



China Sourcing Update

June 13, 2017

Major Price Indicators

1. CPI growth quickens in May

The year-on-year growth rate of China's consumer price index (CPI)¹ went up from 1.2% in April to 1.5% in May, which was in line with market expectations (see exhibits 1 & 2).

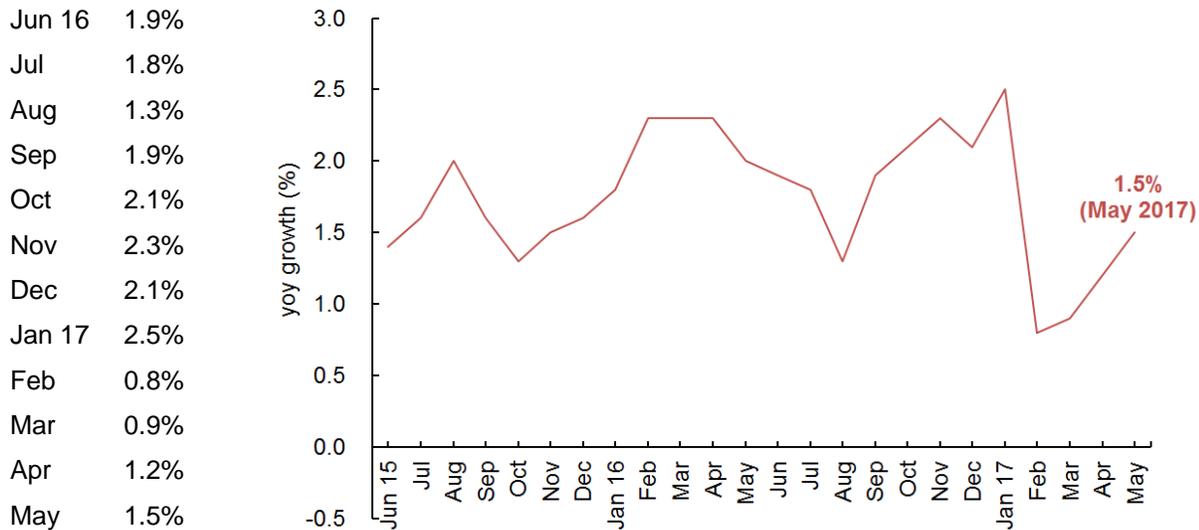
The acceleration in the CPI growth in May was mainly attributable to a slower decline in vegetable prices. The year-on-year growth in vegetable prices, a major driver of China's inflation, improved markedly from minus 21.6% in April to minus 6.3% in May. Consequently, the year-on-year growth in the food component in the CPI also picked up from minus 3.5% in April to minus 1.6% in May. Meanwhile, the year-on-year growth in the non-food component in the CPI edged down from 2.4% in April to 2.3% in May, largely due to slower price increases in tourism and transportation services.

Looking ahead, we predict that the food deflation will slow further and eventually disappear in the near future, as the year-on-year growth of vegetable prices is expected to return to the positive territory soon; meanwhile, we expect the non-food inflation to ease in the near term as the recent declines in domestic ex-factory prices will be

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.

translated into weaker non-food prices. Overall, in our view, the CPI growth is likely to rise slowly and stay below 2% in the coming months.

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



Source: National Bureau of Statistics, PRC

Exhibit 2: China's CPI growth by commodity, December 2016 to May 2017²

yoy growth (%)

	Dec 16	Jan 17	Feb	Mar	Apr	May
Clothing	1.1	1.1	1.2	1.3	1.3	1.3
Household articles and services	0.4	0.6	0.5	0.7	0.8	1.0
Education, culture and recreation	2.3	3.3	1.8	2.3	2.6	2.6

Source: National Bureau of Statistics, PRC

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

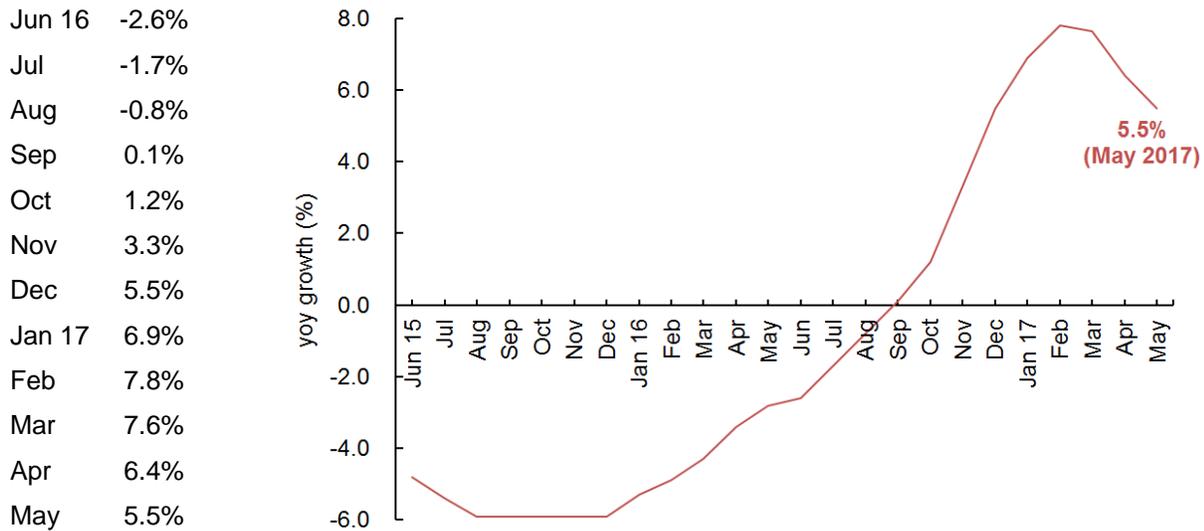
The year-on-year growth in China's producer price index of industrial products (PPI) slowed from 6.4% in April to 5.5% in May (see exhibits 3 & 4).

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 fell by 0.3% in May, narrowing from the 0.4% drop in April. The fall in the PPI in May was mainly due to declines in ex-factory prices in the ‘mining of ferrous metal ores’, ‘manufacture and processing of ferrous metals’, and ‘manufacture and processing of non-ferrous metals’ industries in the month.

Going forward, 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, June 2015 to May 2017



Source: National Bureau of Statistics, PRC

Exhibit 4: China’s PPI growth by selected industry, December 2016 to May 2017

	yoy growth (%)					
	Dec 16	Jan 17	Feb	Mar	Apr	May
Textile	1.0	2.6	3.2	3.5	3.8	3.8
Textile wearing apparel and ornament	0.5	0.6	0.9	1.0	1.0	1.0
Processing of timbers, manufacture of wood, bamboo, rattan, palm, and straw products	0.1	0.2	0.1	0.6	0.5	0.5

Source: National Bureau of Statistics, PRC

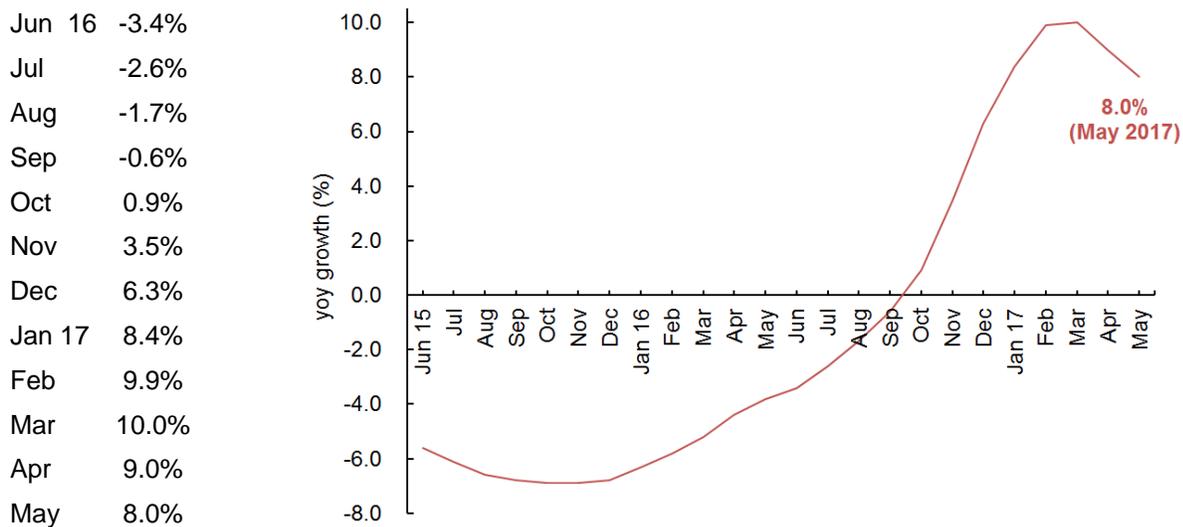
3. Domestic prices of production inputs drop on month-on-month basis

The year-on-year growth rate of the purchaser price index of industrial products went down from 9.0% in April to 8.0% in May (see exhibits 5 & 6).

On a month-on-month basis, the purchaser price index of industrial products fell by 0.3% in April, posting month-on-month drop for two consecutive months. We believe that the decline indicates that the rebound in the domestic prices of production inputs was over, following 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 47.6 in May. The index reading is below the neutral level of 50, indicating that domestic prices of production inputs have been falling. Thus, we believe that the year-on-year growth rate of the purchaser price index of industrial products is likely to fall further in the coming months.

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



Source: National Bureau of Statistics, PRC

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

yoy growth (%)

	Dec 16	Jan 17	Feb	Mar	Apr	May
Fuel and power	10.1	14.7	18.7	19.0	17.6	15.8
Non-ferrous metal materials and wires	14.9	15.8	17.1	16.1	15.4	13.9
Chemical raw materials	5.3	8.1	10.3	10.0	8.1	7.1
Wood and pulp	2.1	3.3	4.0	4.5	4.7	4.9
Textile raw materials	2.5	3.3	4.0	4.6	4.7	4.9

Source: National Bureau of Statistics, PRC

(i) Purchaser price index of fuel and power

The purchaser price index of fuel and power increased at a slower pace, by 15.8% yoy, in May, after rising by 17.6% yoy in April (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 eased to 13.9% in May from 15.4% in April (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 registered 7.1% in May, down from 8.1% in April (see exhibit 6).

(iv) Purchaser price index of wood and pulp

The purchaser price index of wood and pulp gained 4.9% yoy in May, compared with the 4.7% yoy growth in April (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 4.9% in May from 4.7% in April (see exhibit 6).

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