



China Sourcing Update

June 29, 2016

Energy Costs

1. Crude prices rise, then retreat

In line with the movement of global crude prices, China's crude prices trended upward from late January to late May, and have given up some of the gains since then.¹ For example, the Daqing² crude price rose from the recent low of US\$ 20.0 per barrel on 21 January to US\$ 45.6 per barrel on 26 May, the highest level since late July last year, and then trended downward to US\$ 39.8 per barrel on 24 June (see *exhibit 1*).

We believe that the main reason for the bottoming out of global oil prices in early 2016 was the proposed freeze on oil production levels initially agreed by Saudi Arabia, Russia, Qatar and Venezuela on 16 February. Although major oil producing countries failed to reach an agreement on the oil freeze in meetings held on 17 April and 2 June, global oil production fell in the last few months, driven by non-OPEC production declines.

Besides, supply disruptions, such as terrorist attacks on oil facilities in Nigeria and wildfires in the oil-rich western provinces of Canada in May, also helped support global oil prices.

However, according to the *Monthly Oil Market Report* published by the Organization of the Petroleum Exporting Countries (OPEC) on 13 June, the global oil oversupply still persisted in 2Q16. According to secondary sources quoted by the report, the crude production from the OPEC member countries averaged 32.46 million and 32.36 million barrels per day in April and May respectively. Also, according to the report, the total

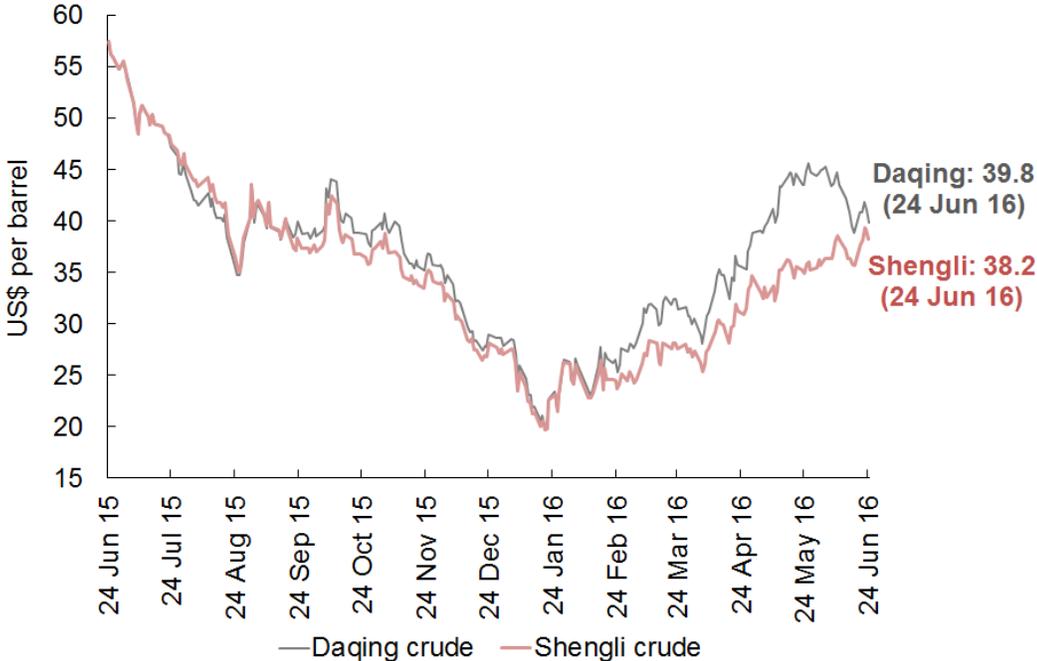
¹ From the year 2000 onwards, China's crude prices were determined with reference to global crude prices.

² Daqing Field is the largest oil field in China.

supply excluding the OPEC crude oil production is forecast to average 62.1 million barrels per day in 2Q16; and the world oil demand is forecast to average 93.26 million barrels per day in the same period. Based on the forecast, there will be an oversupply by about 1.2 million barrels per day. Thus, we believe that the recent rebound in oil price is a correction of the previous overshooting and a short-lived rally.

Looking ahead, the oversupply of crude oil is expected to last in the coming months; and the uncertainty of the European Union’s future prospects brought about by the ‘Brexit’ decision increases the possibility of a global recession. Therefore, the crude prices are unlikely to rise further, in our view.

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



Source: ifeng.com

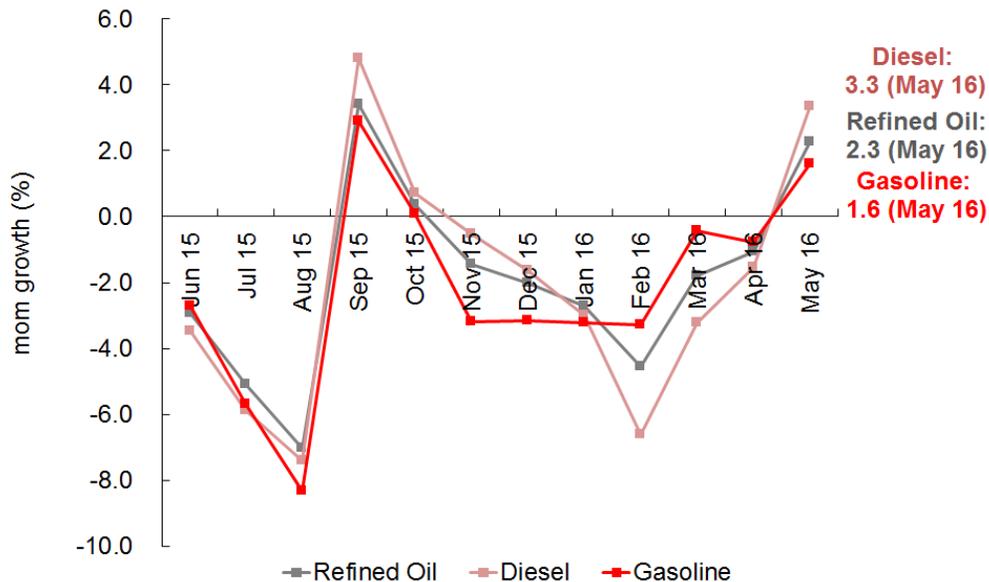
2. Wholesale price index of refined oil products rebounds in May

After having fallen for six consecutive months, the wholesale price index of refined oil products rebounded by 2.3% mom in May (see *exhibit 2*).³ Specifically, the wholesale price index of diesel rose by 3.3% mom, while that of gasoline gained 1.6% mom in the month.

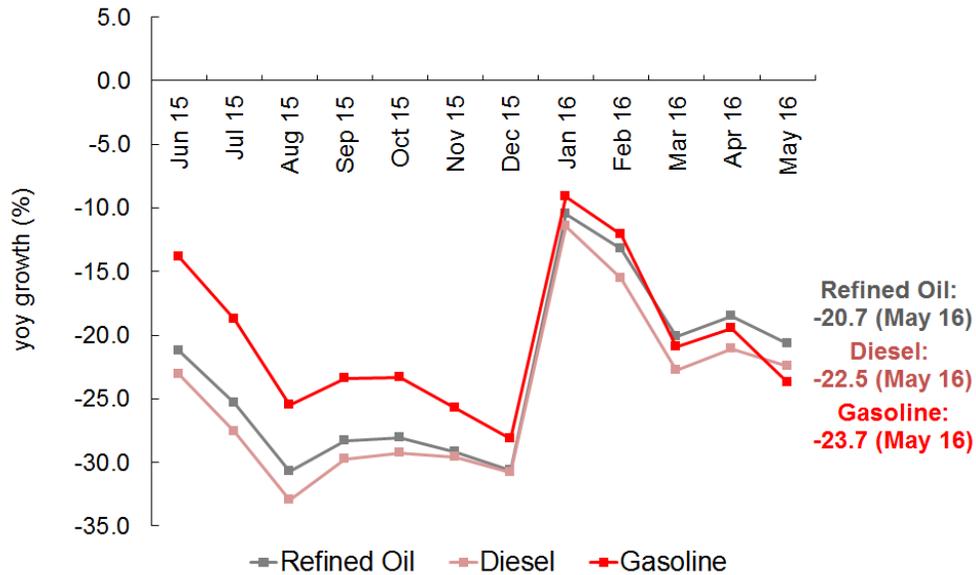
The movement of the price index in the month was mainly driven by the government moves to adjust the wholesale prices of refined oil products. The National Development and Reform Commission (NDRC) made upward adjustments to the wholesale prices of refined oil products on 12 May and 26 May, in response to the further rise in global crude prices in May.

Looking ahead, we expect the wholesale price index of refined oil products to rise further in June, as the NDRC raised the maximum prices of diesel and gasoline again on 9 June. According to the pricing mechanism of 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, June 2015 to May 2016



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



Source: China Logistics Information Center

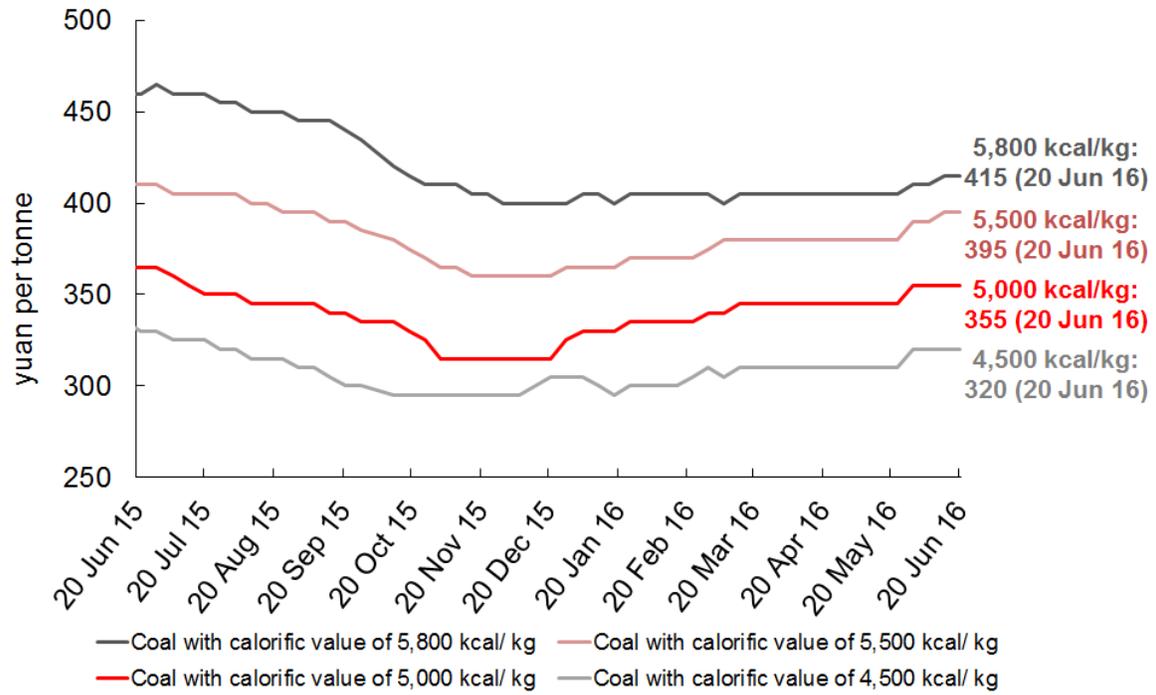
3. Benchmark Qinhuangdao coal prices rise

The benchmark Qinhuangdao coal prices have edged up since late May (see exhibit 3). For instance, the price of coal with calorific value of 5,500 kcal/ kg increased from 380 yuan per tonne on 23 May to 395 yuan per tonne on 20 June, the highest level since early September last year.

According to the local media, the demand for coal from power enterprises has picked up lately, boosted by the hot weather in southern China. Moreover, coal producers' efforts to cut their production capacities have led to a yoy drop in coal output by 8.4% in the first five months of the year, which has helped support the coal prices.⁴ Looking ahead, we expect that the domestic coal prices may continue its rebound in the near future.

⁴ http://www.stats.gov.cn/tjsj/zxfb/201606/t20160613_1366538.html

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



Source: Cqcoal.com

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