



China Sourcing Update

March 20, 2017

Major Price Indicators

1. CPI growth falls sharply in February

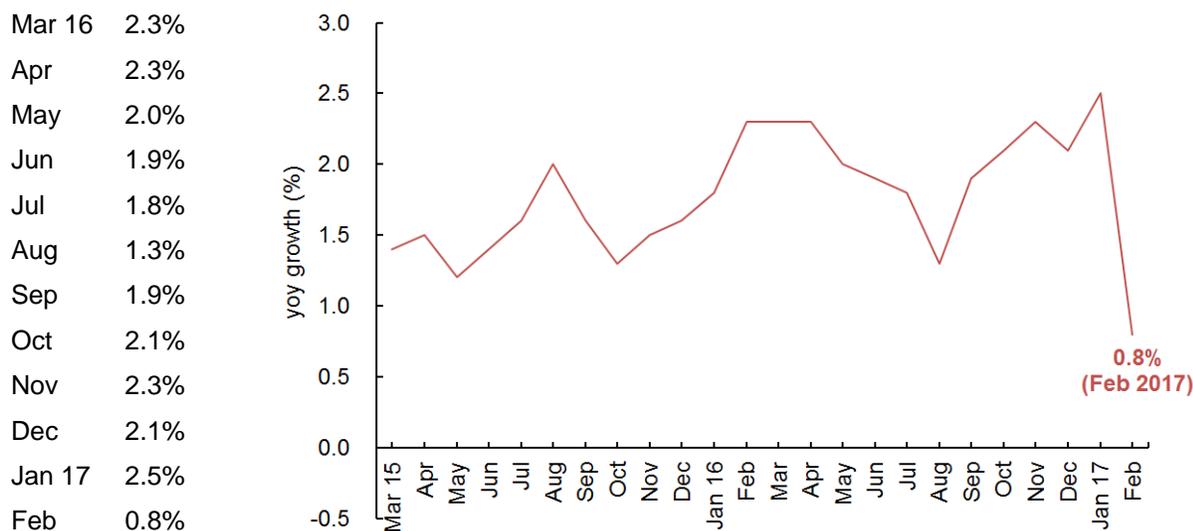
The year-on-year growth rate of China's consumer price index (CPI)¹ slumped to a two-year low of 0.8% in February from 2.5% in January, lower than market expectations (see *exhibits 1 & 2*).

The timing of the Chinese New Year this year continued to skew the CPI reading in February. The Chinese new year in 2016 was from early February, while that in 2017 began in the final week of January. Due to a higher comparison base in February last year, the year-on-year growth in the food component in the CPI went down from 2.7% in January to minus 4.3% in February, and the year-on-year growth in the non-food component dropped from a five-year high of 2.5% in January to 2.2% in February.

Looking ahead, we predict that the food inflation will stay negative in the near future due to a recent fall in food prices; meanwhile, we expect the non-food inflation to rebound in the near term. Overall, in our view, the CPI growth is likely to rise but stay below 2% in the coming couple of 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, March 2015 to February 2017



Source: National Bureau of Statistics, PRC

Exhibit 2: China's CPI growth by commodity, September 2016 to February 2017²

yoy growth (%)

	Sep 16	Oct	Nov	Dec	Jan 17	Feb
Clothing	1.2	1.3	1.4	1.1	1.1	1.2
Household articles and services	0.3	0.4	0.3	0.4	0.6	0.5
Education, culture and recreation	2.0	2.1	2.2	2.3	3.3	1.8

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) rose from 6.9% in January to 7.8% in February, the highest level in more than eight years (see exhibits 3 & 4).

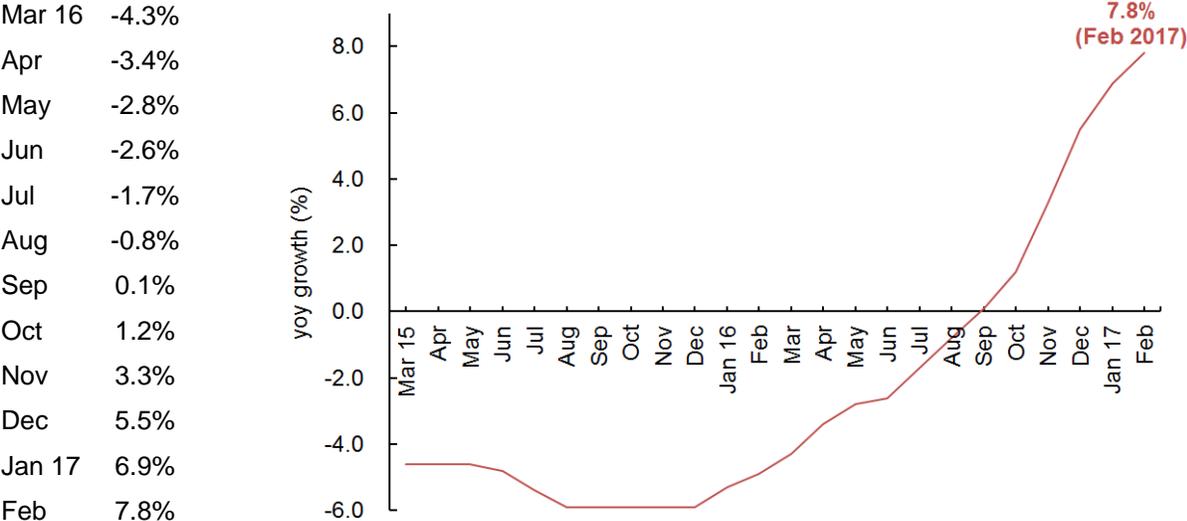
On a month-on-month basis, the PPI went up by 0.6% in February, posting month-on-month gain for eight consecutive months. We believe that the rise in the PPI in recent

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'.

months was mainly caused by an increase in imported commodity prices boosted by a weaker yuan and a better supply-demand balance as the demand for industrial products improved and the impacts of de-capacity further materialized.

Going forward, driven by the increase in prices of production inputs, the year-on-year growth in the PPI is expected to stay high in the near future.

Exhibit 3: China’s PPI growth, March 2015 to February 2017



Source: National Bureau of Statistics, PRC

Exhibit 4: China’s PPI growth by selected industry, September 2016 to February 2017

	Sep 16	Oct	Nov	Dec	Jan 17	Feb
Textile	-0.4	0.3	1.0	1.0	2.6	3.2
Textile wearing apparel and ornament	0.3	0.3	0.5	0.5	0.6	0.9
Processing of timbers, manufacture of wood, bamboo, rattan, palm, and straw products	-0.2	0.0	0.1	0.1	0.2	0.1

Source: National Bureau of Statistics, PRC

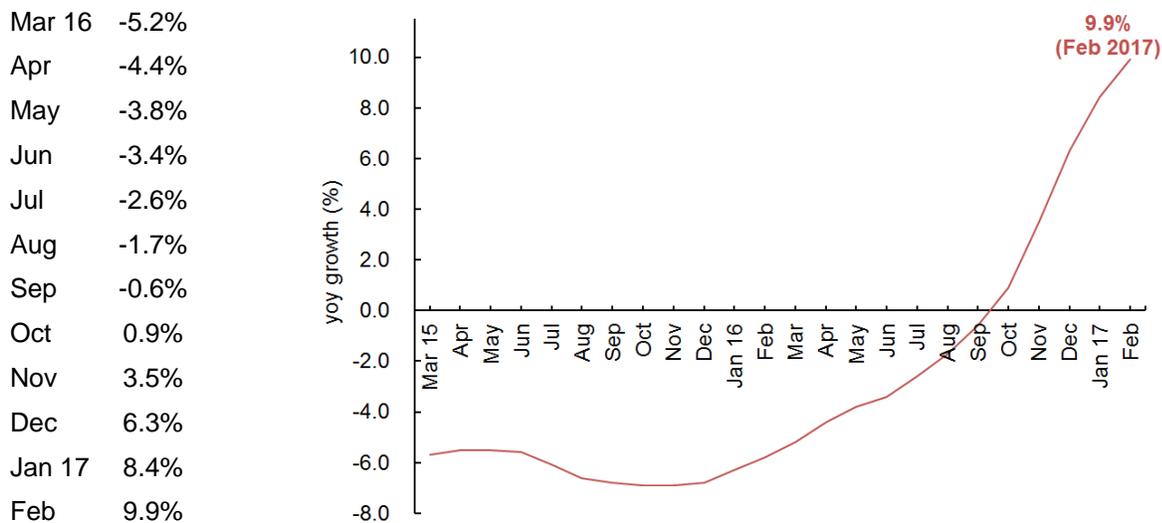
3. Domestic prices of production inputs continue to rise

The year-on-year growth rate of the purchaser price index of industrial products went up from 8.4% in January to 9.9% in February, the highest level since September 2011 (see exhibits 5 & 6).

On a month-on-month basis, the purchaser price index of industrial products rose by 0.8% in February, a smaller increase than the 1.2% growth seen in the previous month. The main reasons for the hike in the purchaser price index in recent months were a rise 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, came in at 64.2 in February. The index reading is well above the neutral level of 50, 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 stay high in the near future.

Exhibit 5: Growth of China's purchaser price index of industrial products, March 2015 to February 2017



Source: National Bureau of Statistics, PRC

**Exhibit 6: China's purchaser price index of industrial products
by selected commodity, September 2016 to February 2017**

yoy growth (%)

	Sep 16	Oct	Nov	Dec	Jan 17	Feb
Fuel and power	-1.9	1.8	6.0	10.1	14.7	18.7
Non-ferrous metal materials and wires	0.3	2.2	9.5	14.9	15.8	17.1
Chemical raw materials	-1.6	-0.1	2.0	5.3	8.1	10.3
Wood and pulp	-0.7	-0.3	0.5	2.1	3.3	4.0
Textile raw materials	0.1	1.0	1.8	2.5	3.3	4.0

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 surged to 18.7% in February from 14.7% in January (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 went up by 17.1% yoy in February, compared with the 15.8% yoy growth in January (see exhibit 6).

(iii) Purchaser price index of chemical raw materials

The purchaser price index of chemical raw materials increased at a faster pace, by 10.3% yoy, in February, after rising by 8.1% yoy in January (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 4.0% in February, up from 3.3% in January (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 4.0% in February from 3.3% in January (see exhibit 6).

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