



China Sourcing Update

October 3, 2016

Energy Costs

1. Crude prices fluctuate in September

In line with the movement of global crude prices, China's crude prices trended upward in early September and gave up most of the gains in mid-September, before rising sharply in late September.¹ For example, the Daqing² crude price rose from the recent low of US\$ 37.6 per barrel on 2 September to US\$ 41.9 per barrel on 9 September, and then trended downward to US\$ 38.6 per barrel on 20 September, before rebounding to US\$ 40.9 per barrel on 29 September (*see exhibit 1*).

The main reasons for the rise in global oil prices in early September were the speculation that Russia and members of the Organization of the Petroleum Exporting Countries (OPEC) would agree on an output freeze soon, and an unexpected drop in the commercial crude oil inventories (excluding those in the Strategic Petroleum Reserve) in the US during the week ended 2 September.

In mid-September, global oil prices fell as the OPEC and the International Energy Agency made gloomy predictions about the oil market, which suggested that the lingering oversupply of crude oil may persist for a longer time than initially anticipated.

On 28 September, the OPEC announced the first planned output cut in eight years in an attempt to lift global oil prices up. Under the agreement, OPEC oil production is expected to reduce to a range of 32.5 to 33 million barrels per day, down from the current level of 33.5 million barrels per day. Although full details of the deal remain to be

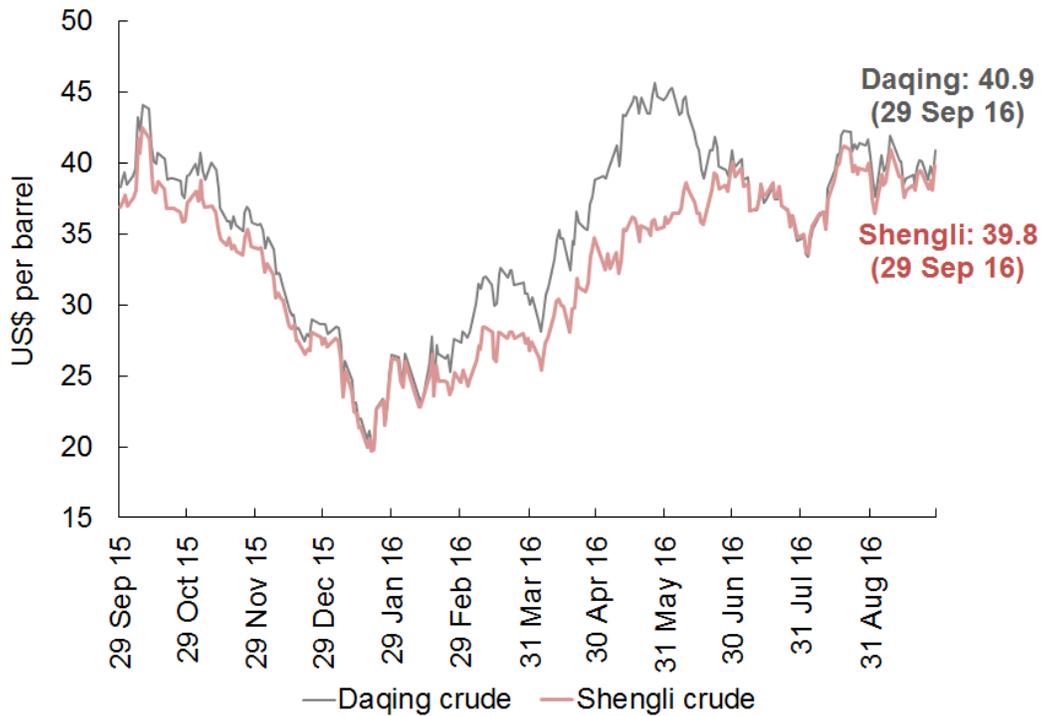
¹ From the year 2000 onwards, China's crude prices were determined with reference to global crude prices.

² Daqing Field is the largest oil field in China.

worked out in OPEC's next meeting in November, global oil prices jumped on the announcement.

Looking ahead, there are still doubts as to whether the OPEC can finalise the deal in November and, if successful, whether the output cut can substantially mitigate the global oversupply of crude oil. All in all, we do not expect the oil prices to rise further in the foreseeable future.

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



Source: ifeng.com

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

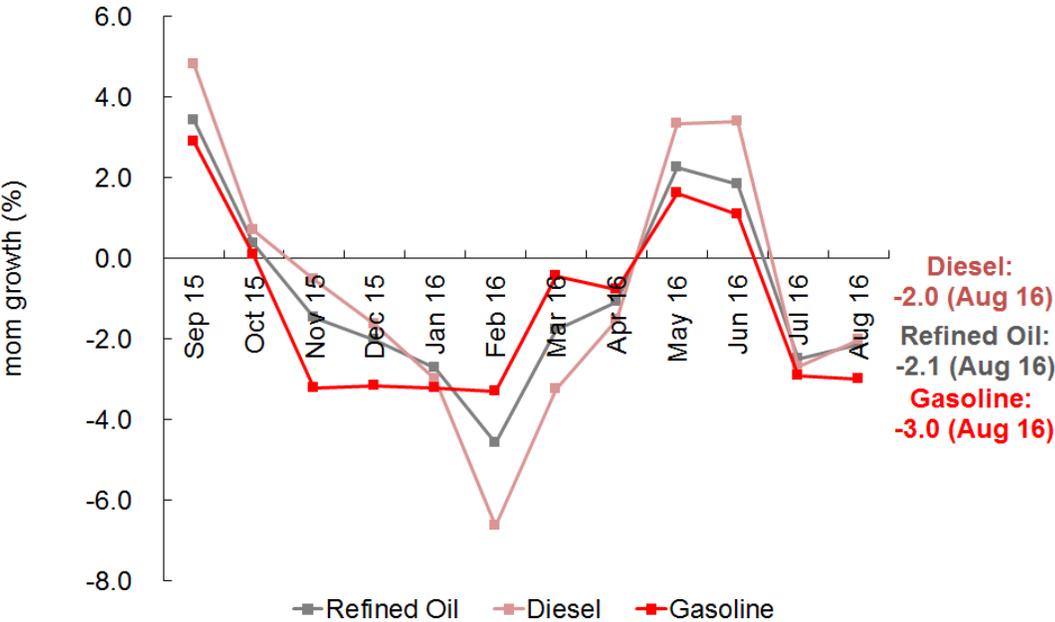
The wholesale price index of refined oil products went down by 2.1% mom in August, posting a month-on-month decline for two consecutive months (see exhibit 2).³ Specifically, the wholesale price index of diesel fell by 2.0% mom, while that of gasoline dropped by 3.0% mom in the month.

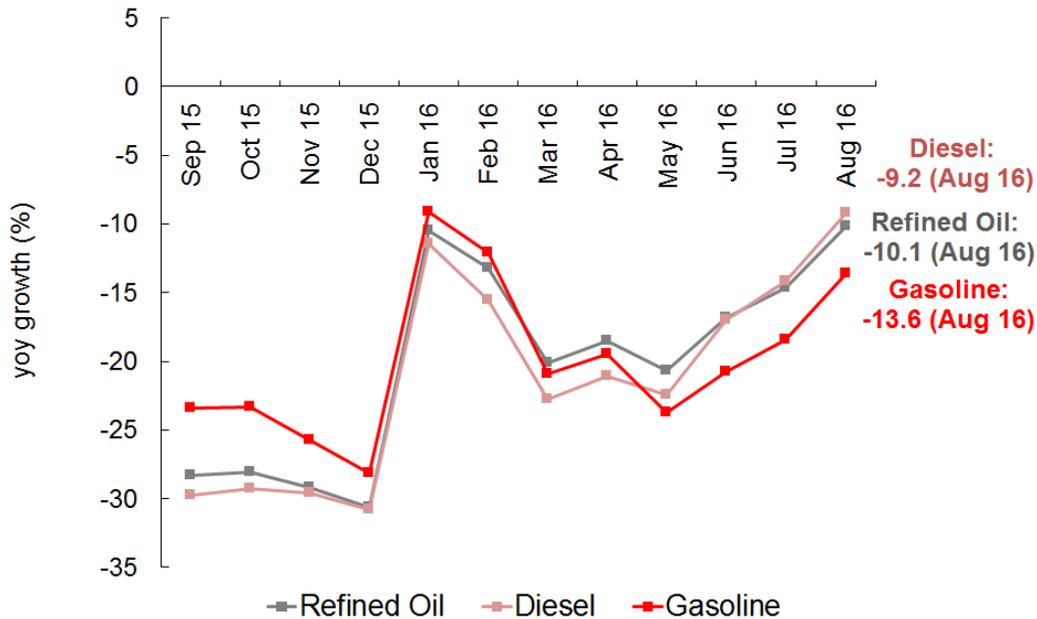
³ The index is compiled by the China Logistics Information Center (CLIC).

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 5 August, in response to the drop 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. In line with the movement of global crude prices, the NDRC raised the maximum wholesale prices of diesel and gasoline by 200 yuan per tonne and 205 yuan per tonne respectively on 2 September and then lowered the prices by 150 yuan per tonne and 155 yuan per tonne respectively on 19 September. All in all, we expect the wholesale price index of refined oil products to go up slightly in September.

Exhibit 2: China’s wholesale price indices of refined oil products, September 2015 to August 2016





Source: China Logistics Information Center

3. Benchmark Qinhuangdao coal prices surge

The benchmark Qinhuangdao coal prices went up sharply during mid-August to late September (see exhibit 3). For instance, the price of coal with calorific value of 5,500 kcal/ kg soared from 470 yuan per tonne on 15 August to 560 yuan per tonne on 26 September, the highest level since January 2014.

According to the local media, the continued rise in domestic coal prices in recent months was mainly triggered by a tight supply of coal in China. Coal producers' efforts to reduce their production capacities led to a marked year-on-year drop in China's raw coal output in the first eight months of the year. According to the National Bureau of Statistics, raw coal production of industrial enterprises above a designated size in China fell by 10.2% yoy in January to August 2016.⁴ Moreover, the pre-winter restocking demand for coal from power producers has been strong since early September.

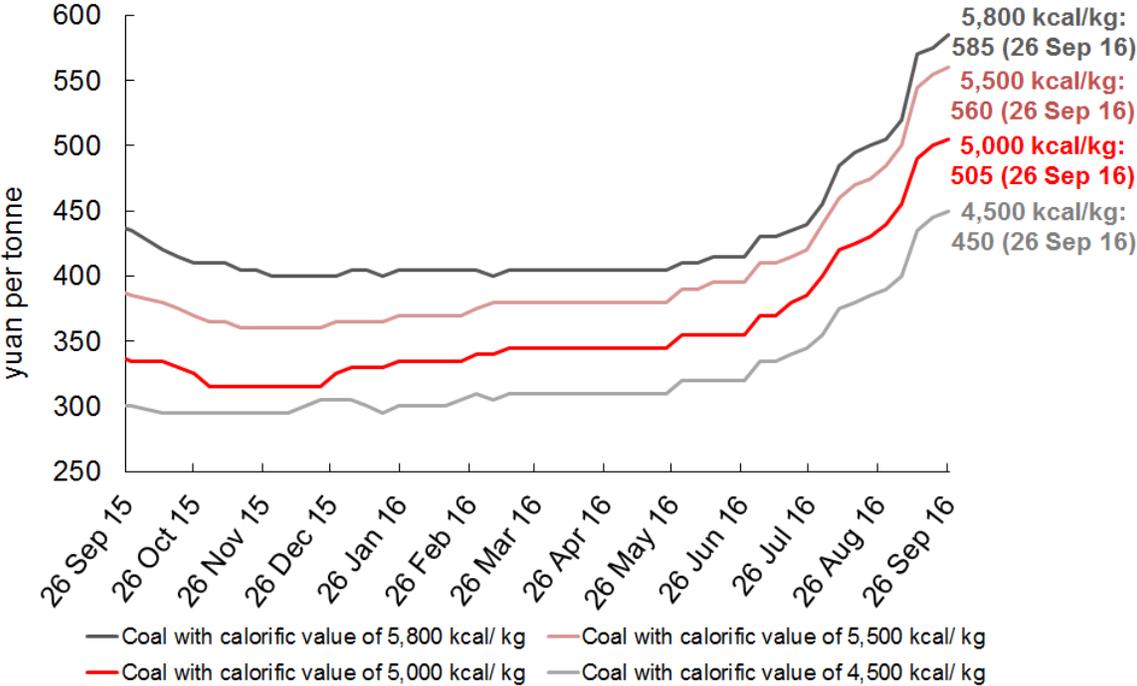
On 8 September, the NDRC held a meeting with representatives from major domestic coal producers. They came to an agreement that allows coal producers to increase coal production when coal prices reach certain levels, with the aim of preventing coal prices from surging further.⁵

⁴ http://www.stats.gov.cn/tjsj/zxfb/201609/t20160919_1401266.html

⁵ http://finance.ifeng.com/a/20160909/14869347_0.shtml

Looking ahead, the demand for coal from power producers is likely to remain strong in the near future; however, the domestic supply of coal may increase as coal producers have got the green light to raise coal output. Thus, we expect that the domestic coal prices will start to stabilize or rise only slightly in the near term.

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



Source: Cqcoal.com

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