



China Sourcing Update

July 25, 2016

Energy Costs

1. Crude prices drop

In line with the movement of global crude prices, China's crude prices trended downward during late June to mid-July.¹ For example, the Daqing² crude price fell from US\$ 41.8 per barrel on 22 June to US\$ 37.4 per barrel on 20 July (see exhibit 1).

The decline in global oil prices was mainly caused by the market turmoil and uncertainty created by the 'Brexit' decision. The Brent crude, the international oil benchmark, fell sharply from US\$ 50.91 per barrel on 23 June to US\$ 47.16 per barrel on 25 June in the wake of the 'Brexit' vote results. Although oil prices rebounded in the following days as 'Brexit' fears temporarily eased, concerns over the impact of the 'Brexit' on global trade and growth dragged down oil prices again during early to mid-July.

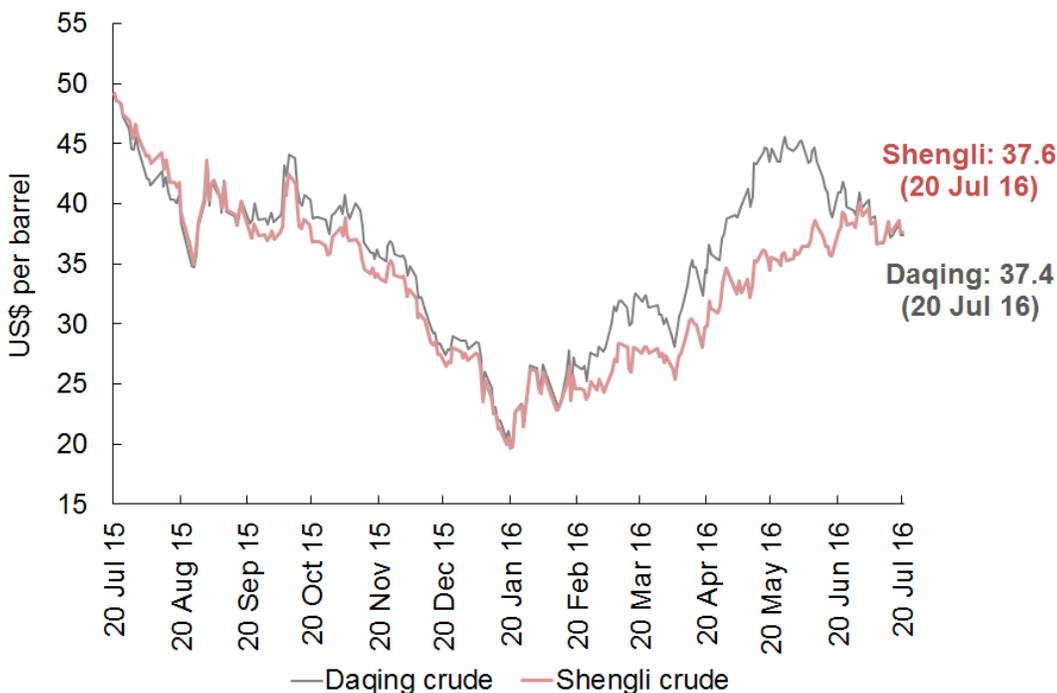
Besides, the lingering oversupply of crude also put downward pressure on global crude prices. According to secondary sources quoted by the *Monthly Oil Market Report* published by the Organization of the Petroleum Exporting Countries (OPEC) on 12 July, crude production by the OPEC member countries increased to 32.69 million barrels per day in 2Q16, boosted by record-high production in June. Also, according to the report, the total supply excluding the OPEC crude oil production averaged 61.65 million barrels per day in 2Q16; and the world oil demand averaged 93.25 million barrels per day in the same period. Thus, there was an oversupply of about 1.1 million barrels per day in 2Q16.

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, the oversupply of crude oil is expected to last in the coming months; and the 'Brexit' decision has raised the risk of a global recession. Therefore, in our view, the crude prices are likely to stay low or even drop in the near future.

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



Source: ifeng.com

2. Wholesale price index of refined oil products rises further in June

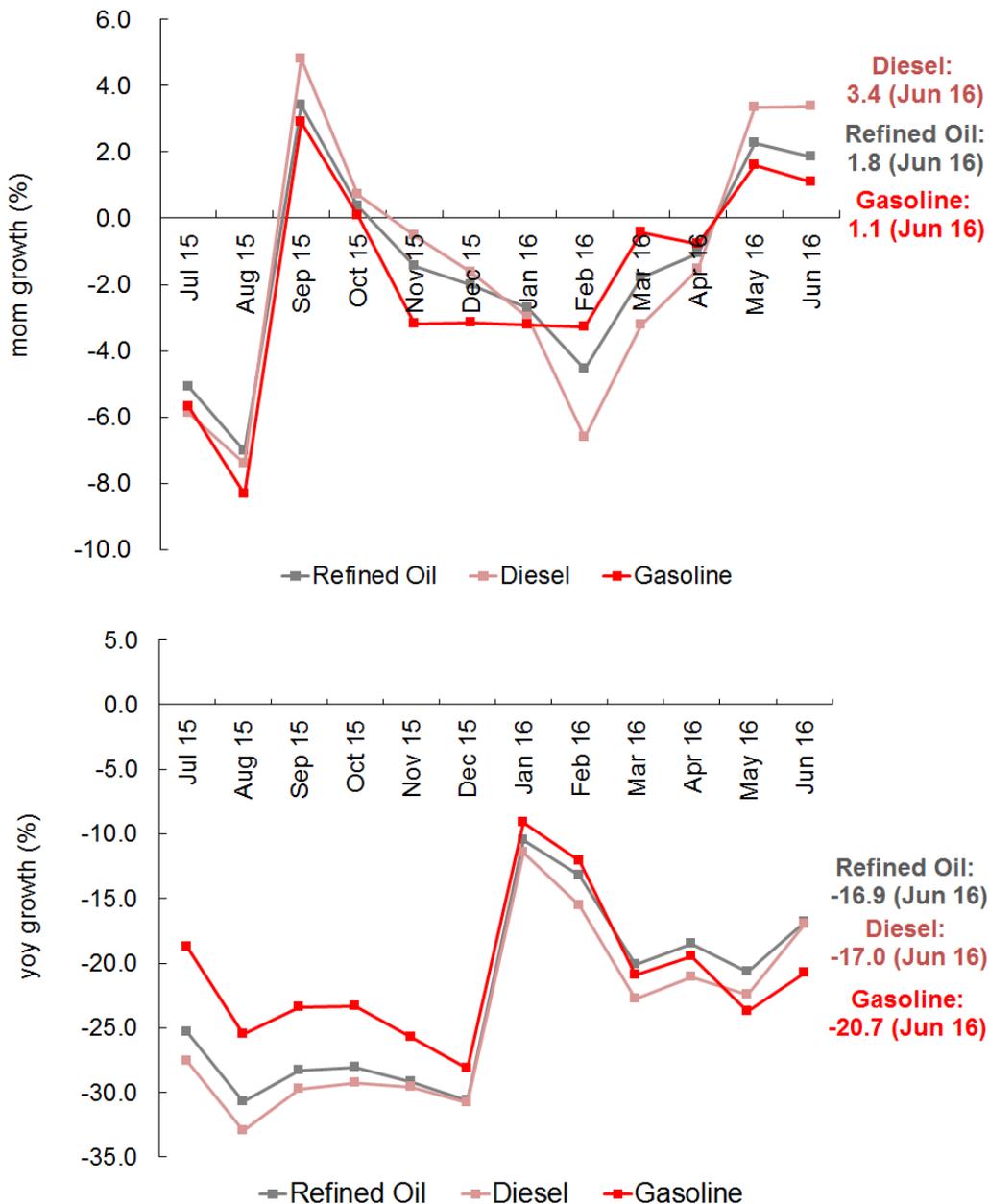
The wholesale price index of refined oil products went up by 1.8% mom in June, posting month-on-month gain for two consecutive months (see exhibit 2).³ Specifically, the wholesale price index of diesel rose by 3.4% mom, while that of gasoline gained 1.1% mom in the month.

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 upward adjustment to the maximum wholesale prices of refined oil products on 9 June, in response to the rise in global crude prices during late May to early June.

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 July, as the NDRC lowered the maximum wholesale prices of diesel and gasoline on 22 July following the recent fall 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, July 2015 to June 2016



Source: China Logistics Information Center

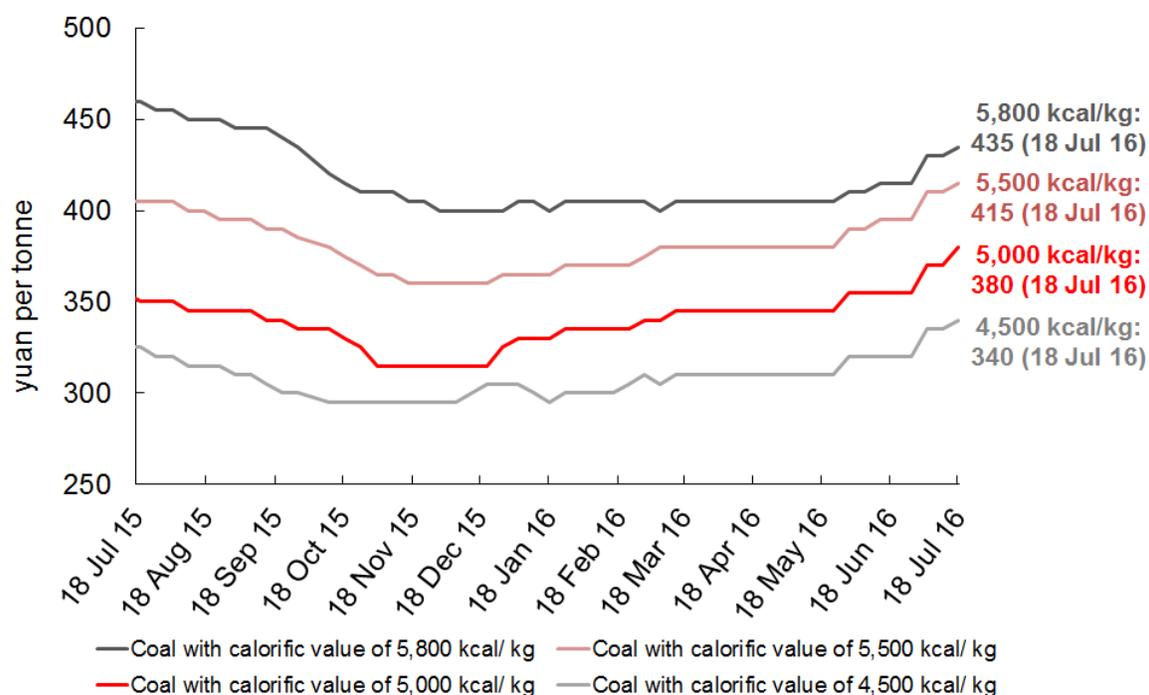
3. Benchmark Qinhuangdao coal prices go up further

The benchmark Qinhuangdao coal prices rose during early to mid-July (see exhibit 3). For instance, the price of coal with calorific value of 5,500 kcal/ kg increased from 395 yuan per tonne on 27 June to 415 yuan per tonne on 18 July.

According to the local media, the demand for coal from power enterprises picked up in the period; and the fall in domestic coal output led to a tight supply of coal in recent months, which helped support coal prices.

Looking ahead, the hot weather in the coming months will boost power consumption for air conditioning; meanwhile, the domestic supply of coal is expected to remain tight, as coal producers have reduced their production capacities. Thus, we expect the domestic coal prices to rise further in the near future.

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



Source: Cqcoal.com

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