

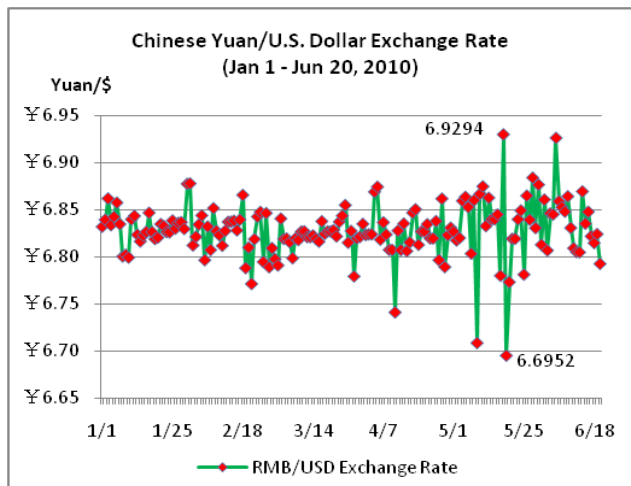


## RMB REVALUATION AND THE CHINESE ECONOMY

**The Chinese government announced recently that it would further reform the RMB exchange rate determination mechanism, thus initiating a possible revaluation of the Chinese currency in the months ahead. This move would most probably lead to an initial slow-down in the Chinese economy for the rest of the year, but China is still expected to maintain an annual rate of about 10 percent in economic growth. A stronger Chinese currency also entails stronger purchasing power for the Chinese people, which could in turn lead to higher oil demand.**

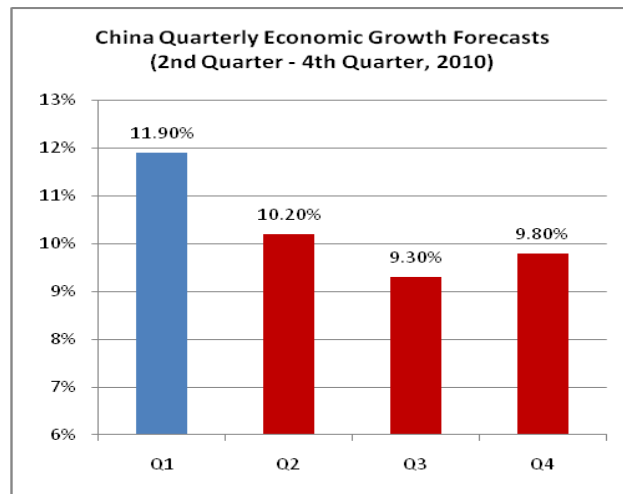
### Moving Towards Revaluation

The People’s Bank of China announced on June 19<sup>th</sup> that it would further reform the mechanism for the determination of the RMB exchange rate and allow for more flexibility in the Yuan’s exchange rate. This announcement is widely interpreted as an initial step taken by the Chinese Central Bank to revalue its currency. As a matter of fact, the RMB exchange rate against the U.S. dollar already started to see wider fluctuations as early as April, swinging even between 6.7 and 6.9 Yuan per dollar in late May (See chart below). The value of the Yuan had been pegged to the dollar at about 6.83 Yuan per dollar until early April. The chart below clearly shows wider fluctuations in the last three months, indicating minor steps already under way well before the announcement.



Despite high expectations for RMB revaluation, however, worries about market speculation as well as China’s concerns with its own growth and employment situation rule out the possibility of a sudden substantial rise in the value of the Yuan. As the Chinese Central Bank emphasized, the reform would only be a gradual process. ESAI thus expects that a 5 percent revaluation over a period of one year could be the most probable scenario, under which the value of the dollar against Yuan will decline from the current

rate of 6.8 Yuan per dollar to about 6.5 Yuan per dollar by next June.



### Implications for the Chinese Economy

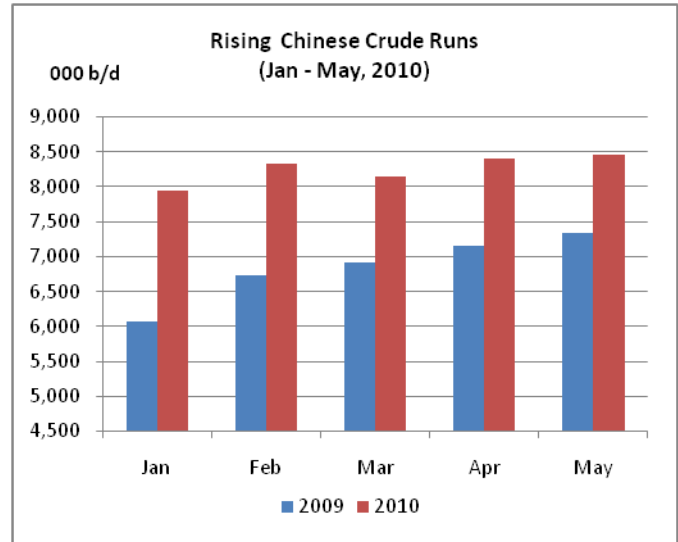
The rise in the value of the Chinese currency surely does not augur well for the Chinese export-oriented manufacturers, which would most probably see their exports decline depending on the actual size and timing of the revaluation, but it would also compel them to undertake restructuring, orienting themselves towards the domestic market. Credit tightening in the second quarter is expected to slow down the Chinese economy for the rest of the year; the RMB revaluation would further moderate economic growth as exports may drop in the months ahead. ESAI thus estimates that the second quarter economic growth will fall to about 10.2 percent from the 11.9 percent already seen in the first quarter, and then further down to 9.3 percent for the third quarter before rebounding to 9.8 percent for the last quarter, with an annualized growth rate of about 10 percent (See chart above).

A moderated but still robust economic growth with a stronger currency should sustain bullish oil demand. ESAI forecasts China’s overall oil demand for the rest of the year to grow by about 300,000 b/d from the first six months, standing at around 8.9 million b/d.

**CRUDE OIL:**

**Bullish**

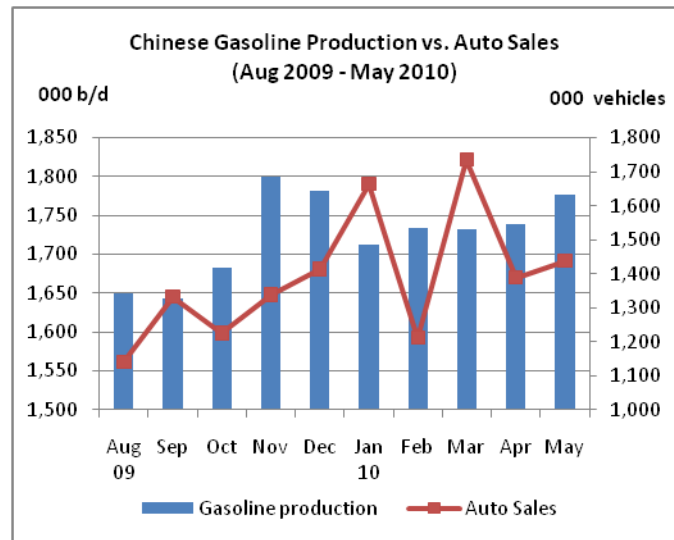
Crude runs rose slightly from the April level of 8.4 million b/d to 8.465 million b/d in May, an increase of 15 percent on year. Refinery utilization in turn rose from 87.5 percent in April to 88.1 percent in May. Crude runs for the first five months of this year averaged 8.25 million b/d, an increase of more than 20 percent from an average of 6.84 million b/d for the same period last year (See Chart: *Rising Chinese Crude Runs*). Strong domestic demand expectations boosted by a rapid economic recovery and expanded refining capacities have both combined to provide support for the higher crude runs. ESI expects the current trend to remain in June with the turnaround season coming to an end in May, but minor fluctuations may occur as evidenced by a fall in crude imports from more than 5 million b/d in April to 4.2 million b/d in May.



**GASOLINE:**

**Slightly Bullish**

Gasoline output in May rose 36,000 b/d to reach 1.78 million b/d, a 2 percent increase on month. Average production for the first five months of this year reached 1.74 million b/d, 6.7 percent higher from the same period of last year. Higher gasoline production corresponds to rising auto sales. After falling from 1.7 million vehicles sold in March to 1.38 million in April, auto sales rebounded slightly to 1.438 million sold in May (See Chart: *Chinese Gasoline Production vs. Auto Sales*). Total auto sales for the first five months of this year reached 7.4 million vehicles, compared with 4.9 million vehicles sold in the first five months of last year. Meanwhile, exports remained strong in May at about 150,000 b/d, a fall of 26 percent on month, but a 73 percent increase on year. ESI expects demand to remain bullish in the summer months, but higher levels of crude runs will also yield a surplus of over 160,000 b/d.



**GASOIL:**

**Slightly Bearish**

Gasoil production continued to trend upward in May, reaching 3.2 million b/d, an increase of 1.3 percent on month. Data also show that average gasoil production in the first five months of this year shot up by almost 20 percent from the same period last year, totaling 3.11 million b/d. Exports dipped slightly from 140,000 b/d in April to 135,000 b/d in May, but still represent an increase of 42 percent on year. With higher crude runs expected ahead, ESI expects supply to continue to outpace demand in the coming months.

**FUEL OIL:**

**Bearish**

Fuel oil output saw a consecutive decline from March through May, settling at 370,000 b/d in May, and was only 10,000 b/d higher on year. Both exports and imports in May dropped from April, indicating a downward trend in both supply and demand against rising crude runs. With cleaner or cheaper substitutes cutting into and eroding the domestic inland residual market, ESI expects overall fuel oil demand to remain weak ahead.

<b>Table 1 Oil Production, Throughput, and Consumption (thousand b/d)</b>											
	Apr 10	May 10	May 09	YTD10	YTD09	Apr 10	May 10	May 09	YTD10	YTD09	
Crude Oil	<b>Production:</b>					<b>Refinery Throughput:</b>					
	3,957	4,039	3,775	3,978	3,757	8,407	8,465	7,344	8,253	6,843	
Principal Products	<b>Production:</b>					<b>Notional Demand:</b>					
	Gasoline	1,740	1,776	1,731	1,739	1,634	1,569	1,656	1,673	1,619	1,592
	Diesel	3,158	3,200	2,857	3,112	2,600	2,945	2,926	2,794	2,915	2,550
	Kerosene	376	371	293	357	270	334	323	323	339	293
	Fuel Oil	340	371	361	377	340	630	601	736	606	708
	5,613	5,718	5,243	5,585	4,844	5,478	5,507	5,527	5,480	5,142	
<b>Table 2 Crude and Products Exports/Imports (thousand b/d)</b>											
	Apr 10	May 10	May 09	YTD10	YTD09	Apr 10	May 10	May 09	YTD10	YTD09	
Total Products	<b>Exports</b>					<b>Imports</b>					
	665.4	543.4	431.0	603.2	418.6	800.0	824.1	856.0	748.3	849.3	
Gasoline	198.1	147.5	85.4	149.1	70.8	0.0	0.0	0.0	0.0	0.9	
Jet Fuel	100.7	0.0	98.8	107.0	110.6	94.5	138.0	129.0	121.5	132.7	
Naphtha	14.3	47.5	0.0	27.4	6.0	50.8	41.2	26.8	61.6	46.1	
Light Diesel	139.8	134.8	94.8	116.1	87.5	25.6	25.8	31.3	33.6	38.6	
Fuel Oil	191.2	181.6	131.4	177.8	118.1	547.7	453.9	506.6	435.8	483.7	
LPG	20.2	27.3	19.7	22.9	24.6	80.7	96.9	161.6	68.9	146.7	
<b>Table 3 Crude and Products Imports/Exports by Source/Destination (thousand b/d)</b>											
	Apr 10	May 10	May 09	YTD10	YTD09	Apr 10	May 10	May 09	YTD10	YTD09	
Exports by Destination	<b>Crude</b>					<b>Gasoline</b>					
	Total Exports	47.2	45.6	111.1	49.3	114.6	198.1	147.5	85.4	149.1	70.8
Japan	18.1	0.0	3.4	10.5	14.8	n.a.	n.a.	n.a.	n.a.	n.a.	
S. Korea	17.1	14.9	0.0	12.3	22.1	0.0	0.0	0.0	0.0	0.0	
U.S.A.	0.0	8.8	53.8	7.2	24.0	0.0	0.0	0.0	0.0	0.0	
Indonesia	0.0	0.0	0.0	0.0	0.0	77.3	71.8	18.8	54.5	23.2	
Vietnam	n.a.	n.a.	n.a.	n.a.	n.a.	11.3	19.1	16.5	15.3	3.9	
Singapore	0.0	0.0	20.1	0.0	27.7	74.6	52.0	48.8	62.9	38.9	
Others	12.0	22.0	33.7	19.3	25.9	35.0	4.7	1.3	16.3	4.8	
Imports by Source	<b>Crude</b>					<b>Fuel Oil</b>					
	Total Imports	5151.4	4201.1	4024.7	4626.2	3585.0	547.7	453.9	506.6	435.8	483.7
Indonesia	40.4	55.1	77.7	34.0	62.1	37.0	27.6	6.9	25.3	17.7	
Singapore	0.0	0.0	0.0	0.0	0.0	69.4	101.2	88.0	104.8	99.7	
South Korea	0.0	0.0	0.0	0.0	0.0	26.0	30.1	60.3	39.8	58.9	
Kazakhstan	208.9	193.3	95.5	197.7	97.2	26.5	18.5	35.1	13.5	11.7	
Oman	268.9	381.8	318.1	306.0	274.8	n.a.	n.a.	n.a.	n.a.	n.a.	
Saudi Arabia	751.7	882.4	650.3	801.8	739.8	0.0	0.2	0.0	0.1	3.8	
Iran	422.5	188.0	727.2	352.3	544.3	13.9	17.0	0.0	6.2	12.3	
Yemen	58.7	65.5	72.5	86.8	58.2	n.a.	n.a.	n.a.	n.a.	n.a.	
U.A.E.	79.7	62.9	9.7	96.5	52.8	12.1	0.0	0.0	2.5	7.5	
Iraq	293.2	64.1	62.4	194.9	78.7	0.0	0.0	0.0	0.0	0.0	
Kuwait	263.0	140.4	243.3	182.0	170.7	n.a.	n.a.	n.a.	n.a.	n.a.	
Algeria	94.5	0.0	0.0	18.8	0.0	n.a.	n.a.	n.a.	n.a.	n.a.	
Angola	1043.7	747.6	480.6	868.5	450.8	n.a.	n.a.	n.a.	n.a.	n.a.	
Congo	130.4	124.1	96.0	82.7	115.3	n.a.	n.a.	n.a.	n.a.	n.a.	
Sudan	316.6	189.6	244.9	250.5	217.3	n.a.	n.a.	n.a.	n.a.	n.a.	
Libya	126.1	101.9	125.6	162.6	93.4	n.a.	n.a.	n.a.	n.a.	n.a.	
Equatorial Guinea	0.0	31.5	99.1	13.1	26.7	n.a.	n.a.	n.a.	n.a.	n.a.	
Russia	319.1	370.4	393.9	358.1	299.0	76.3	65.8	61.2	48.3	51.5	
Venezuela	138.6	61.7	34.2	111.7	55.0	173.8	96.4	66.5	105.4	82.2	
Others	595.2	540.8	293.8	508.4	248.9	112.6	97.0	188.6	89.9	138.4	

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