



China Sourcing Update

August 22, 2016

Energy Costs

1. Crude prices soar during early to mid-August

In line with the movement of global crude prices, China's crude prices trended downward during mid-July to early August, and have risen sharply since then.¹ For example, the Daqing² crude price fell from US\$ 38.3 per barrel on 18 July to US\$ 33.4 per barrel on 3 August, the lowest level since mid-April. Afterwards, it surged to US\$ 42.3 per barrel on 19 August (see exhibit 1).

The drop in global oil prices during mid-July to early August was mainly triggered by market concerns about the overproduction and large stockpiles of crude oil. According to secondary sources quoted by the *Monthly Oil Market Report* published by the Organization of the Petroleum Exporting Countries (OPEC) on 10 August, crude production by OPEC member countries increased to an all-time high of 33.11 million barrels per day in July. Meanwhile, the commercial crude oil inventories (excluding those in the Strategic Petroleum Reserve) in the US also rose to 523.6 million barrels as at 5 August, a historically high level for this time of year, according to the US Energy Information Administration (EIA).

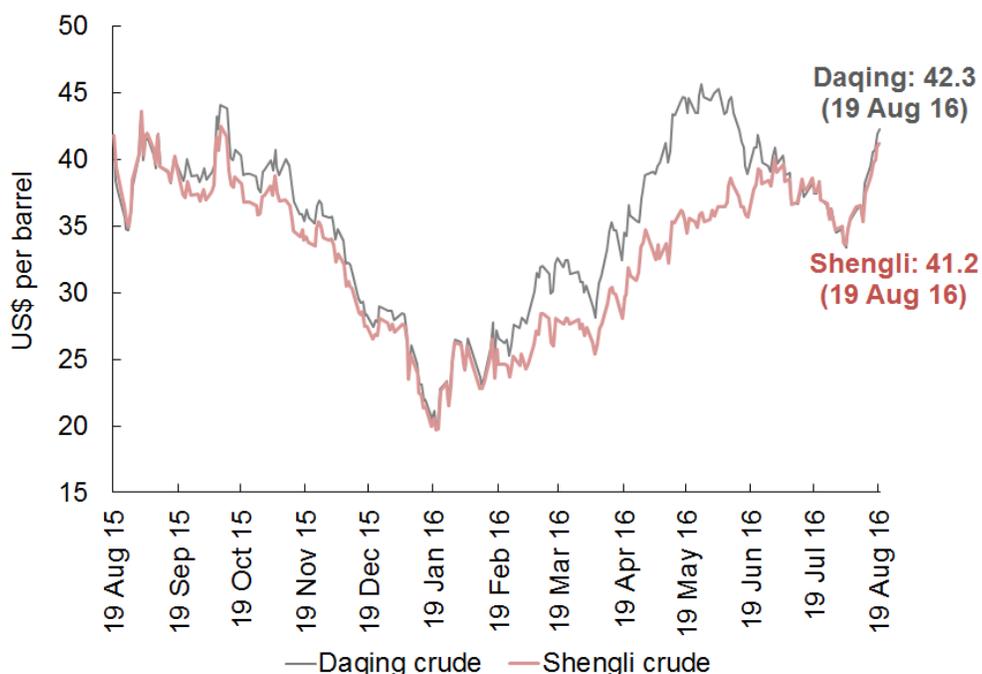
On 8 August, the OPEC announced its plan to hold an informal meeting in late September in Algeria, fuelling speculation that major oil producing countries may propose a production freeze, which then led to a rebound in oil prices.

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 widely believed that chances of reaching an oil output freeze agreement by major oil producers remain slim, and that the oversupply of crude oil will last in the coming months. Therefore, oil prices are unlikely to rise further, in our view.

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



Source: ifeng.com

2. Wholesale price index of refined oil products falls in July

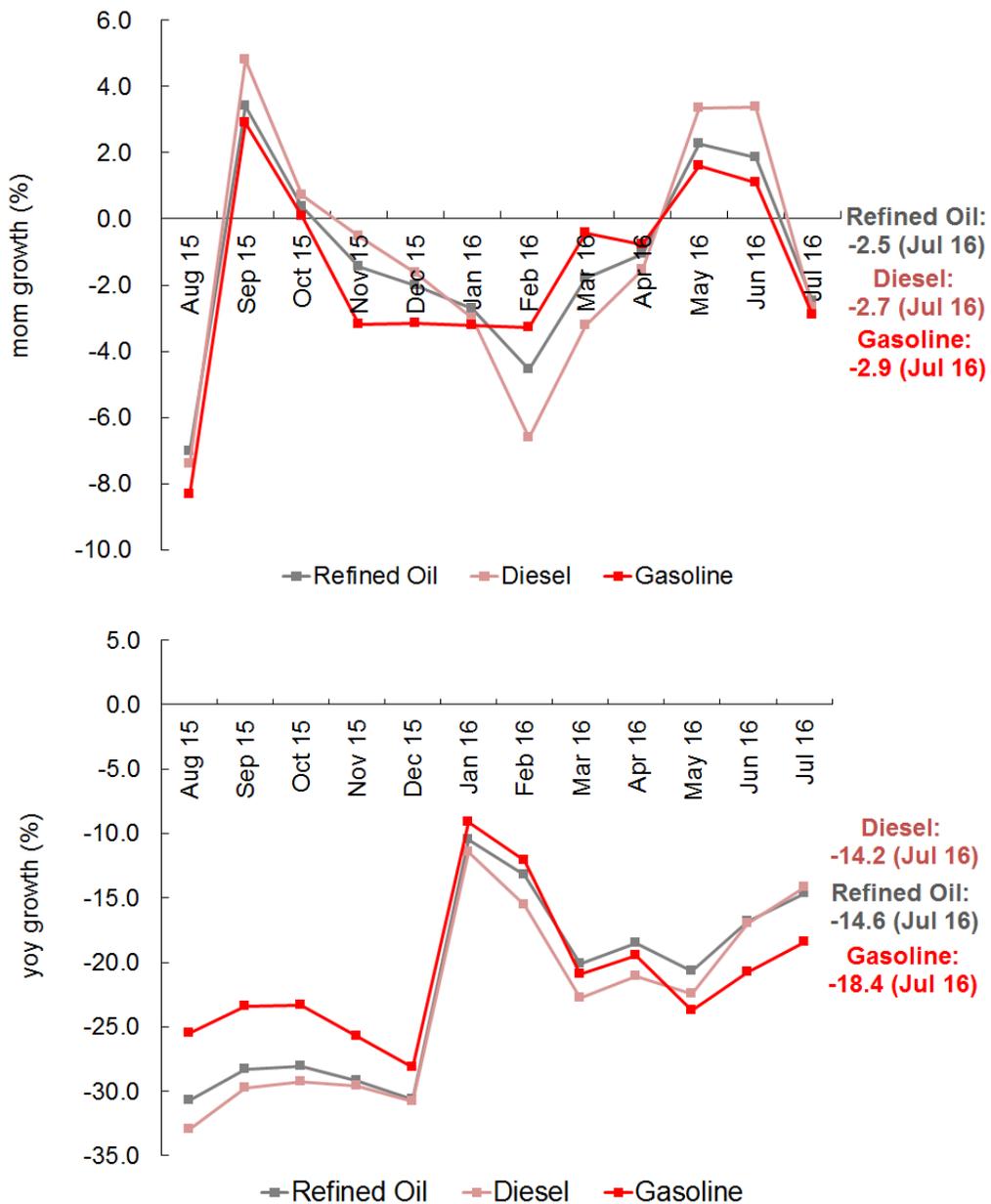
The wholesale price index of refined oil products went down by 2.5% mom in July, after having risen for two consecutive months (see exhibit 2).³ Specifically, the wholesale price index of diesel fell by 2.7% mom, while that of gasoline declined by 2.9% mom in the month.

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 22 July, in response to the drop in global crude prices in the first half of July.

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 further in August, as the NDRC lowered the maximum wholesale prices of diesel and gasoline again on 5 August following a further decline in global crude prices in late July and early August. 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 2015 to July 2016



Source: China Logistics Information Center

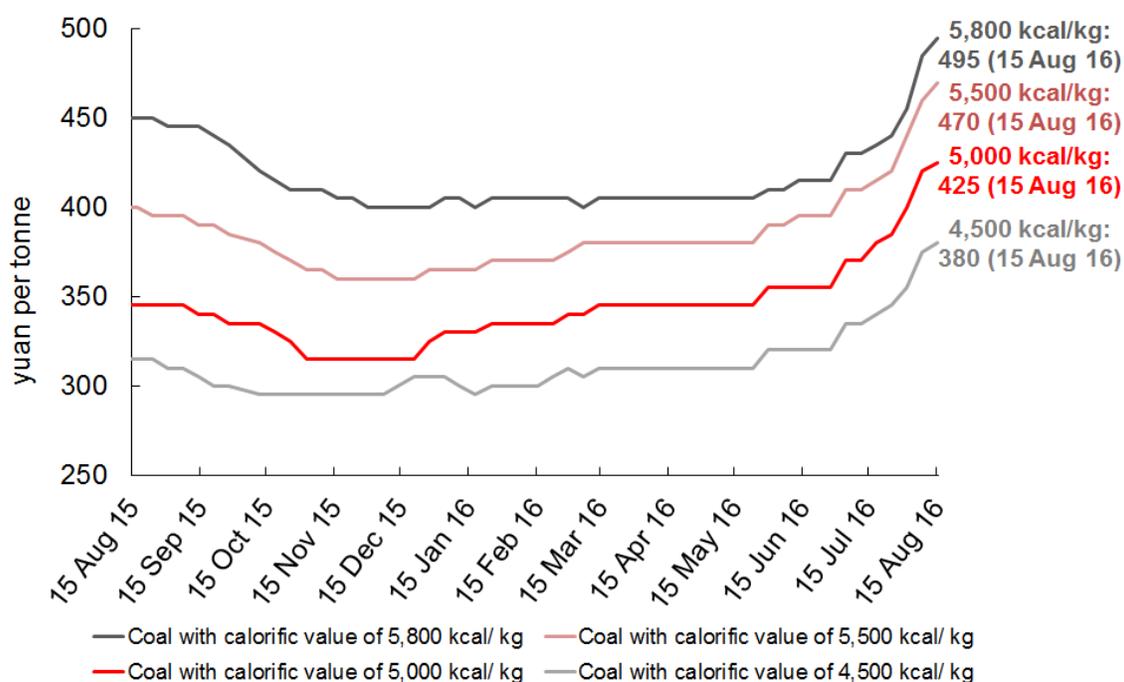
3. Benchmark Qinhuangdao coal prices go up further

The benchmark Qinhuangdao coal prices rose during mid-July to mid-August (see exhibit 3). For instance, the price of coal with calorific value of 5,500 kcal/ kg increased from 415 yuan per tonne on 18 July to 470 yuan per tonne on 15 August, the highest level since March last year.

According to the local media, the main reason for the continued rise in coal prices in recent months was a tight supply of coal. Coal producers' efforts to reduce their production capacities led to a year-on-year drop in China's raw coal output by 10.1% in the first seven months of the year.⁴ Moreover, the environmental examinations conducted by the central government since mid-July forced some coal mines in Inner Mongolia to cut or even suspend production. Meanwhile, the demand for coal from power producers remained strong during July to mid-August, boosted by the hot weather in southern China.

Looking ahead, the demand for coal from power producers is likely to stay stable in the near future; meanwhile, the domestic supply of coal is expected to remain tight. Thus, we expect the domestic coal prices to rise further in the coming months.

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



Source: Cqcoal.com

⁴ http://www.stats.gov.cn/tjsj/zxfb/201608/t20160812_1387693.html

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