



China Sourcing Update

September 13, 2018

Major Price Indicators

1. CPI growth speeds up in August

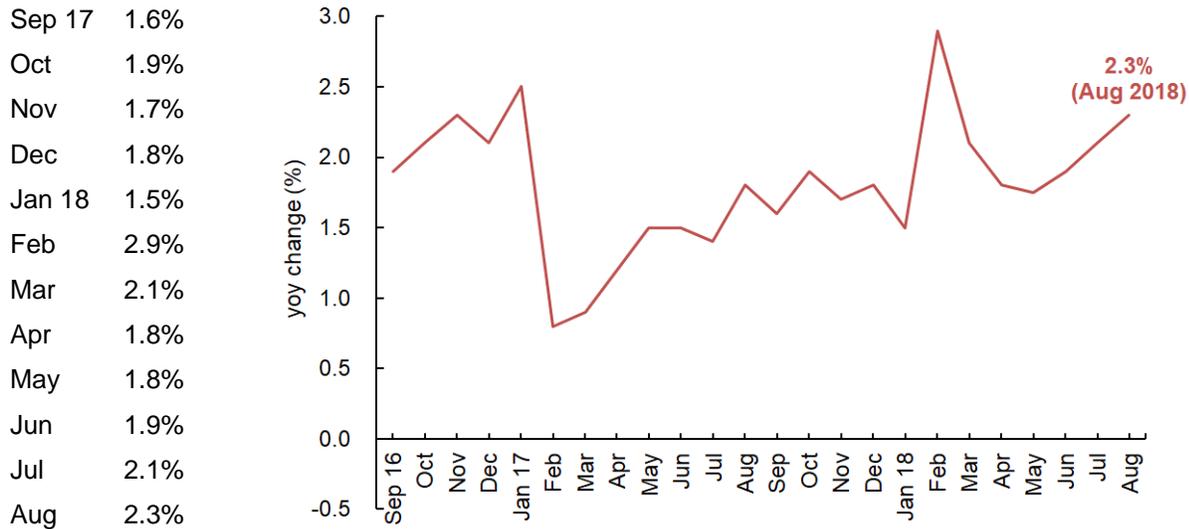
The year-on-year growth rate of China's consumer price index (CPI)¹ climbed from 2.1% in July to 2.3% in August, which was above market expectations (see exhibits 1 & 2).

The rise in the CPI growth in August was mainly attributable to a faster increase in food prices in the month: the year-on-year growth in the food component in the CPI went up from 0.5% in July to 1.7% in August. There were two major reasons for the accelerated hike in food prices. First, the Chinese government has slapped 25% additional tariffs on US\$50 billion worth of US imports, which cover mainly agricultural products (including soybeans, which are mostly used as livestock feed) and aquatic products. Second, African swine fever outbreaks have been reported in pig farms and live pig markets across six provinces since August, which have led to a tightened supply of pork. Meanwhile, the year-on-year growth in the non-food component edged up from 2.4% in July to 2.5% in August, due partly to higher fuel prices.

Looking ahead, we expect that China's CPI growth will trend slightly upward in the coming months, as the factors mentioned above will continue to put upward pressures on food prices.

¹ The CPI, compiled by the National Bureau of Statistics (NBS) of China, measures the price of a basket of goods and services purchased by a typical household. It is noteworthy that the NBS has changed the weights assigned to the various components in the CPI basket, effective from January 2016. The weight of the food component, for example, has been reduced by 3.2 ppt; the weight of the housing component has been increased by 2.2 ppt; and the weights of other components have been adjusted by around or less than 1 ppt. The impact of the re-weighting on the CPI growth was limited, according to the NBS.

Exhibit 1: China's CPI growth, September 2016 to August 2018



Source: National Bureau of Statistics, PRC

Exhibit 2: China's CPI growth by commodity, March to August 2018²

yoy growth (%)

| | Mar 18 | Apr | May | Jun | Jul | Aug |
|-----------------------------------|--------|-----|-----|-----|-----|-----|
| Clothing | 1.1 | 1.1 | 1.1 | 1.1 | 1.2 | 1.3 |
| Household articles and services | 1.6 | 1.5 | 1.5 | 1.5 | 1.6 | 1.6 |
| Education, culture and recreation | 2.2 | 2.0 | 1.9 | 1.8 | 2.3 | 2.6 |

Source: National Bureau of Statistics, PRC

2. Ex-factory prices of industrial products rise in August

The year-on-year growth in China's producer price index of industrial products (PPI) slowed from 4.6% in July to 4.1% in August (see exhibits 3 & 4).

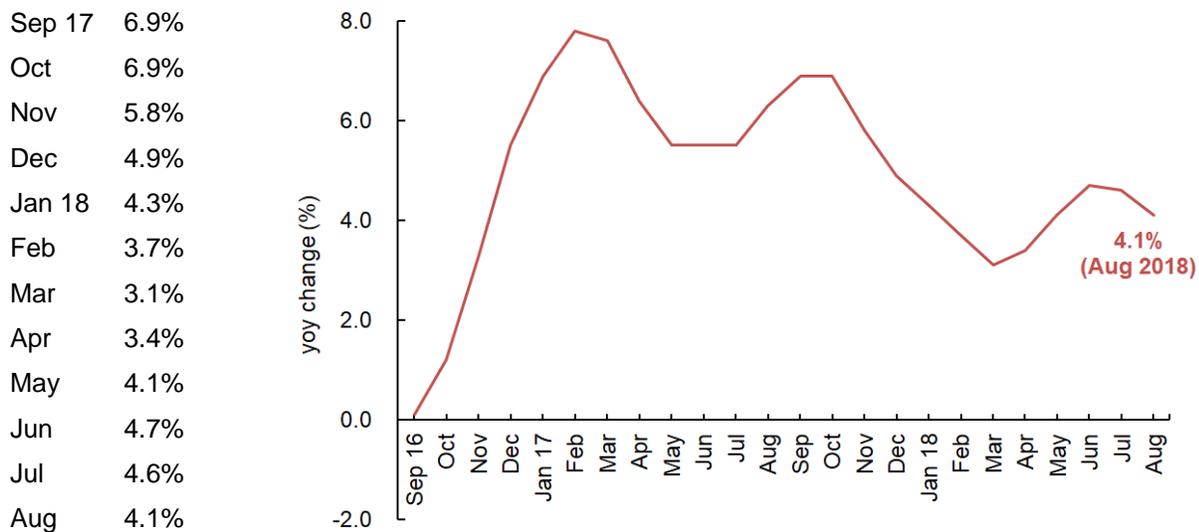
On a month-on-month basis, the PPI climbed by 0.4% in August, posting month-on-month rise for four consecutive months. The increase in the PPI in the month was caused mainly by higher ex-factory prices in the 'manufacture and processing of ferrous

² Starting from January 2016, the old category of 'household facilities, articles and maintenance services' has been re-categorized into a new category called 'household articles and services' and the category of 'other articles and services'. The old category of 'recreation, education, culture articles and services' has been re-categorized into a new category called 'education, culture and recreation' and the category of 'other articles and services'.

metals’, ‘processing of petroleum, coking, processing of nucleus fuel’ and ‘manufacture of chemical raw material and chemical products’ industries.

In our view, China’s tariffs imposed on US\$50 billion worth of US imports³ and the recent depreciation of the Chinese yuan would raise the import prices of materials and intermediate goods, putting mild inflationary pressures on ex-factory prices of industrial products. That being said, we expect that the year-on-year growth in the PPI will fall sharply in the rest of the year, due partly to a higher base for comparison in the same period last year.

Exhibit 3: China’s PPI growth, September 2016 to August 2018



Source: National Bureau of Statistics, PRC

Exhibit 4: China’s PPI growth by selected industry, March to August 2018

| | yoy growth (%) | | | | | |
|--|----------------|-----|-----|-----|-----|-----|
| | Mar 18 | Apr | May | Jun | Jul | Aug |
| Textile | 1.7 | 1.7 | 1.9 | 2.1 | 2.3 | 3.0 |
| Textile wearing apparel and ornament | 0.4 | 0.5 | 0.6 | 0.6 | 1.1 | 1.3 |
| Processing of timbers, manufacture of wood, bamboo, rattan, palm, and straw products | 1.2 | 1.6 | 1.7 | 1.9 | 2.0 | 2.2 |

Source: National Bureau of Statistics, PRC

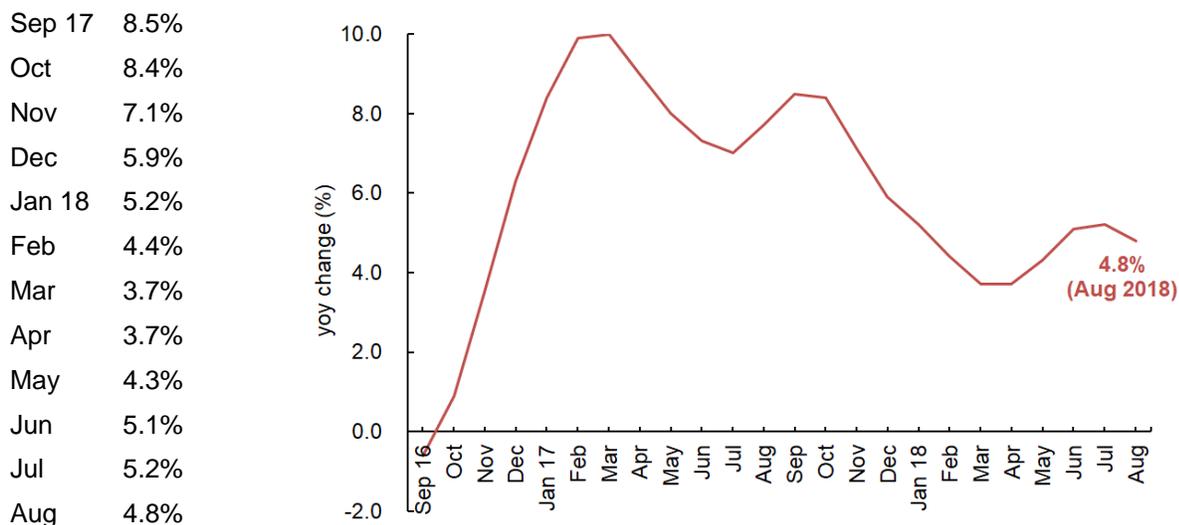
³ Of which, US\$34 billion kicked in on 6 July, and the remaining US\$16 billion took effect on 23 August.

3. Domestic prices of production inputs go up in August

The year-on-year growth rate of the purchaser price index of industrial products eased from 5.2% in July to 4.8% in August (see exhibits 5 & 6). On a month-on-month basis, the purchaser price index jumped by 0.5% in August, a much larger increase than the 0.1% growth recorded in the previous month.

In our view, the retaliatory tariffs levied on US\$50 billion worth of US goods by China⁴ and the Chinese yuan's recent weakness would lead to a rise in the prices of imported production inputs. That being said, the year-on-year growth in the purchaser price index is likely to decline sharply in the coming months till year-end, due mainly to a higher comparison base in the same period last year.

Exhibit 5: Growth of China's purchaser price index of industrial products, September 2016 to August 2018



Source: National Bureau of Statistics, PRC

⁴ Of which, US\$34 billion kicked in on 6 July, and the remaining US\$16 billion took effect on 23 August.

**Exhibit 6: China's purchaser price index of industrial products
by selected commodity, March to August 2018**

yoy growth (%)

| | Mar 18 | Apr | May | Jun | Jul | Aug |
|---------------------------------------|--------|-----|-----|-----|-----|-----|
| Fuel and power | 4.9 | 4.6 | 5.5 | 8.1 | 9.9 | 9.7 |
| Non-ferrous metal materials and wires | 6.8 | 6.4 | 7.6 | 7.9 | 5.6 | 2.5 |
| Chemical raw materials | 3.4 | 4.2 | 5.3 | 5.8 | 5.7 | 6.1 |
| Wood and pulp | 6.5 | 7.0 | 7.8 | 7.4 | 7.1 | 6.6 |
| Textile raw materials | 1.7 | 1.7 | 1.7 | 2.1 | 2.4 | 2.6 |

Source: National Bureau of Statistics, PRC

(i) Purchaser price index of fuel and power

The year-on-year growth rate of the purchaser price index of fuel and power eased to 9.7% in August from 9.9% in July (see exhibit 6).

(ii) Purchaser price index of non-ferrous metal materials and wires

The year-on-year growth rate of the purchaser price index of non-ferrous metal materials and wires registered 2.5% in August, down sharply from 5.6% in the previous month (see exhibit 6).

(iii) Purchaser price index of chemical raw materials

The purchaser price index of chemical raw materials gained 6.1% yoy in August, compared with the 5.7% yoy growth last month (see exhibit 6).

(iv) Purchaser price index of wood and pulp

The purchaser price index of wood and pulp increased at a slower pace, by 6.6% yoy, in August, after rising by 7.1% yoy in July (see exhibit 6).

(v) Purchaser price index of textile raw materials

The year-on-year growth rate of the purchaser price index of textile raw materials edged up to 2.6% in August from 2.4% in the previous month (see exhibit 6).

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