



China Sourcing Update

May 10, 2016

Energy Costs

1. Crude prices are on an upward trend

In line with the movement of global crude prices, China's crude prices have trended upward since late January.¹ For example, the Daqing² crude price rose from the recent low of US\$ 20.0 per barrel on 21 January to US\$ 39.5 per barrel on 5 May, the highest level since mid-November last year (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. The proposed agreement was aimed at capping the crude oil output at January levels.³ This can be viewed as the first step towards stabilization of the crude oil market.

Further steps are needed to realize the freeze on oil outputs. A meeting among major oil producing countries was held in Doha on 17 April to discuss the details of the freeze. However, the oil producing countries failed to reach an agreement in the meeting, according to media report.⁴

Despite such a failure, we believe that oil producers have strong incentives to take moves to stabilize oil prices in coming future. It is expected that member countries of the Organization of the Petroleum Exporting Countries (OPEC) will discuss the oil production freeze again in their meeting in June. If oil producing countries are able to reach an agreement in June, the crude prices are likely to rise further, in our view.

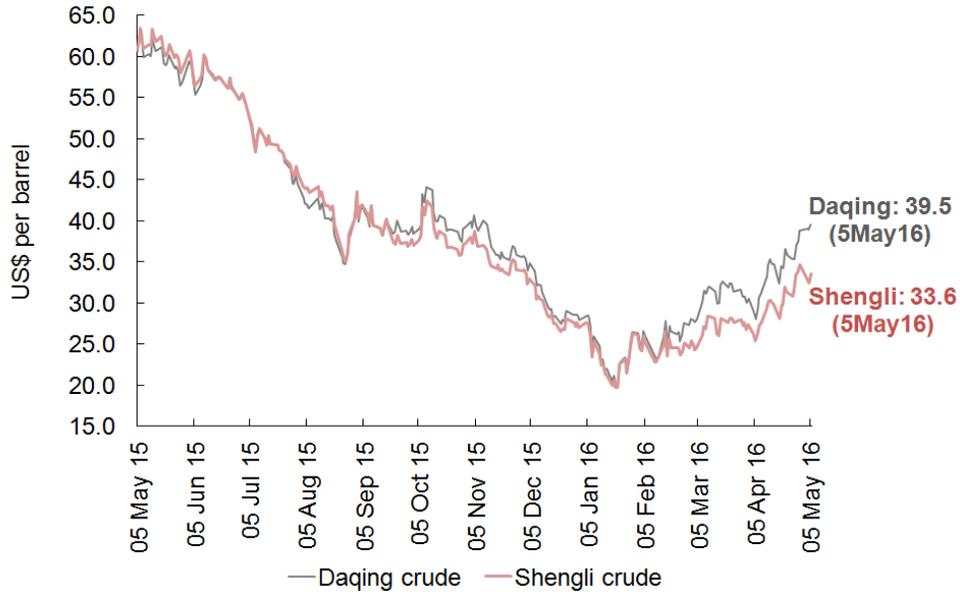
¹ From the year 2000 onwards, China's crude prices were determined with reference to global crude prices.

² Daqing Field is the largest oil field in China.

³ <http://www.bloomberg.com/news/articles/2016-02-16/saudi-arabia-and-russia-agree-oil-output-freeze-in-qatar-talks>

⁴ <http://www.reuters.com/article/us-oil-meeting-draft-idUSKCN0XE02Y>

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



Source: ifeng.com

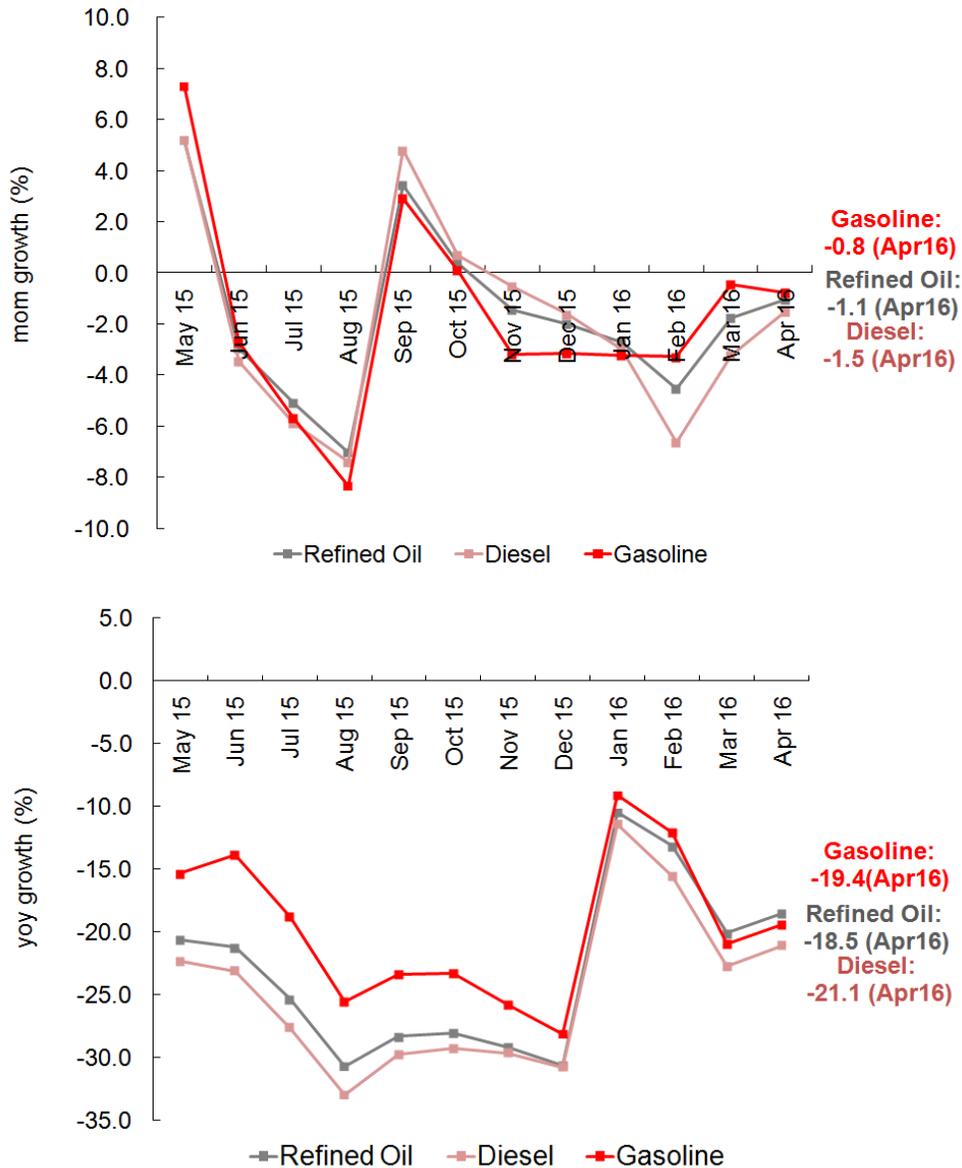
2. Wholesale price index of refined oil products falls in April

The wholesale price index of refined oil products dropped by 1.1% mom in April (see *exhibit 2*).⁵ Specifically, the wholesale price index of diesel fell by 1.5% mom, while that of gasoline slid 0.8% mom in the month.

Looking ahead, we expect that the wholesale price index of refined oil products will bottom out soon, as the government is set to raise the maximum prices of diesel and gasoline due to the recent rise in the global crude prices. 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.

⁵ The index is compiled by the China Logistics Information Center (CLIC).

Exhibit 2: China's wholesale price indices of refined oil products, May 2015 to April 2016



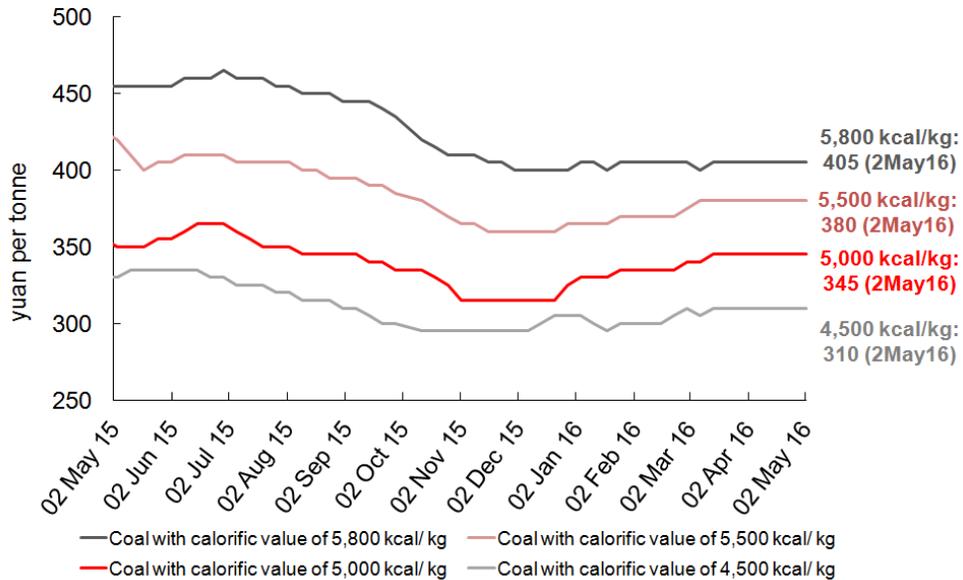
Source: China Logistics Information Center

3. Benchmark Qinhuangdao coal prices stay stable

The benchmark Qinhuangdao coal prices rose slightly in the second week of March, and have stayed stable since then (see exhibit 3). For instance, the price of coal with calorific value of 5,800 kcal/ kg increased from 400 yuan per tonne on 7 March to 405 yuan per tonne on 14 March, and stayed at the same level until 2 May.

According to the local media, the demand for coal from power enterprises has been weak lately; meanwhile, major coal producers have striven to cut industrial capacity, an important task set by the central government, which has led to a drop in coal output. Looking ahead, we expect that the domestic coal prices will stay stable in the foreseeable future.

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



Source: Cqcoal.com

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