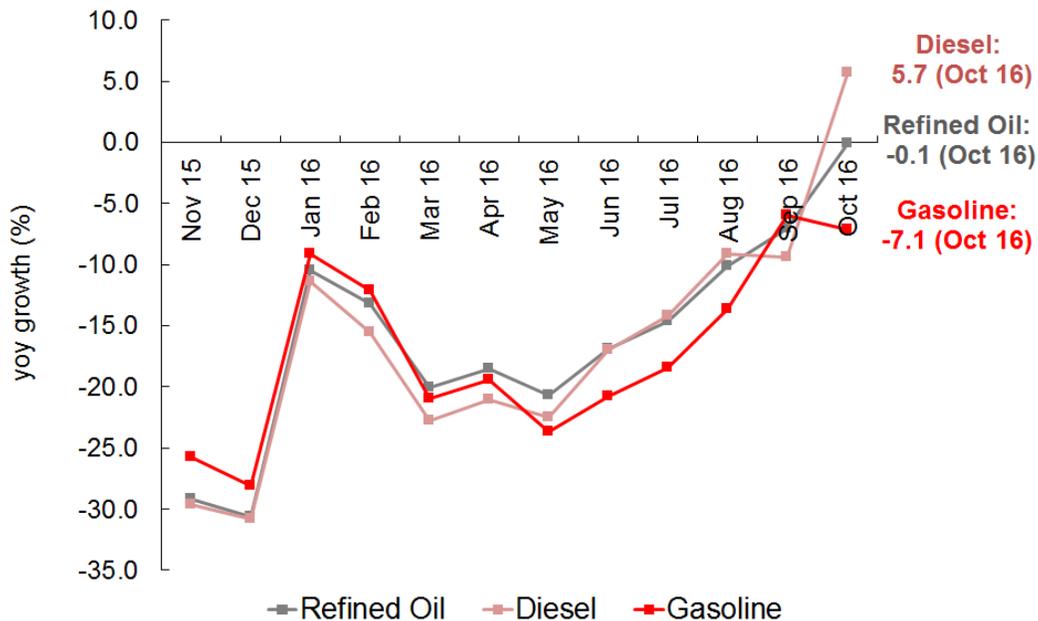
The movement of the price index in the two-month period was mainly driven by the government moves to adjust the wholesale prices of refined oil products. The National Development and Reform Commission (NDRC) made an upward adjustment to the maximum wholesale prices of refined oil products on 2 September, and a downward adjustment on 19 September, resulting in slightly higher prices of refined oil products in September than in August. Afterwards, the NDRC raised the maximum prices of diesel and gasoline again on 20 October, pushing up prices of refined oil products further.

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

Looking ahead, we expect the wholesale price index of refined oil products to fall in November, as the NDRC lowered the maximum prices of diesel and gasoline on 17 November following a sharp fall in global crude prices since mid-October. 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, November 2015 to October 2016





Source: China Logistics Information Center

3. Benchmark Qinhuangdao coal prices soar in October and early November

The benchmark Qinhuangdao coal prices fell slightly in early October, but have risen sharply since then (see exhibit 3). For instance, the price of coal with calorific value of 5,000 kcal/ kg dropped from 505 yuan per tonne on 26 September to 495 yuan per tonne on 10 October, and then surged to 625 yuan per tonne on 7 November, the highest level since June 2012.

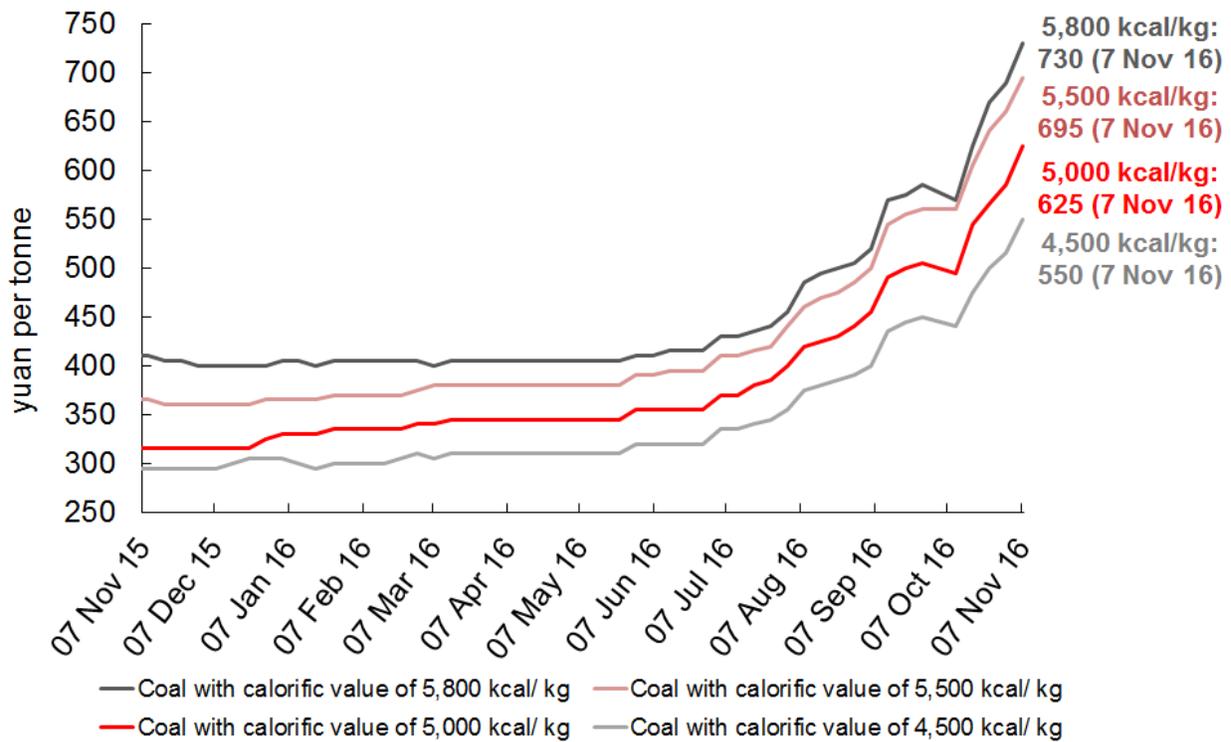
The fall in domestic coal prices in early October was mainly triggered by an official announcement in late September that major domestic coal producers would be allowed to increase coal production in the fourth quarter of 2016. According to media reports, however, coal producers have been slow to raise their output, leading to a continued tight supply of coal and a marked rise in coal prices since early October. Moreover, the pre-winter restocking demand for coal from power producers has been strong since early September in anticipation of a cold winter.

Lately, the Chinese government has taken further steps to stabilise domestic coal prices. On 27 October, the NDRC held an emergency meeting with major domestic coal producers to ask the latter to cap the prices for their 2017 long-term supply contracts at 600 yuan per tonne for 5,000 kcal thermal coal and 660 yuan per tonne for 5,500 kcal

thermal coal. Afterwards, on 1 November, the government issued a notice allowing even more coal producers to increase coal production.

Looking ahead, the demand for coal from power producers is likely to remain strong in the near future; however, the domestic supply of coal is expected to increase following a series of government measures. All in all, we expect that the domestic coal prices will start to stabilize in the near term.

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



Source: Cqcoal.com

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