



China Sourcing Update

October 17, 2016

Major Price Indicators

1. CPI growth rebounds in September

The year-on-year growth rate of China's consumer price index (CPI)¹ rose from a 10-month low of 1.3% in August to 1.9% in September, higher than market expectations (see exhibit 1 and 2).

The rebound in CPI growth in September was largely due to the pick-up in the year-on-year growth of the food component in the CPI, which came in at 3.2% in September after registering 1.3% in August. For example, the year-on-year growth of vegetable prices, a major driver of China's inflation, jumped from minus 3.9% in August to 7.5% in September. Meanwhile, the year-on-year growth of the non-food component in the CPI also rose from 1.4% in August to 1.6% in September, driven by the rise in gasoline prices.

Looking ahead, we expect the food inflation to stay high in the near future, due mainly to high vegetable prices; and we expect that the non-food inflation will rise slightly in the coming months, given the low base for comparison in 4Q15. Overall, in our view, the CPI growth is likely to stay around 2.0% 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, October 2014 to September 2016



Source: National Bureau of Statistics, PRC

Exhibit 2: China's CPI growth by commodity, April to September 2016²

yoy growth (%)

	Apr 16	May	Jun	Jul	Aug	Sep
Clothing	1.5	1.5	1.4	1.4	1.5	1.2
Household articles and services	0.5	0.6	0.6	0.6	0.4	0.3
Education, culture and recreation	1.2	1.2	1.4	1.6	1.3	2.0

Source: National Bureau of Statistics, PRC

2. Ex-factory prices of industrial products rise

The year-on-year growth of China's producer price index of industrial products (PPI)³ improved from minus 0.8% in August to 0.1% in September, returning to the positive territory for the first time in more than four years (see exhibits 3 & 4).

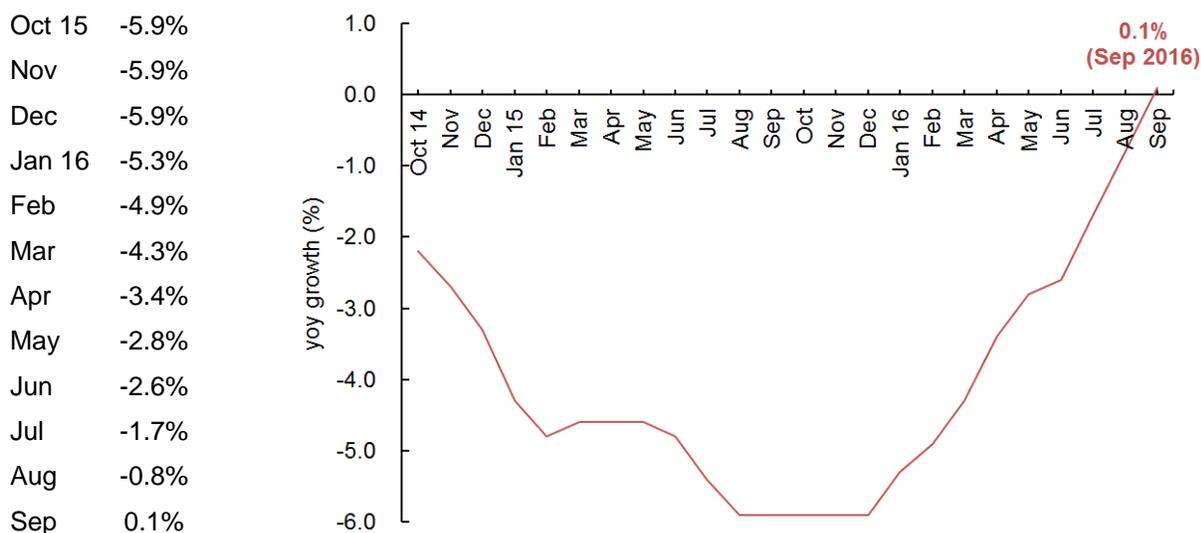
² Starting from January 2016, the old category of 'household facilities, articles and maintenance services' has been re-categorized into a new category called 'household articles and services' and the category of 'other articles and services'. The old category of 'recreation, education, culture articles 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 basis, the PPI rose by 0.5% in September, posting month-on-month gain for three consecutive months. The rise in the PPI in September was mainly due to the increases in the ex-factory prices of the 'manufacture and processing of ferrous metals', 'manufacture and processing of non-ferrous metals' and 'mining and washing of coal' industries in the month.

Going forward, driven by the increase in prices of production inputs, the year-on-year growth of the PPI is expected to rise further in the coming months.

Exhibit 3: China's PPI growth, October 2014 to September 2016



Source: National Bureau of Statistics, PRC

Exhibit 4: China's PPI growth by selected industry, April to September 2016

	yoy growth (%)					
	Apr 16	May	Jun	Jul	Aug	Sep
Textile	-2.5	-2.6	-2.3	-1.4	-0.8	-0.4
Textile wearing apparel and ornament	0.5	0.5	0.6	0.7	0.4	0.3
Processing of timbers, manufacture of wood, bamboo, rattan, palm, and straw products	-0.8	-0.5	-0.3	0.4	-0.2	-0.2

Source: National Bureau of Statistics, PRC

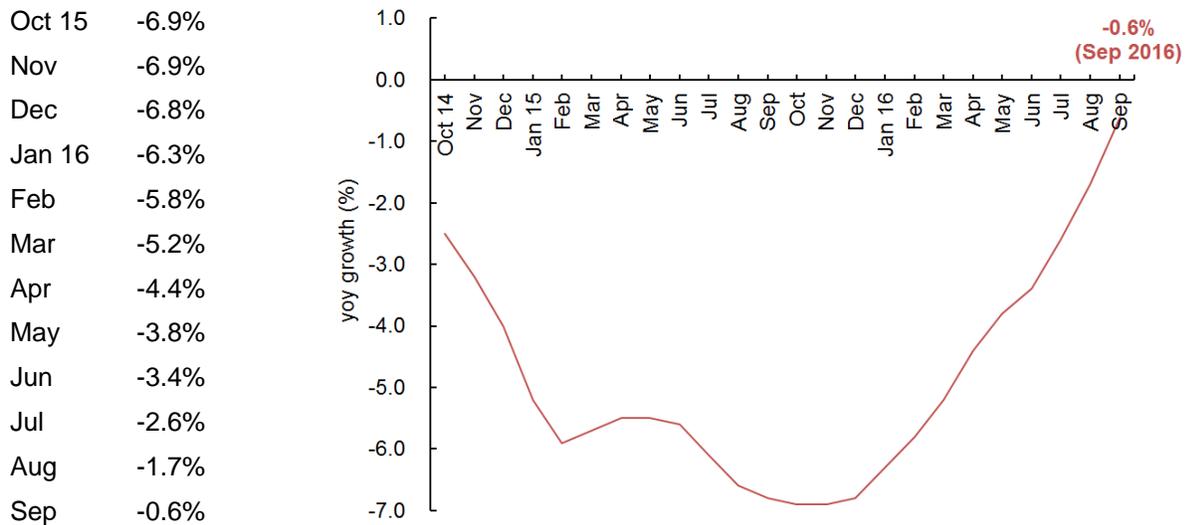
3. Domestic prices of production inputs go up further

On a month-on-month basis, the purchaser price index of industrial products rose by 0.4% in August, posting month-on-month gain for seven consecutive months. The increase in the purchaser price index in recent months can be attributed to the bottoming out of global commodity prices and the Chinese government's efforts to cut excessive industrial capacity, in our view.

The year-on-year growth rate of the purchaser price index of industrial products rose to a four-year high of minus 0.6% in September from minus 1.7% in August (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 eight straight months from February through September, 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 further improve in the near future and will return to the positive territory in the fourth quarter of 2016.

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



Source: National Bureau of Statistics, PRC

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

yoy growth (%)

	Apr 16	May	Jun	Jul	Aug	Sep
Fuel and power	-9.4	-8.3	-7.2	-6.2	-5.0	-1.9
Non-ferrous metal materials and wires	-6.9	-7.0	-5.7	-2.5	-0.3	0.3
Chemical raw materials	-3.9	-4.1	-4.2	-3.6	-2.5	-1.6
Wood and pulp	-0.8	-0.7	-0.8	-0.8	-0.6	-0.7
Textile raw materials	-1.4	-1.3	-1.2	-0.4	0.1	0.1

Source: National Bureau of Statistics, PRC

(i) Purchaser price index of fuel & power

The purchaser price index of fuel and power dropped by 1.9% yoy in September, improving markedly from the minus 5.0% yoy growth in August (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 returned to the positive territory with a 0.3% growth in September (see exhibit 6).

(iii) Purchaser price index of chemical raw materials

The purchaser price index of chemical raw materials fell at a slower pace, by 1.6% yoy, in September, after dropping by 2.5% yoy in August (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 down to minus 0.7% in September from minus 0.6% in August (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 0.1% in September, the same as in August (see exhibit 6).

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