



China Sourcing Update

June 21, 2018

Major Price Indicators

1. CPI growth stays steady in May

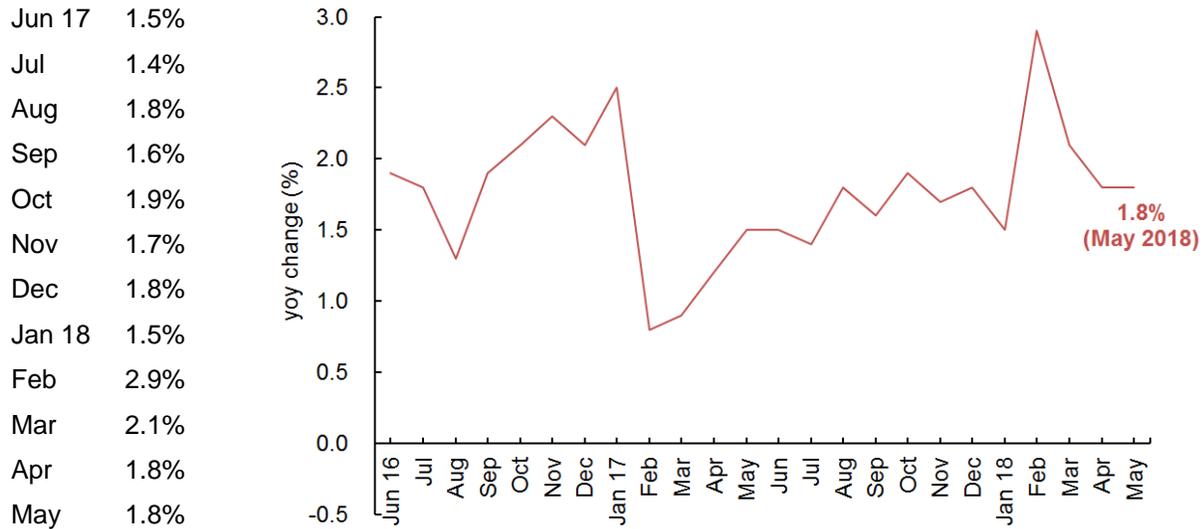
The year-on-year growth rate of China's consumer price index (CPI)¹ stayed flat at 1.8% yoy in May, which was in line with market expectations (see exhibits 1 & 2).

The reason for the stabilization of the CPI growth in May was that a drop in food inflation was offset by a slight rise in non-food inflation. The year-on-year growth in the food component in the CPI went down from 0.7% in April to 0.1% in May, due largely to a fall in pork and fruit prices. Meanwhile, the year-on-year growth in the non-food component edged up from 2.1% in April to 2.2% in May.

Looking ahead, we believe that the CPI growth will stay stable or trend slightly upward in the coming months, as food prices have shown signs of bottoming out lately.

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, June 2016 to May 2018



Source: National Bureau of Statistics, PRC

Exhibit 2: China's CPI growth by commodity, December 2017 to May 2018²

yoy growth (%)

| | Dec 17 | Jan 18 | Feb | Mar | Apr | May |
|-----------------------------------|--------|--------|-----|-----|-----|-----|
| Clothing | 1.3 | 1.4 | 1.1 | 1.1 | 1.1 | 1.1 |
| Household articles and services | 1.6 | 1.5 | 1.8 | 1.6 | 1.5 | 1.5 |
| Education, culture and recreation | 2.1 | 0.9 | 3.7 | 2.2 | 2.0 | 1.9 |

Source: National Bureau of Statistics, PRC

2. Ex-factory prices of industrial products go up in May

The year-on-year growth in China's producer price index of industrial products (PPI) accelerated from 3.4% in April to 4.1% in May (see exhibits 3 & 4).

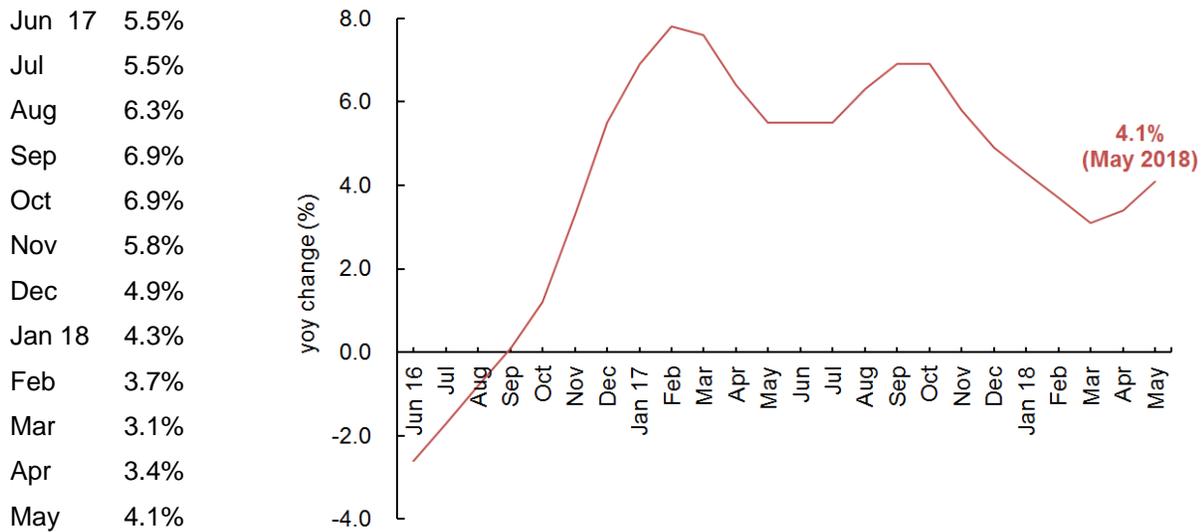
After having posted month-on-month drop for three consecutive months, the PPI went up by 0.4% mom in May, due mainly to increases in ex-factory prices in the 'extraction of petroleum and natural gas', 'processing of petroleum, coking, processing of nucleus

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'.

fuel' and 'manufacture and processing of ferrous metals' industries in the month. The pick-up in the PPI indicated that the ex-factory prices of industrial products have stabilized after three months of correction, in our view.

Going forward, the year-on-year growth in the PPI is expected to rise further in the near term, as the latest reading of the input prices sub-index of China's manufacturing PMI shows a recent hike in the domestic prices of production inputs.

Exhibit 3: China's PPI growth, June 2016 to May 2018



Source: National Bureau of Statistics, PRC

Exhibit 4: China's PPI growth by selected industry, December 2017 to May 2018

| | yoy growth (%) | | | | | |
|--|----------------|--------|-----|-----|-----|-----|
| | Dec 17 | Jan 18 | Feb | Mar | Apr | May |
| Textile | 2.4 | 2.1 | 1.7 | 1.7 | 1.7 | 1.9 |
| Textile wearing apparel and ornament | 0.5 | 0.8 | 0.7 | 0.4 | 0.5 | 0.6 |
| Processing of timbers, manufacture of wood, bamboo, rattan, palm, and straw products | 1.0 | 1.2 | 1.2 | 1.2 | 1.6 | 1.7 |

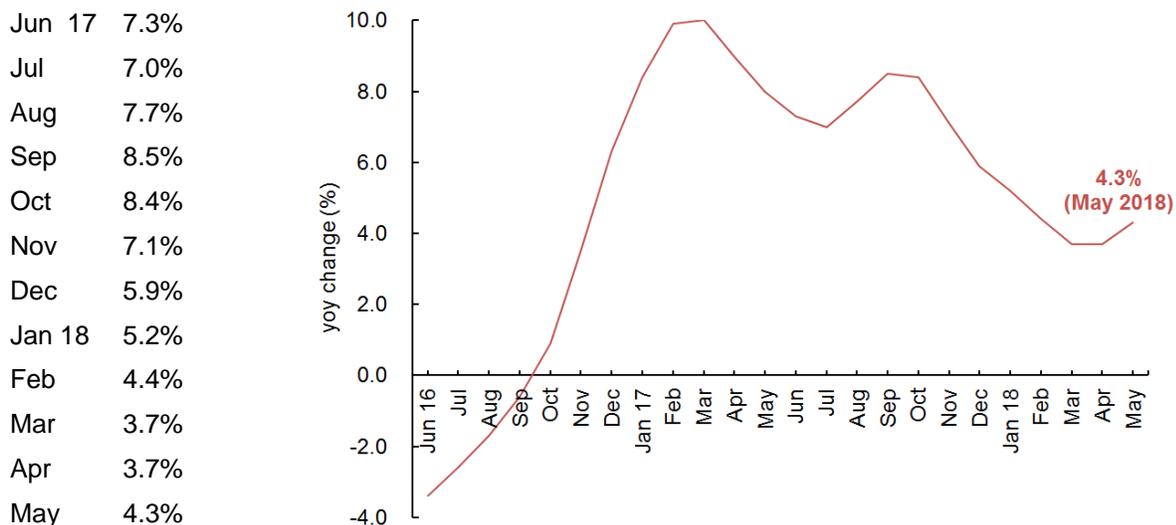
Source: National Bureau of Statistics, PRC

3. Domestic prices of production inputs rise in May

The year-on-year growth rate of the purchaser price index of industrial products went up from 3.7% in April to 4.3% in May (see exhibits 5 & 6). On a month-on-month basis, the purchaser price index increased by 0.3% in May, after having posted month-on-month fall for two consecutive months.

The input prices sub-index of China's manufacturing PMI, a leading indicator of upstream prices, registered 56.7 in May. The index reading is higher than that of last month (53.0) and is well above the neutral level of 50, indicating that domestic prices of production inputs have been rising strongly. Thus, we expect that the year-on-year growth rate of the purchaser price index will go up further in the coming months.

Exhibit 5: Growth of China's purchaser price index of industrial products, June 2016 to May 2018



Source: National Bureau of Statistics, PRC

Exhibit 6: China's purchaser price index of industrial products by selected commodity, December 2017 to May 2018

| | Dec 17 | Jan 18 | Feb | Mar | Apr | May |
|---------------------------------------|--------|--------|-----|-----|-----|-----|
| Fuel and power | 7.1 | 6.2 | 6.0 | 4.9 | 4.6 | 5.5 |
| Non-ferrous metal materials and wires | 10.4 | 10.5 | 8.3 | 6.8 | 6.4 | 7.6 |
| Chemical raw materials | 7.6 | 5.9 | 4.3 | 3.4 | 4.2 | 5.3 |
| Wood and pulp | 7.6 | 7.0 | 6.4 | 6.5 | 7.0 | 7.8 |
| Textile raw materials | 2.8 | 2.3 | 1.7 | 1.7 | 1.7 | 1.7 |

Source: National Bureau of Statistics, PRC

(i) Purchaser price index of fuel and power

The purchaser price index of fuel and power gained 5.5% yoy in May, compared with the 4.6% yoy growth 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 registered 7.6% in May, up from 6.4% in the previous month (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 5.3% yoy, in May, after rising by 4.2% yoy in April (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 went up to 7.8% in May from 7.0% in the previous month (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 stayed flat at 1.7% in May, compared with the previous month (see exhibit 6).

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