



China Sourcing Update

August 12, 2016

Major Price Indicators

1. CPI growth eases further in July

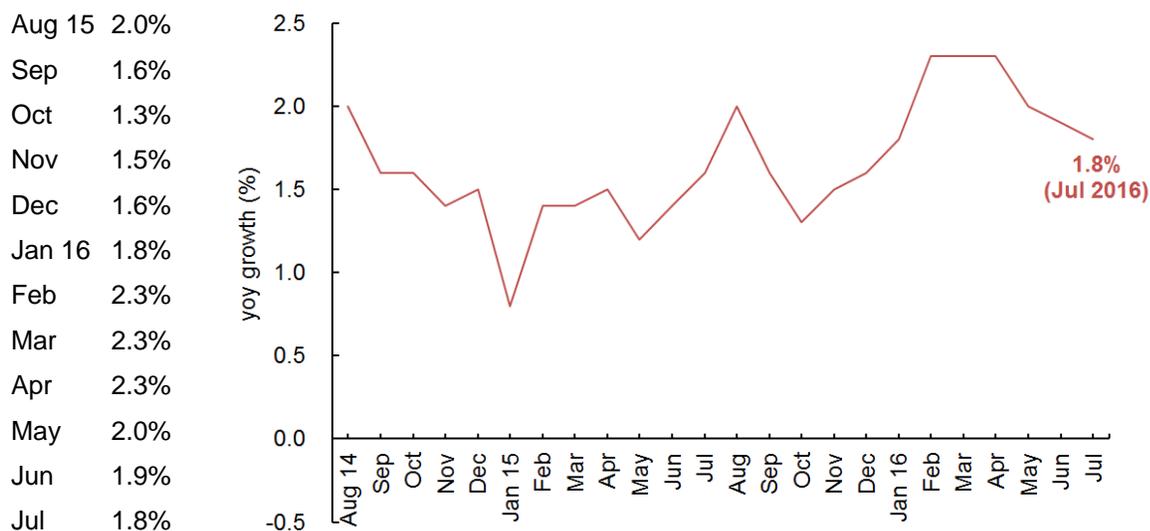
The year-on-year (yoy) growth rate of China's consumer price index (CPI)¹ dropped from 1.9% in June to a six-month low of 1.8% in July, which was in line with expectations (see exhibit 1 and 2).

The moderation in CPI growth in July was largely due to the decline in the year-on-year growth of the food component in the CPI, which came in at 3.3% in July after registering 4.6% in June. For example, the year-on-year growth of pork prices, a major driver of China's inflation, dropped from 30.1% in June to 16.1% in July. Meanwhile, the year-on-year growth of the non-food component in the CPI edged up to 1.4% in July from 1.2% in June.

Looking ahead, we expect that the non-food inflation will stay around the current level in the near future, unless the domestic demand improves significantly; and we expect the food inflation to fall further in the coming months, given the high base for comparison in the third quarter of 2015. 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, August 2014 to July 2016



Source: National Bureau of Statistics, PRC

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

yoy growth (%)

	Feb 16	Mar	Apr	May	Jun	Jul
Clothing	1.6	1.5	1.5	1.5	1.4	1.4
Household articles and services	0.3	0.4	0.5	0.6	0.6	0.6
Education, culture and recreation	0.9	1.2	1.2	1.2	1.4	1.6

Source: National Bureau of Statistics, PRC

2. Ex-factory prices of industrial products rise on month-on-month basis

The year-on-year growth of China's producer price index of industrial products (PPI)³ improved from minus 2.6% in June to minus 1.7% in July, the slowest decline in nearly two years (see exhibits 3 & 4).

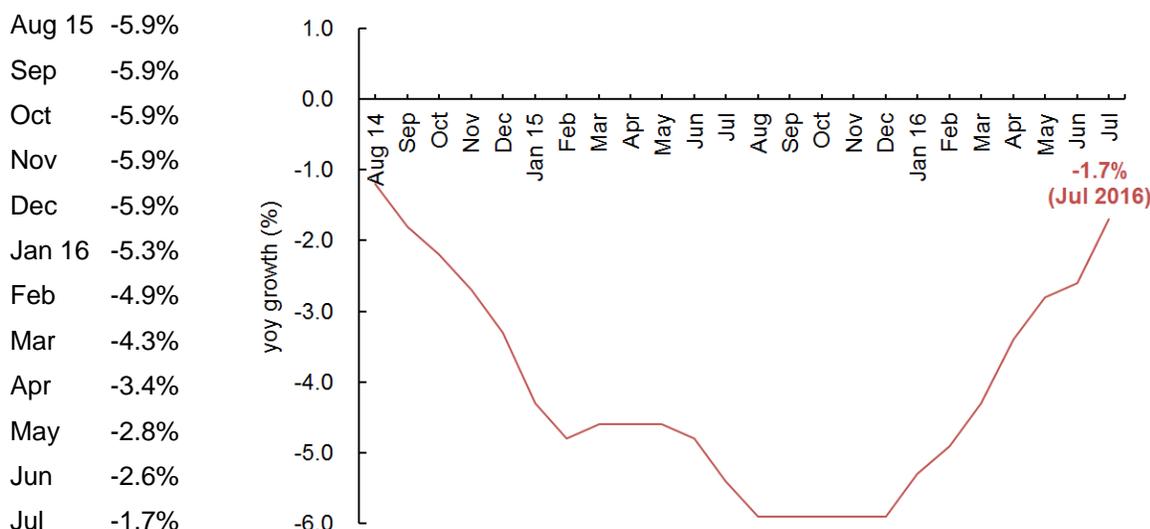
² Starting from January 2016, the old category of 'household facilities, articles and maintenance services' has been re-categorized into a new category called 'household articles and services' and the category of 'other articles and services'. The old category of 'recreation, education, culture articles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

³ The PPI, compiled by the National Bureau of Statistics of China, measures the prices of industrial products when they are sold for the first time after production.

On a month-on-month (mom) basis, the PPI rose by 0.2% in July, after dropping by 0.2% in June. The rise in the PPI in the month was mainly due to the increases in the ex-factory prices in the ferrous metals, non-ferrous metals, coal and crude oil industries in July.

Looking ahead, we expect that the year-on-year growth of the PPI will further improve in the coming months, driven by the rise in prices of production inputs.

Exhibit 3: China's PPI growth, August 2014 to July 2016



Source: National Bureau of Statistics, PRC

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

yoy growth (%)

	Feb 16	Mar	Apr	May	Jun	Jul
Textile	-2.7	-2.5	-2.5	-2.6	-2.3	-1.4
Textile wearing apparel and ornament	0.3	0.3	0.5	0.5	0.6	0.7
Processing of timbers, manufacture of wood, bamboo, rattan, palm, and straw products	-0.8	-0.8	-0.8	-0.5	-0.3	0.4

Source: National Bureau of Statistics, PRC

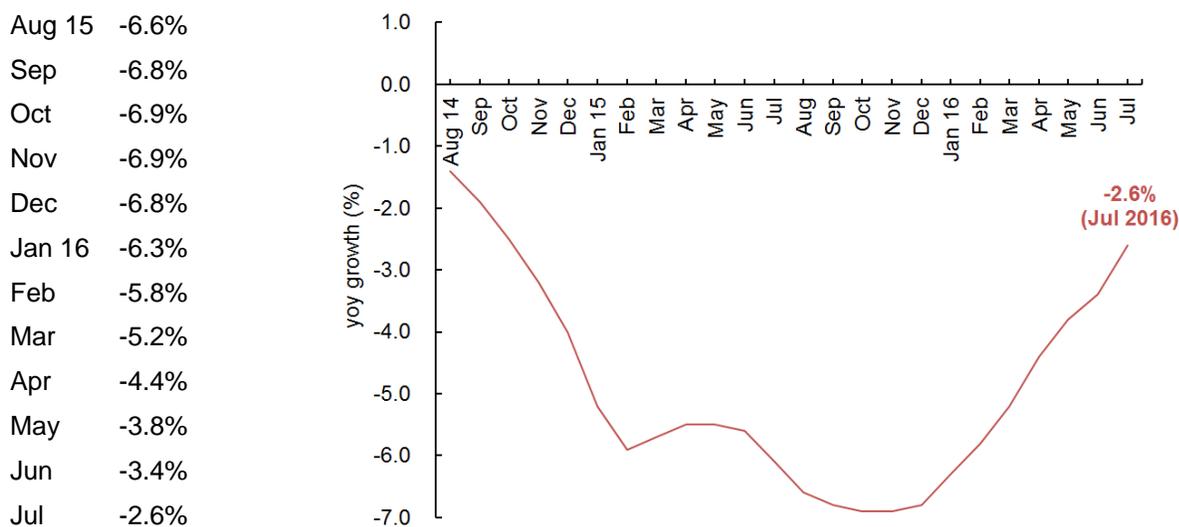
3. Domestic prices of production inputs rise further

On a month-on-month basis, the purchaser price index of industrial products went up by 0.3% in July, posting month-on-month gains for five consecutive months. The rise in the purchaser price index in recent months can be attributed to the bottoming out of global commodity prices, in our view.

The year-on-year growth rate of the purchaser price index of industrial products rose to a 21-month high of minus 2.6% in July from minus 3.4% in June (see exhibits 5 & 6).

The input prices sub-index of China's manufacturing PMI, a leading indicator of upstream prices, has stayed above the critical 50-mark for six straight months from February through July, indicating that prices of production inputs have been bottoming out. Thus, we believe that the year-on-year growth rate of the purchaser price index of industrial products will improve further in near future.

Exhibit 5: Growth of China's purchaser price index of industrial products, August 2014 to July 2016



Source: National Bureau of Statistics, PRC

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

yoy growth (%)

	Feb 16	Mar	Apr	May	Jun	Jul
Fuel and power	-10.0	-10.4	-9.4	-8.3	-7.2	-6.2
Non-ferrous metal materials and wires	-9.1	-7.2	-6.9	-7.0	-5.7	-2.5
Chemical raw materials	-5.1	-4.3	-3.9	-4.1	-4.2	-3.6
Wood and pulp	-0.6	-0.6	-0.8	-0.7	-0.8	-0.8
Textile raw materials	-1.5	-1.5	-1.4	-1.3	-1.2	-0.4

Source: National Bureau of Statistics, PRC

(i) Purchaser price index of fuel & power

The year-on-year growth rate of the purchaser price index of fuel and power fell at a slower pace, by 6.2% yoy, in July, after dropping by 7.2% yoy in June (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 dropped by 2.5% yoy in July, improving markedly from the minus 5.7% yoy growth in June (see *exhibit 6*).

(iii) Purchaser price index of chemical raw materials

The purchaser price index of chemical raw materials declined by 3.6% yoy in July, compared with a 4.2% year-on-year drop in June (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 was minus 0.8% in July, the same as in June (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 registered minus 0.4% in July, improving from minus 1.2% in June (see *exhibit 6*).

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