



China Sourcing Update

February 1, 2016

Energy Costs

1. Crude prices drop further in early to mid-January

In line with the movement of global crude prices, China's crude prices continued to drop in early to mid-January.¹ For example, the Daqing² crude price plunged further from US\$ 27.9 per barrel on 31 December to US\$ 21.1 per barrel on 19 January (*see exhibit 1*).

The price of Brent crude, the international oil benchmark, plunged all the way from US\$ 37.28 per barrel on 31 December to US\$ 27.92 per barrel on 21 January. One of the major factors contributing to the plunge in crude prices was the lifting of economic sanctions against Iran in January. The International Atomic Energy Agency (IAEA) announced on 16 January that Iran had abided by the agreement last year with six countries to curtail its nuclear program, which triggered the end of sanctions.³ As the market anticipated a rise in Iranian exports after the lifting of sanctions, the crude prices slumped.

According to the *Monthly Oil Market Report* published by the Organization of the Petroleum Exporting Countries (OPEC) on 18 January 2016, the global oil oversupply still persisted in 4Q15. According to secondary sources quoted by the report, the crude production from the OPEC member countries averaged 32.18 million barrels per day in December, down by 211,000 barrels per day from the previous month, and averaged 32.2 million barrels per day in 4Q15, staying significantly above the target of 30 million barrels per day. Also, according to the report, the total supply excluding the OPEC

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

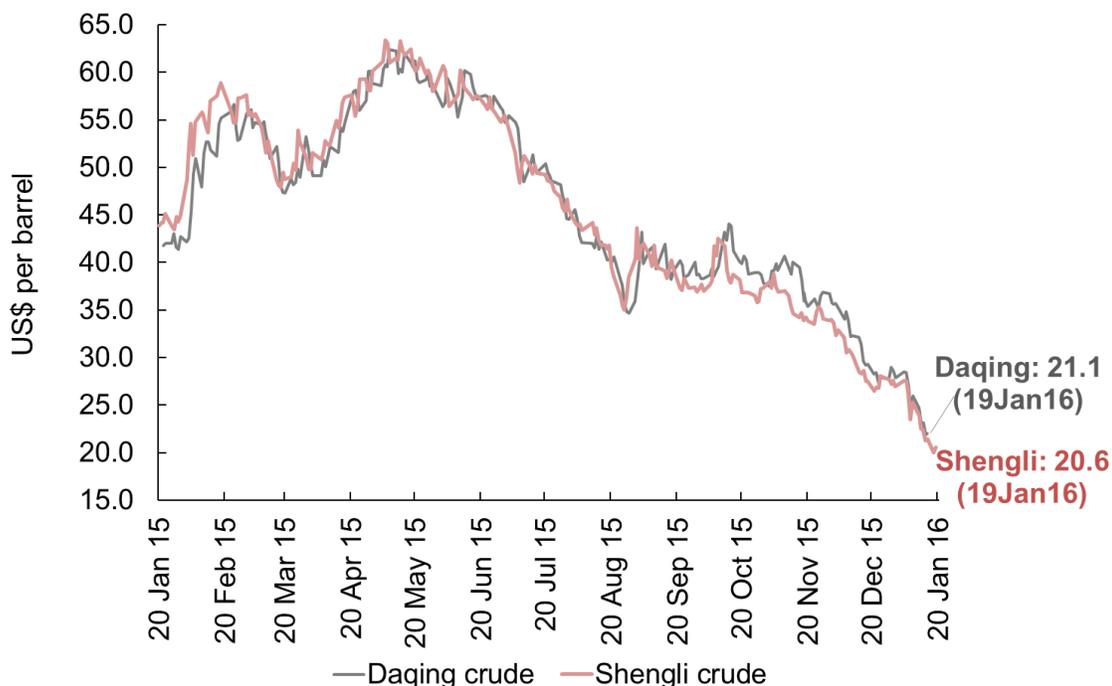
² Daqing Field is the largest oil field in China.

³ <http://www.reuters.com/article/us-iran-nuclear-zarif-idUSKCN0UU0C7>

crude oil production averaged 63.07 million barrels per day in 4Q15; and the world oil demand averaged 93.95 million barrels per day in 4Q15. Thus, there remained an oversupply of crude oil by about 1.32 million barrels per day on average, during 4Q15.

Looking ahead, the oversupply of crude oil is expected to last in the coming months. We therefore expect the oil prices to fluctuate at low levels in the foreseeable future.

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



Source: ifeng.com

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

The wholesale price index of refined oil products dropped by 2.0% mom in December (see exhibit 2).⁴

The movement of the price index in the month was mainly driven by the government moves to adjust the wholesale prices of refined oil products. The National Development and Reform Commission (NDRC) made downward adjustments to the wholesale prices of refined oil products on 2 December, in response to the further drop in global crude prices in the second half of November. However, on 15 December the NDRC suspended the adjustment mechanism for refined oil prices, in a bid to contain the excessive growth of petroleum consumption and protect the environment.⁵ On 13 January 2016, the NDRC announced some revisions to the pricing mechanism for

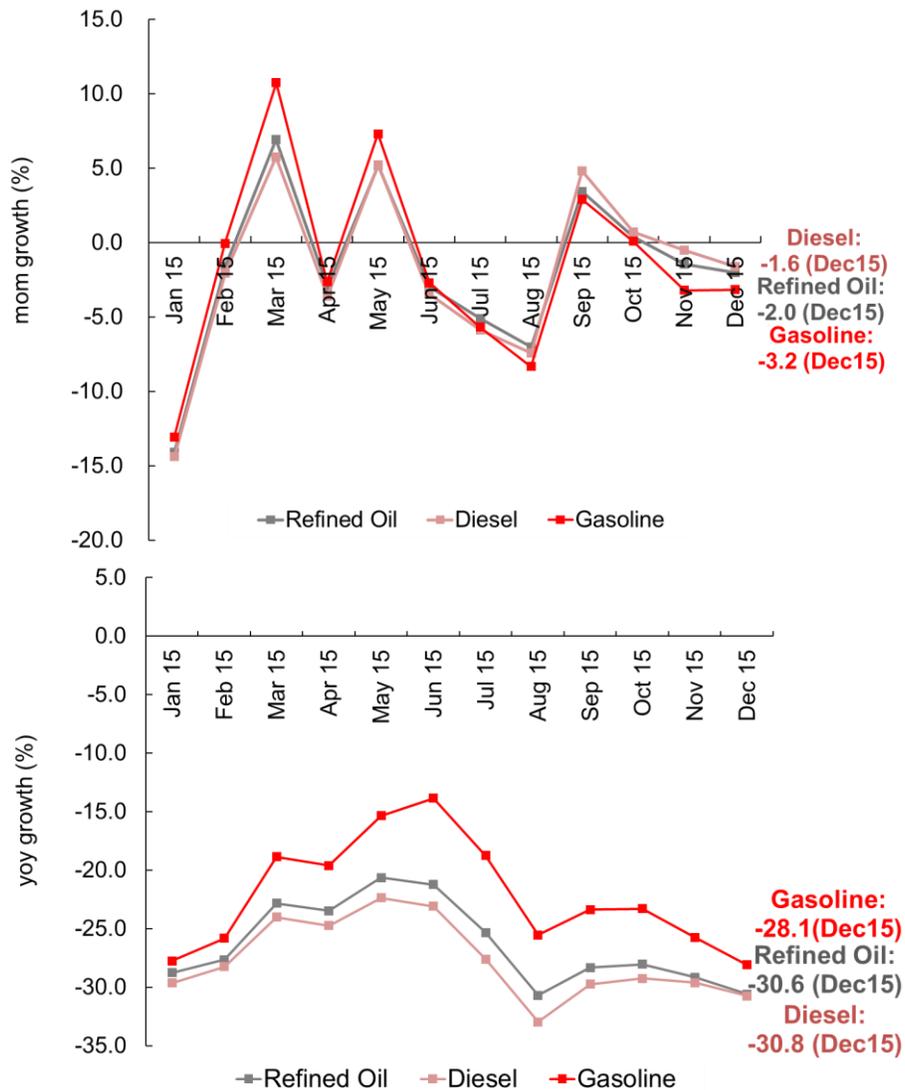
⁴ The index is compiled by the China Logistics Information Center (CLIC).

⁵ http://www.ndrc.gov.cn/xwzx/xwfb/201512/t20151215_767558.html

refined oil products.⁶ The revised pricing mechanism sets a lower bound on the prices of refined oil products. Specifically, if the global crude prices fall below US\$ 40 per barrel, the NDRC will not adjust the prices of refined oil products downward anymore.

Looking ahead, we expect the global crude prices to stay around the current low levels. Besides, the newly revised pricing mechanism will help ensure the stability of the prices of refined oil products if the global crude prices continue to be on a downward trend. Overall, the refined oil prices are expected to stay stable at low levels in the near future.

Exhibit 2: China's wholesale price indices of refined oil products, January to December 2015



Source: China Logistics Information Center

⁶ http://www.sdpc.gov.cn/zcfb/zcfbtz/201601/t20160113_771288.html

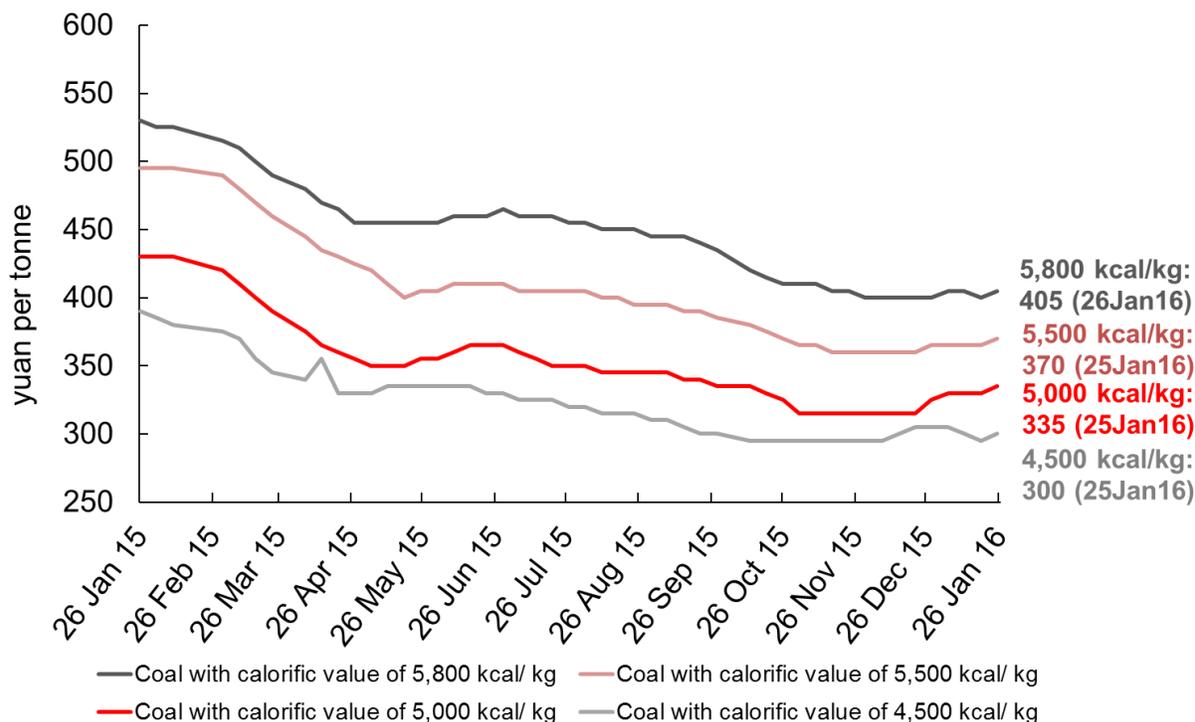
3. The benchmark Qinhuangdao coal prices rise slightly

The benchmark Qinhuangdao coal prices have edged up since early December (see *exhibit 3*). For instance, the price of coal with calorific value of 5,500 kcal/ kg rose slightly from 360 yuan per tonne on 7 December 2015 to 370 yuan per tonne on 25 January 2016.

According to the local media, a number of major coal enterprises continued to stabilize the coal prices in December and January. Also, affected by the cold weather since early December, the domestic demand for coal has increased, which has in turn supported the coal prices.

Looking ahead, the average temperatures over central and eastern areas in China are forecast to rebound since early February. Also, the industrial consumption of coal is expected to stay low in the coming month, as most factories will suspend operations during the Chinese New Year holidays. Thus, in our view, the domestic coal prices are unlikely to start an upward trend, but are likely to stay stable around the current levels in the foreseeable future.

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



Source: Cqcoal.com

THE FUNG BUSINESS INTELLIGENCE CENTRE

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