



China Sourcing Update

January 13, 2017

Major Price Indicators

1. CPI growth edges down in December

The year-on-year growth rate of China's consumer price index (CPI)¹ slowed from 2.3% in November to 2.1% in December, lower than market expectations (*see exhibit 1 and 2*).

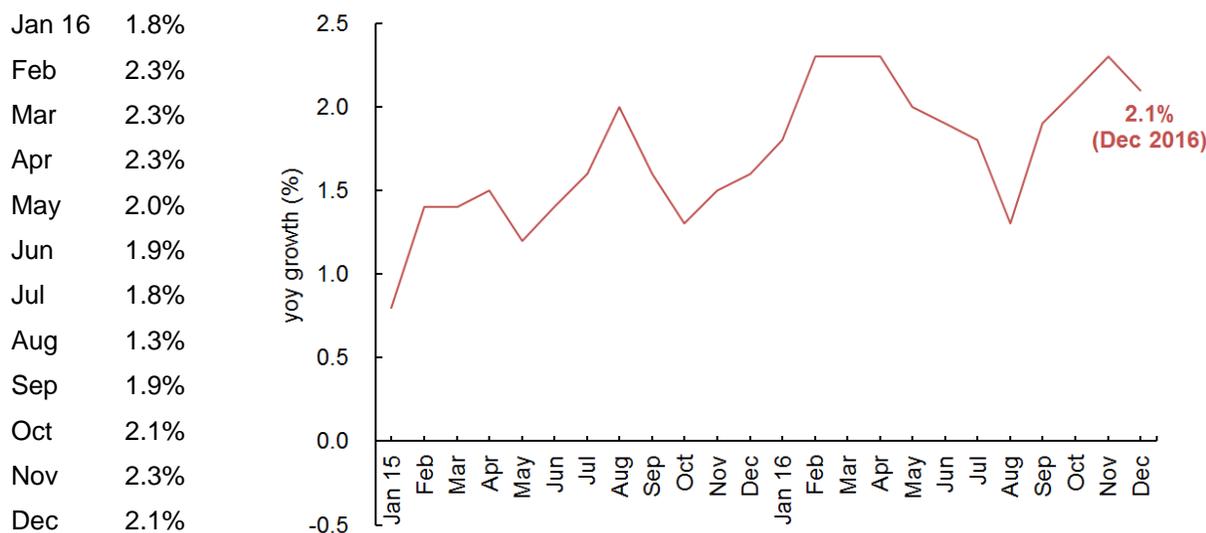
The slowdown in CPI growth in December was mainly attributable to a high comparison base in December 2015 and a slower increase in vegetable prices. The year-on-year growth in vegetable prices, a major driver of China's inflation, fell from 15.8% in November to 2.6% in December. Consequently, the year-on-year growth in the food component in the CPI also dropped from 4.0% in November to 2.4% in December. Meanwhile, the year-on-year growth in the non-food component in the CPI rose from 1.8% in November to a five-year high of 2.0% in December, driven by the rise in prices of healthcare and transportation and communication.

For 2016, China's CPI growth was 2.0% yoy, up from 1.4% yoy in 2015, but was still below the government's target of 3.0% set for the year.

Going forward, we predict that the food inflation will stay low in the near term, due to the recent stabilization of pork prices and vegetable prices; and we expect the non-food inflation to stay around the current level in the near future. Overall, in our view, the CPI growth is likely to stay soft in the coming months.

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, January 2015 to December 2016



Source: National Bureau of Statistics, PRC

Exhibit 2: China's CPI growth by commodity, July to December 2016²

yoy growth (%)

	Jul 16	Aug	Sep	Oct	Nov	Dec
Clothing	1.4	1.5	1.2	1.3	1.4	1.1
Household articles and services	0.6	0.4	0.3	0.4	0.3	0.4
Education, culture and recreation	1.6	1.3	2.0	2.1	2.2	2.3

Source: National Bureau of Statistics, PRC

2. Ex-factory prices of industrial products go up further

The year-on-year growth in China's producer price index of industrial products (PPI) jumped from 3.3% in November to a five-year high of 5.5% in December, continuing the upward trend that began in September (see exhibits 3 & 4).

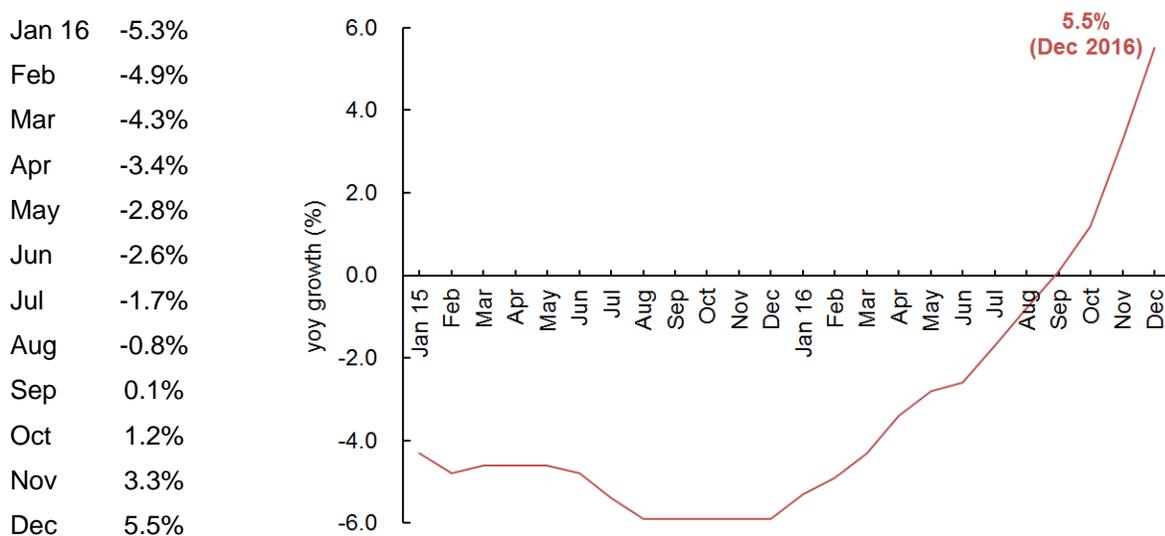
On a month-on-month basis, the PPI went up by 1.6% in December, posting month-on-month gain for six straight months. The rise in the PPI in the month was due largely to an increase in imported commodity prices boosted by a weaker yuan and a better

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'.

supply-demand balance as the demand for industrial products recovered and the effects of de-capacity further materialized.

Looking ahead, driven by the increase in prices of production inputs, the year-on-year growth in the PPI is expected to rise further in the coming months.

Exhibit 3: China's PPI growth, January 2015 to December 2016



Source: National Bureau of Statistics, PRC

Exhibit 4: China's PPI growth by selected industry, July to December 2016

yoy growth (%)

	Jul 16	Aug	Sep	Oct	Nov	Dec
Textile	-1.4	-0.8	-0.4	0.3	1.0	1.0
Textile wearing apparel and ornament	0.7	0.4	0.3	0.3	0.5	0.5
Processing of timbers, manufacture of wood, bamboo, rattan, palm, and straw products	0.4	-0.2	-0.2	0.0	0.1	0.1

Source: National Bureau of Statistics, PRC

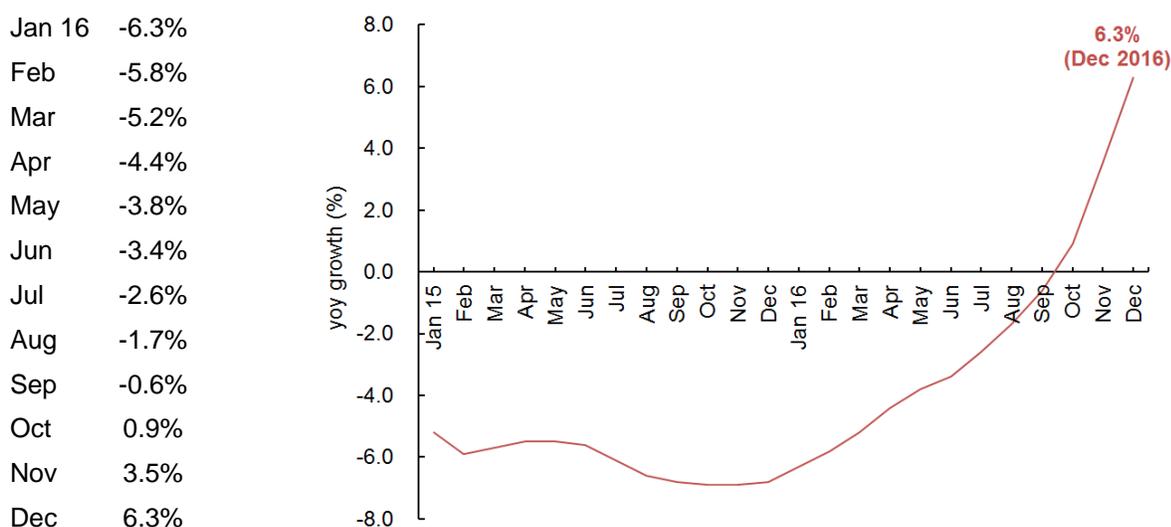
3. Domestic prices of production inputs rise further

The year-on-year growth rate of the purchaser price index of industrial products soared from 3.5% in November to 6.3% in December, the highest level since October 2011 (see exhibits 5 & 6).

On a month-on-month basis, the purchaser price index of industrial products rose markedly by 1.9% in December, posting month-on-month gain for ten consecutive months. The surge in the purchaser price index in recent months can be attributable to the increase in global commodity prices and the Chinese government's efforts in de-capacity and de-stocking, in our view.

The input prices sub-index of China's manufacturing PMI, a leading indicator of upstream prices, went up further to a five-year high of 69.6 in December, indicating that prices of production inputs have been rising strongly. Thus, we believe that the year-on-year growth rate of the purchaser price index of industrial products will rise further in the near future.

Exhibit 5: Growth of China's purchaser price index of industrial products, January 2015 to December 2016



Source: National Bureau of Statistics, PRC

Exhibit 6: China's purchaser price index of industrial products by selected commodity, July to December 2016

	yoy growth (%)					
	Jul 16	Aug	Sep	Oct	Nov	Dec
Fuel and power	-6.2	-5.0	-1.9	1.8	6.0	10.1
Non-ferrous metal materials and wires	-2.5	-0.3	0.3	2.2	9.5	14.9
Chemical raw materials	-3.6	-2.5	-1.6	-0.1	2.0	5.3
Wood and pulp	-0.8	-0.6	-0.7	-0.3	0.5	2.1
Textile raw materials	-0.4	0.1	0.1	1.0	1.8	2.5

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 jumped to 10.1% in December from 6.0% in November (see *exhibit 6*).

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

The purchaser price index of non-ferrous metal materials and wires increased at a faster pace, by 14.9% yoy, in December, after rising by 9.5% yoy in November (see *exhibit 6*).

(iii) Purchaser price index of chemical raw materials

The purchaser price index of chemical raw materials rose by 5.3% yoy in December, improving markedly from the 2.0% yoy growth in November (see *exhibit 6*).

(iv) Purchaser price index of wood and pulp

The year-on-year growth rate of the purchaser price index of wood and pulp registered 2.1% in December, up from 0.5% in November (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 went up to 2.5% in December from 1.8% in November (see *exhibit 6*).

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