



China Sourcing Update

July 18, 2017

Major Price Indicators

1. CPI growth stays steady in June

The year-on-year growth rate of China's consumer price index (CPI)¹ stayed flat at 1.5% yoy in June, which was in line with market expectations (*see exhibits 1 & 2*).

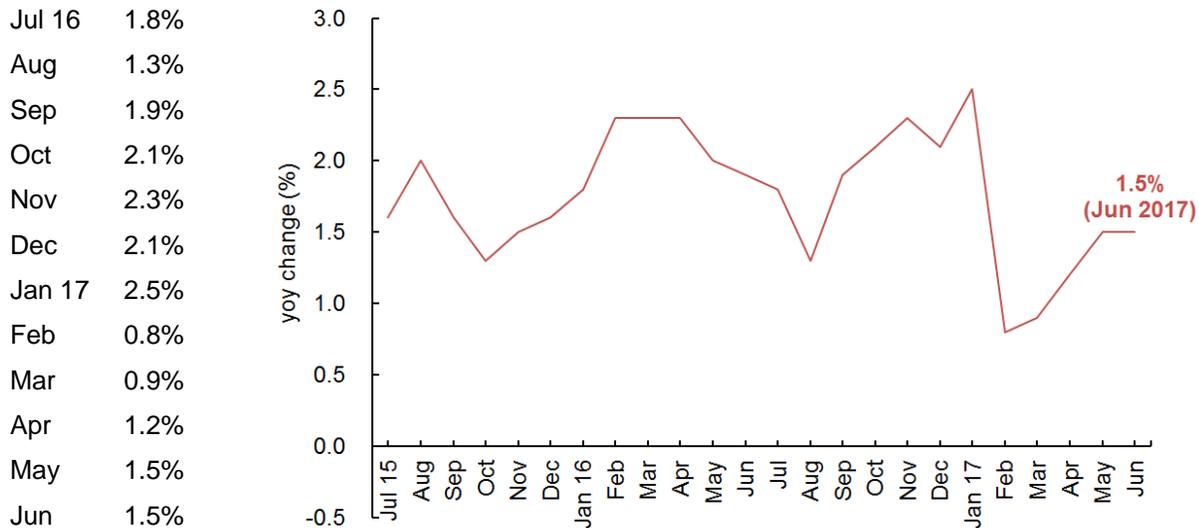
The reason for the stabilization of the CPI growth in June was that a slower decline in food prices was offset by a smaller increase in non-food prices. The year-on-year growth in vegetable prices, a major driver of China's inflation, improved markedly from minus 6.3% in May to 5.8% in June. Consequently, the year-on-year growth in the food component in the CPI picked up from minus 1.6% in May to minus 1.2% in June. Meanwhile, the year-on-year growth in the non-food component in the CPI edged down from 2.3% in May to 2.2% in June, largely due to slower price increases in transportation and health care services.

Looking ahead, we believe that the food deflation will slow further and even disappear in the near term, as the recent flooding in southern China is likely to lead to higher food prices; meanwhile, we expect the non-food inflation to ease further in the foreseeable future as the recent declines in domestic ex-factory prices will be translated into weaker

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.

non-food prices. Overall, in our view, the CPI growth is likely to rise slightly and stay below 2% yoy in the coming couple of months.

Exhibit 1: China's CPI growth, July 2015 to June 2017



Source: National Bureau of Statistics, PRC

Exhibit 2: China's CPI growth by commodity, January to June 2017²

yoy growth (%)

	Jan 17	Feb	Mar	Apr	May	Jun
Clothing	1.1	1.2	1.3	1.3	1.3	1.4
Household articles and services	0.6	0.5	0.7	0.8	1.0	1.1
Education, culture and recreation	3.3	1.8	2.3	2.6	2.6	2.5

Source: National Bureau of Statistics, PRC

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

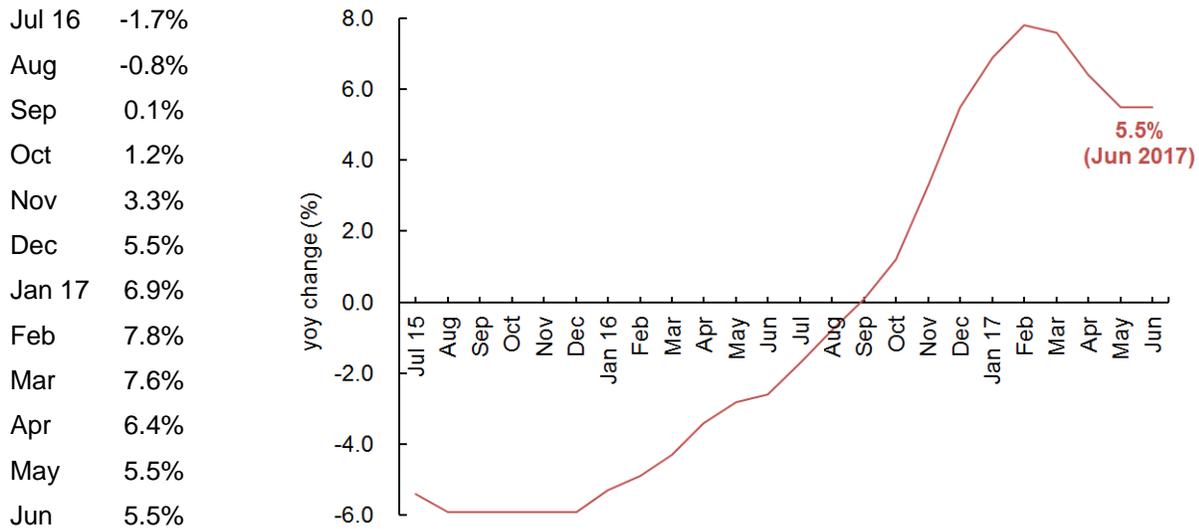
The year-on-year growth in China's producer price index of industrial products (PPI) stayed flat at 5.5% in June (see exhibits 3 & 4).

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'.

On a month-on-month basis, the PPI declined by 0.2% in June, posting month-on-month drop for three consecutive months. The fall in the PPI in June was mainly due to declines in ex-factory prices in the ‘extraction of petroleum and natural gas’, ‘mining and washing of coal’, and ‘processing of petroleum’ industries in the month.

Looking ahead, the year-on-year growth in the PPI is expected to drop slowly in the coming months, driven by the fall in the domestic prices of production inputs.

Exhibit 3: China’s PPI growth, July 2015 to June 2017



Source: National Bureau of Statistics, PRC

Exhibit 4: China’s PPI growth by selected industry, January to June 2017

	yoy growth (%)					
	Jan 17	Feb	Mar	Apr	May	Jun
Textile	2.6	3.2	3.5	3.8	3.8	3.8
Textile wearing apparel and ornament	0.6	0.9	1.0	1.0	1.0	0.9
Processing of timbers, manufacture of wood, bamboo, rattan, palm, and straw products	0.2	0.1	0.6	0.5	0.5	0.4

Source: National Bureau of Statistics, PRC

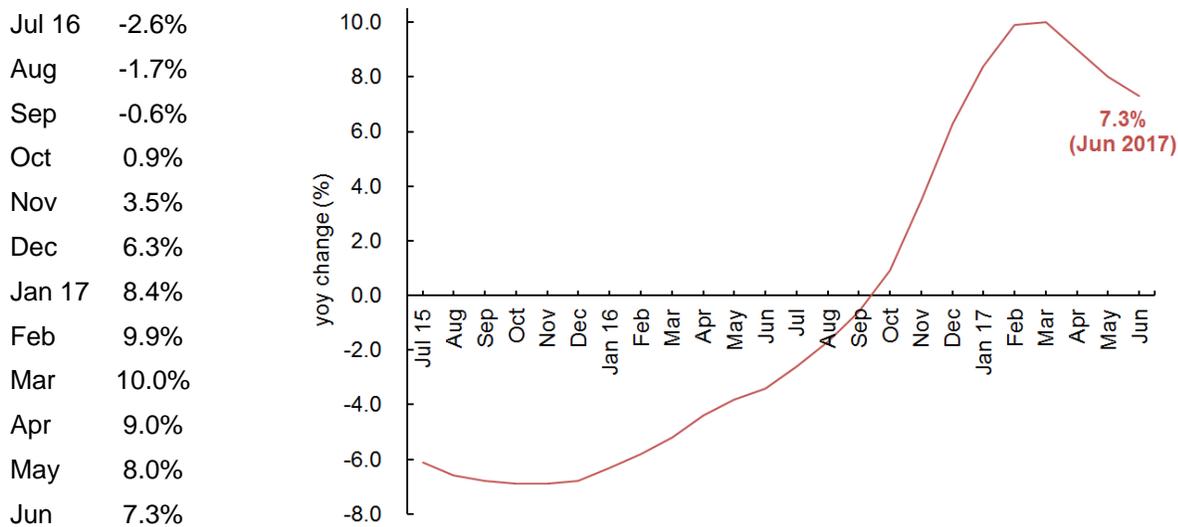
3. Domestic prices of production inputs go down on month-on-month basis

The year-on-year growth rate of the purchaser price index of industrial products dropped from 8.0% in May to 7.3% in June (see exhibits 5 & 6).

On a month-on-month basis, the purchaser price index of industrial products fell by 0.4% in May, widening from the 0.3% drop in May. We believe that the decline was due largely to the recent easing in global commodity prices.

The input prices sub-index of China’s manufacturing PMI, a leading indicator of upstream prices, came in at 50.4 in June. The index reading is higher than that of last month (47.6) and is above the neutral level of 50, indicating that domestic prices of production inputs have stabilized. Thus, we believe that the month-on-month fall in the purchaser price index of industrial products is likely to narrow in the near future. Meanwhile, the year-on-year growth rate of the purchaser price index is expected to continue to fall in the coming months.

Exhibit 5: Growth of China’s purchaser price index of industrial products, July 2015 to June 2017



Source: National Bureau of Statistics, PRC

**Exhibit 6: China's purchaser price index of industrial products
by selected commodity, January to June 2017**

yoy growth (%)

	Jan 17	Feb	Mar	Apr	May	Jun
Fuel and power	14.7	18.7	19.0	17.6	15.8	12.5
Non-ferrous metal materials and wires	15.8	17.1	16.1	15.4	13.9	14.1
Chemical raw materials	8.1	10.3	10.0	8.1	7.1	7.0
Wood and pulp	3.3	4.0	4.5	4.7	4.9	5.3
Textile raw materials	3.3	4.0	4.6	4.7	4.9	4.8

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 12.5% in June from 15.8% in May (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 14.1% yoy, in June, after rising by 13.9% yoy in May (see exhibit 6).

(iii) Purchaser price index of chemical raw materials

The year-on-year growth rate of the purchaser price index of chemical raw materials edged down to 7.0% in June from 7.1% in May (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 5.3% in June, up from 4.9% in May (see exhibit 6).

(v) Purchaser price index of textile raw materials

The purchaser price index of textile raw materials gained 4.8% yoy in June, compared with the 4.9% year-on-year growth in May (see exhibit 6).

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