

ANALYSIS OF RUBBER INVENTORY IN QINGDAO FREE TRADE ZONE AND FORECAST FOR 2014 RUBBER MARKET

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IN QINGDAO FREE TRADE ZONE**

Part 2. FORECAST FOR 2014 RUBBER MARKET



Part 1. Analysis of Rubber Inventory in Qingdao Free Trade Zone



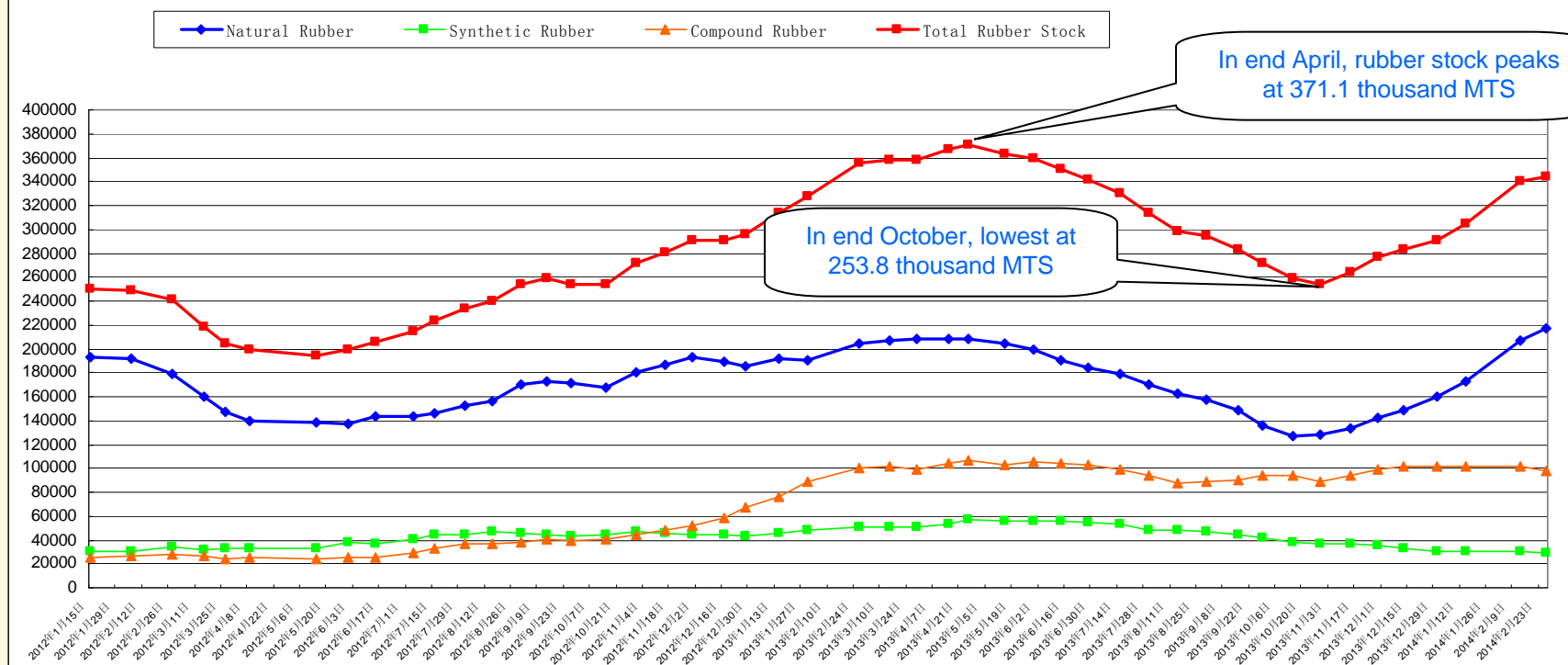
1.1、 Rubber Inventory in QDFTZ

Rubber Inventory in QDFTZ

Date	N.R.	S.R	C.P.R	Total
2013-1-15	191940	46040	76190	314170
2013-1-30	191000	48600	88300	327900
2013-2-27	204330	50870	99740	354940
2013-3-15	206400	50300	101600	358300
2013-3-29	208000	51000	99600	358600
2013-4-15	208800	53600	104500	366900
2013-4-26	207900	56700	106500	371100
2013-5-15	204500	55800	103000	363300
2013-5-30	199500	55600	104900	360000
2013-6-14	190700	56400	103600	350700
2013-6-28	184500	54900	102500	341900
2013-7-15	178800	52800	98700	330300
2013-7-31	170400	48200	94500	313100
2013-8-15	162500	48500	87300	298300
2013-8-30	158000	47500	89500	295000
2013-9-16	148300	44500	90300	283100
2013-9-29	135900	41300	94100	271300
2013-10-15	127200	38700	93700	259600
2013-10-30	127900	37000	88900	253800
2013-11-15	133800	36400	94300	264500
2013-11-29	142000	35000	99300	276300
2013-12-13	148000	32900	101800	282700
2013-12-31	159400	29900	101400	290700
2014-1-15	172400	30100	101800	304300
2014-2-13	207500	30800	101600	339900
2014-2-27	216600	29800	97400	343800

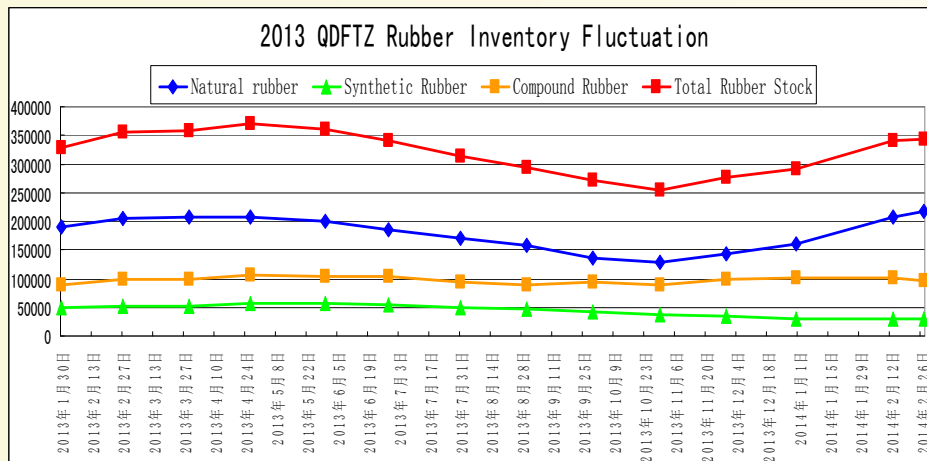
- At the beginning of 2013, total inventory in QDFTZ (short for “Qingdao Free Trade Zone”) was 314,170 Metric Tons, including 191,940 Mts natural rubber, 46,040Mts synthetic rubber and 76,190 Mts compound rubber.
- In end April, rubber Inventory peak at 371,100 Mts.
- By February 27th 2014, Natural Rubber Stock, 216,600 Mts; Synthetic Rubber Stock, 29,800Mts; Compound Rubber Stock, 97,400Mts; Total Rubber Inventory 343,800Mts.

RUBBER INVENTORY IN QDFTZ



- High-level rubber stock became normal: higher than 250,000Mts in the whole year of 2013.
- Total rubber inventory fluctuation in 2013: climbed up from January to April, peaked in end April; came down from May to October, lowest in end October; went up again from November, exceeded 300,000Mts in mid January. The fluctuation relative to seasonal factors and storage capacity in QDFTZ: Peak production season pushed up total inventory and supervisory policy of authority competent and weather factor pressured on it.

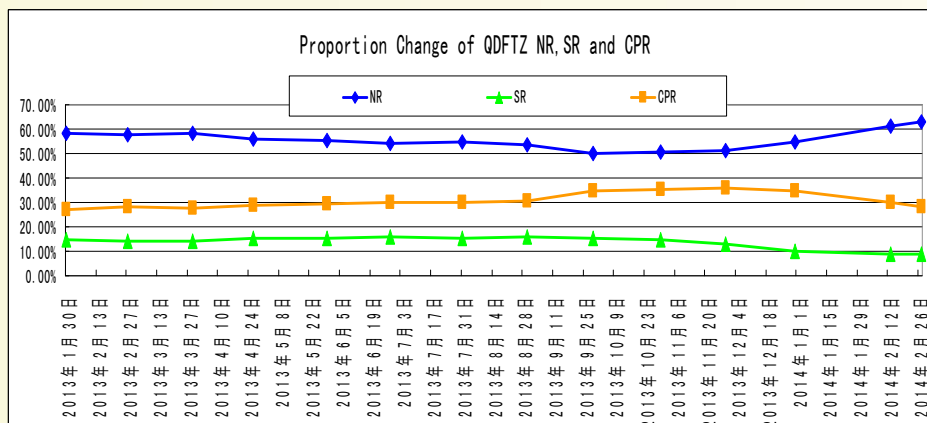
Inventory Fluctuation in Grades



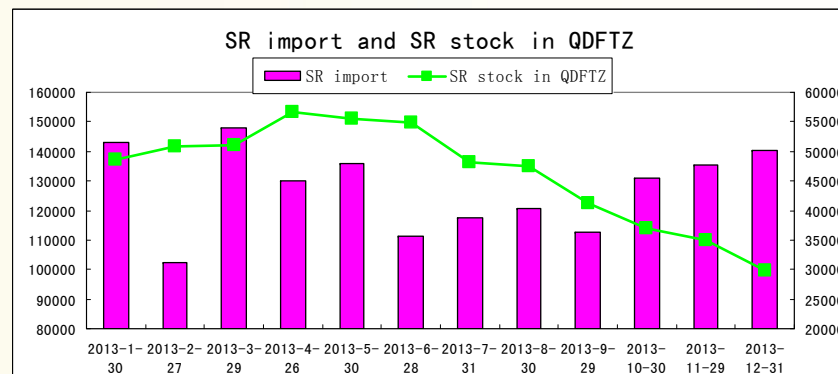
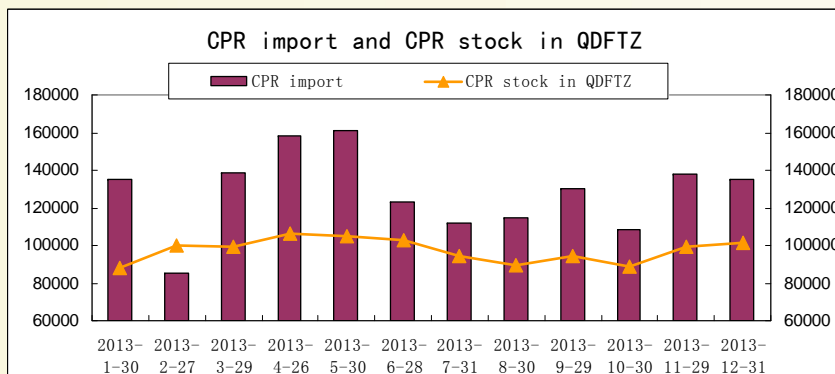
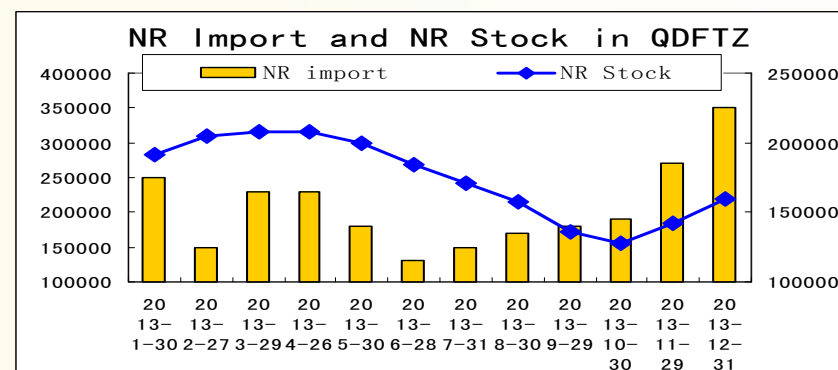
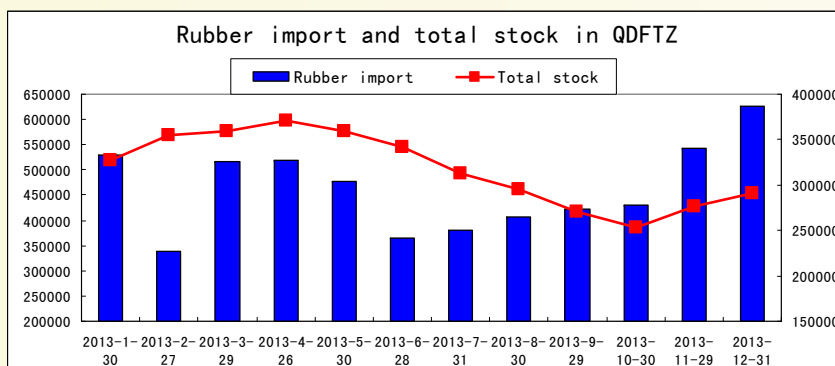
■ Natural Rubber Stock accounts for no less than 50% of the total inventory in the year of 2013, and has the largest influence to the total inventory fluctuation

■ Compound Rubber Stock stabilizes at around 100,000 Mts level

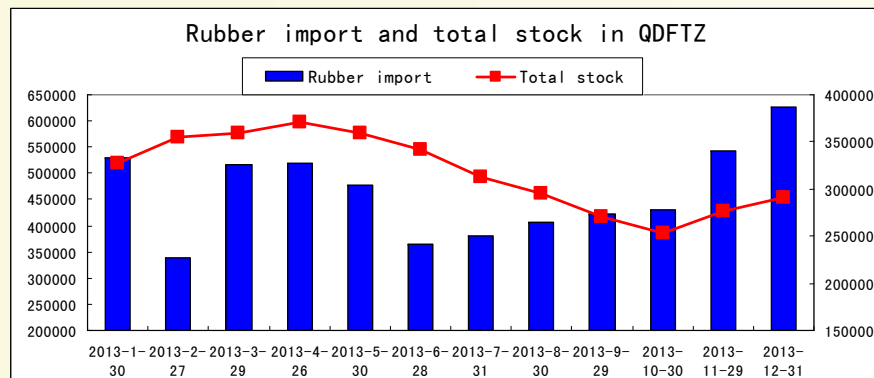
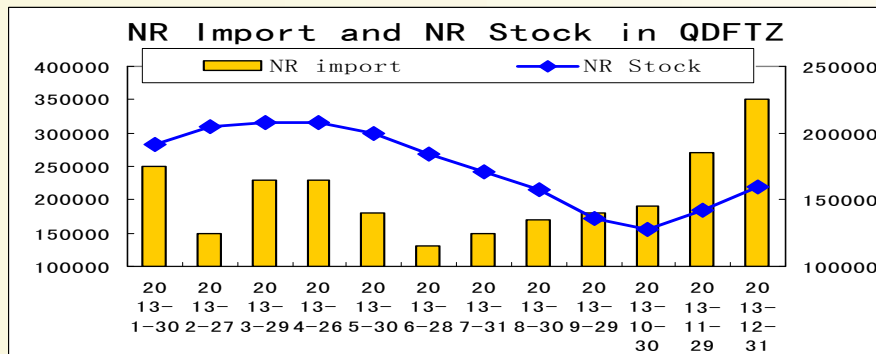
■ Synthetic Rubber Stock falls down in both volume and proportion



Relationship of China Rubber Import to Rubber Inventory in QDFTZ



Relationship between NR Import and NR Stock in QDFTZ

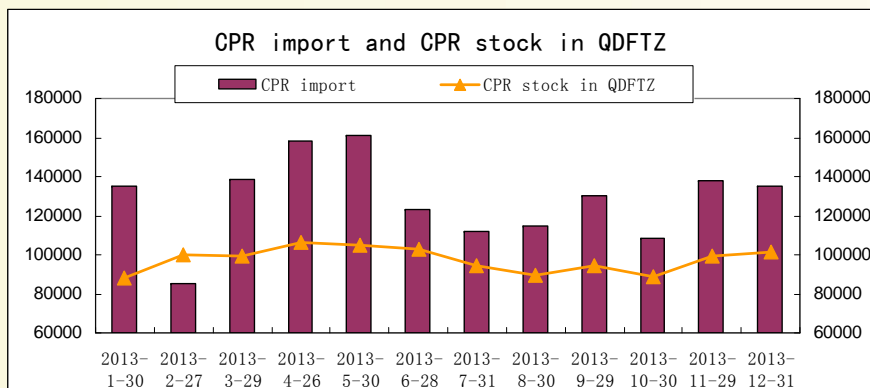


■ Natural Rubber Stock fluctuation and Natural Rubber Import : highly related, showing similar move trends but lagged behind for about 4 months

■ For NR has the largest proportion and influence in total inventory, total inventory and total China import also show similar move trends

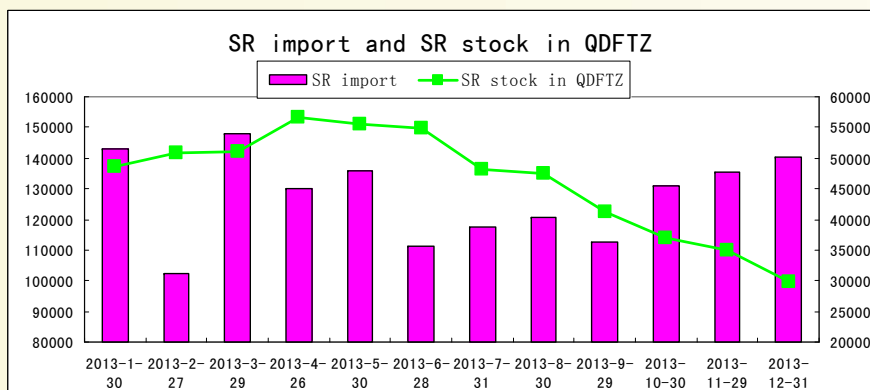
■ Due to sluggish domestic demand, imported natural rubber mainly flows into bonded warehouses in QDFTZ, pushing total inventory up

Relations of CPR import to CPR stock and SR import and SR stock in QDFTZ



■ Compound Rubber Stock stabilizes at 100,000Mts level; CPR import has little influence on CPR stock in QDFTZ

Reason: due to limits of storage capacity and costs, imported Compound Rubber flows to warehouses outside QDFTZ, becoming shadow inventory



■ SR stock in QDFTZ has been declining since last May. SR stock has nothing to do with SR import.

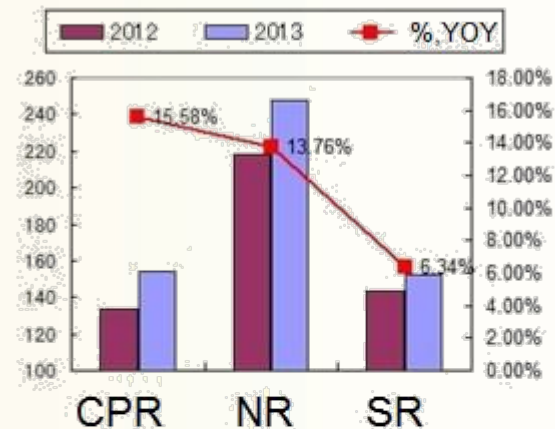
Reason: China SR production capacity expands aggressively in recent years, therefore domestic synthetic rubber becomes more competitive in price and forces imported SR to flow to other countries

China Rubber Import Surged in 2013

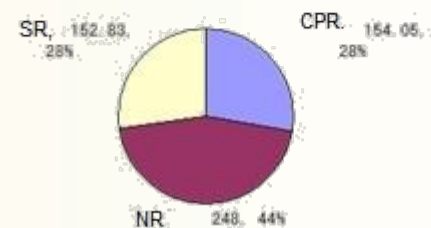
China totally imported 5.55 million Metric Tons rubber in 2013, surged by 0.6 million MTS compared with 2012, or by 12.12% .

Inclusive of , Natural Rubber 2.48 million MTS, an increase of 0.3 million MTS; Compound Rubber 1.54 Million MTS, an increase of 0.21 Million MTS; Synthetic Rubber 1.53 Million MTS, an increase of 90,000 MTS.

2013 Rubber Import and Growth



Quantity and proportion of rubber import

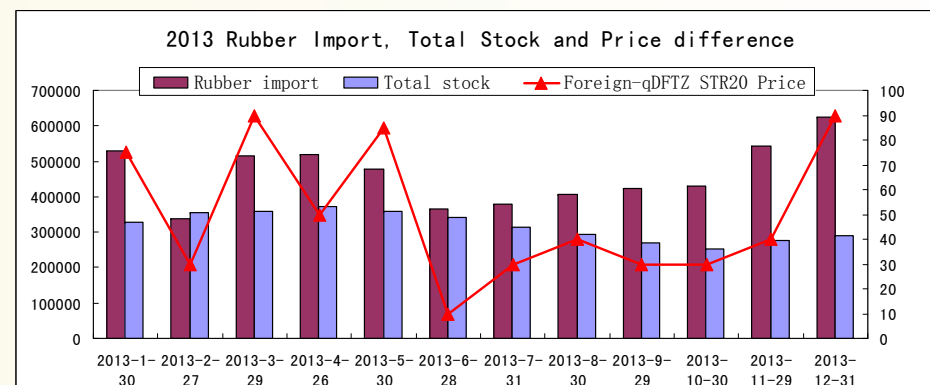
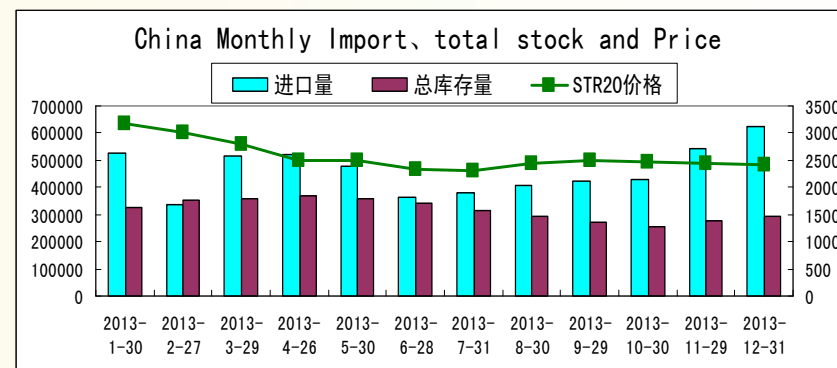


Why China Rubber Import Surged in 2013?

Rubber Industry Status

- QDFTZ rubber inventory stays at high-level for a long time.
Apparently, rubber import surge was not pushed by domestic demand.
- Rubber price keeps on declining and QDFTZ prices is lower than overseas quotation for a long time.
Rubber import surge was not pushed by price trends.

In general, the driving force of rubber import surge in 2013 did not come from rubber industry itself.

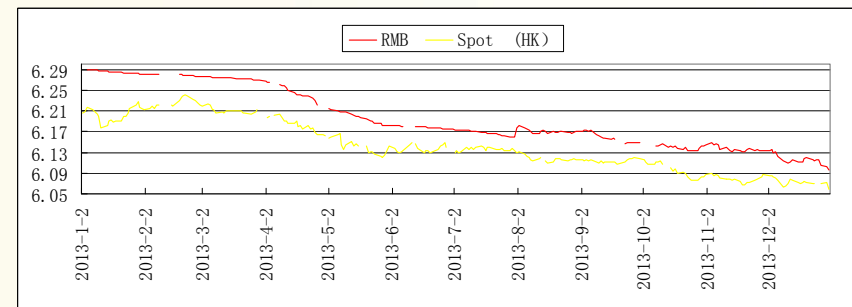
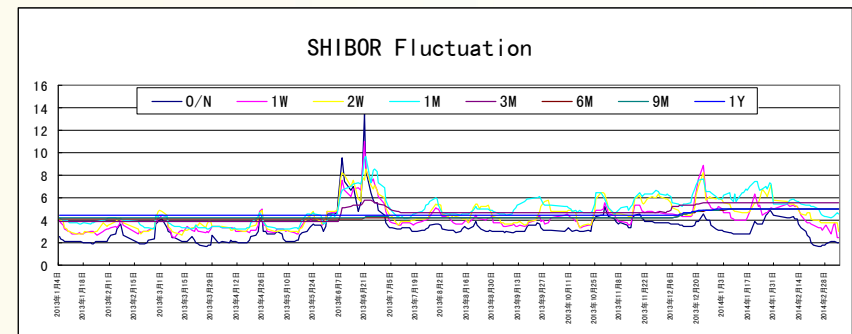


Why China Rubber Import Surged in 2013?

Domestic Monetary and Financial Environment

Phenomenon:

- (1) In end June 2013, SHIBOR rates shot up, “money crunch” crackled.
- (2) RMB appreciation accelerated:
at the beginning of 2013, the exchange rate was ¥6.29 against \$1; at the end of 2013, ¥6.1 only against \$1, appreciated by nearly 3%. The exchange rate maintained between 6.267 and 6.35 in 2012, appreciated by 0.3% only.



Why China Rubber Import Surged in 2013?

● Under the circumstance of domestic “money crunch” and widening of interest rate differential between domestic and foreign market, financial capital engaged in international rubber trading, imported a large quantity of rubber to obtain low-cost financing and thus made interest arbitrage profits. Meanwhile, RMB appreciation provided additional earnings, boosting this kind of operation.

In traditional rubber trading, profits came from the balance of rubber sales price minus the purchase price. But the arbitrage trading did not rely on the balance and sold the imported rubber at low prices, even lower than the purchase prices. As a result, the rubber import was not sensitive to price and actually out of line with downstream rubber demand. A large quantity of imported rubber did not flow into rubber-consumption enterprises for production, but piled up in warehouses.

● Due to the arbitrage trading, traditional traders could not make profits through marketing channels and price differences as before. They lost money each time they imported rubber but had to go on importing in order to lower the average purchase cost and maintain the operation funds. This pushed the rubber inventory up and mired the traditional traders. At present, the traditional traders are at the edge of bankruptcy.

1.2、 Future Fluctuations of QDFTZ Rubber Inventory

- High rubber inventory normalizes

Due to global excessive rubber supply and strong rubber import , domestic rubber inventory tends to stay high. It's very normal to see total rubber inventory of more than 250,000 MTS in Qingdao Free Trade Zone.

- Agricultural product attributes cause fluctuations

The agricultural product attribute causes rubber supply seasonally change, thus results in inventory fluctuations

In conclusion, high rubber inventory of more than 250,000 MTS in QDFTZ tends to be normal; QDFTZ storage capacity limits the maximum rubber inventory at about 380,000Mts.Total rubber inventory will fluctuate around 300,000 MTS on impact of agricultural product attributes.

Part 2. Forecast for 2014 Rubber Market

1. Overview of 2013 Rubber Market

2. Analysis of Rubber Market Conditions

3. Forecast for 2014 Rubber Market

2.1、 Overview of 2013 Rubber Market

SHFE Rubber Contract Price



SHFE Rubber price declined by one third in 2013 : SHFE rubber traded at about ¥27000 a ton at the beginning of 2013, down to around ¥18000 a ton at the end of the year.

2.2、 Analysis of Rubber Market Conditions

Fundamentals

Macro economy

Monetary Policy

2.2.1、 Fundamentals

Rubber Inventory

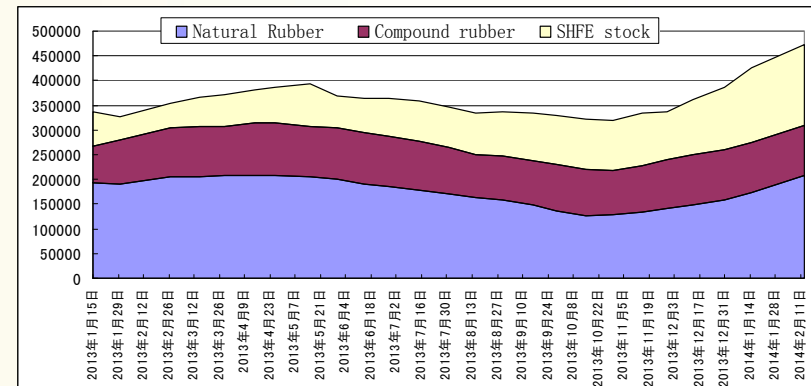
■ Statistical Inventory

Up to 13rd February 2014, 207,500 MTS natural rubber stock, 101,600 MTS compound rubber stock in QDFTZ and 207452 MTS natural rubber in SHFE designated warehouse. Total rubber inventory: 516,552 MTS (exclusive of SR stock in QDFTZ).

■ Shadow Inventory

No less than 100,000Mts imported compound rubber and other imported rubber flew to warehouses outside QDFTZ due to QDFTZ storage capacity and costs factors .

In total, rubber inventory in China see as high as more than 600,000 MTS (not including synthetic rubber).



2.2.1 Fundamentals

■ Natural Rubber Supply

ANRPC data shows global natural rubber production in 2013 was 11.15 million MTS, increased by 0.51 million MTS or 4.7% than in 2012.

Country	Thailand	Indonesia	Vietnam	Malaysia	China	India
NR production (million MTS)	4.07	3.18	1.04	0.82	0.856	0.85
Growth rate	7.7%	4.6%	21%	--	--	--

■ Rubber Import

2013 natural Rubber import 2.48 million MTS, up 0.3 million MTS; compound rubber import 1.54 million MTS, up 0.21million MTS. 2013 natural rubber and compound rubber import increased by 0.51 million MTS ,or 14.53% compared with 2012.

The growth of global natural rubber production coincidently equaled China rubber import increase. We can say, the growth of global natural rubber are all moved into Chinese market.

2.2.1、 Fundamentals

■ Domestic Rubber Demand

China produced 965.036 million outer tyres in 2013, up 8.23% than in 2012. Particularly, radial tyre production up to 583.758 million pieces, surged by 26.77%.

■ State Reserve purchase

In the second half of 2013, China State Reserve Bureau totally purchased 243.7 thousand MTS natural rubber by 4 auctions, including 106.4 thousand MTS SCR-WF and 137.3 thousand MTS RSS3.

Under the background of huge rubber import, tyre production growth and State Reserve Bureau rubber purchase did neither weigh down the high rubber stock nor pull up the declining rubber price. Huge rubber import by arbitrage trading and high rubber stock are the prominent characteristics of current fundamentals.

2.2.2 Macro Economy

China Economy

- 2013 GDP growth 7.7%
- National fixed asset investment up 19.6%
- Total Retail Sales of Social Consumer Goods of China Up 13.1%
- Total import and export value up 7.6%
- 2013 total electricity consumption up 7.5%



2.2.2 Macro Economy

2013 China GDP

2013 China annual GDP
56.8845 trillion Yuan, up by
7.7%.

Q1 increased by 7.7% year on
year, Q2 slowed at 7.5%, the
3rd quarter expanded at 7.8%
and Q4 at 7.7%.



2.2.2 Macro Economy

Three engines for economy: Investment, Consumption and Export

- National fixed asset investment (exclusive of farmers): 43.6528 trillion Yuan in 2013, nominally up 19.6%
- 2013 total Retail Sales of Social Consumer Goods of China: 23.438 trillion Yuan, Up 13.1%
- Total import and export value: 25.83 trillion Yuan, up 7.6% ,higher than 2012 growth rate by 1.4 percentage



2.2.2 Macro Economy

China Economy—Social Electricity Consumption

2013 total social electricity consumption: 5.3223 trillion Kwh, up 7.5%, 2 percentage higher than 2012 growth rate.

The primary industry consumed 101.4 billion Kwh power, up 0.7%; the secondary industry consumed 3.9143 trillion Kwh power, increased by 7.0%; the service sector consumed 627.3 billion Kwh power, up 10.3%.



2.2.2 Macro Economy

Outlook for 2014 China Economy :

Reform bonus continuously releases

Industry upgrading gradually accelerates

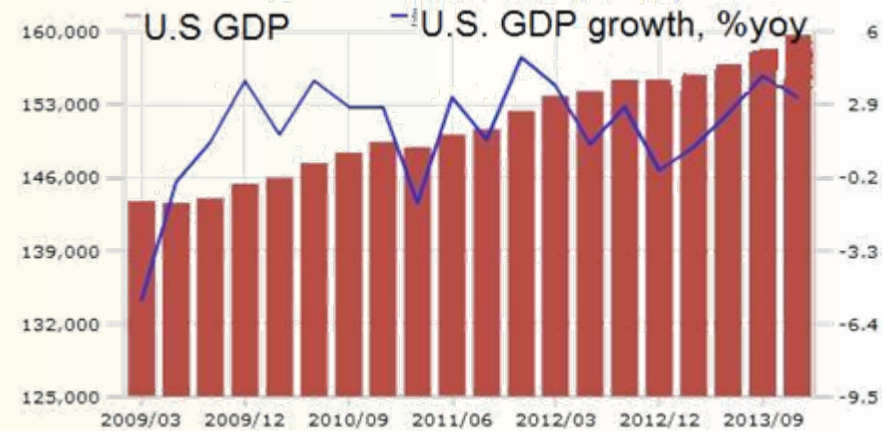
External demand moderately rises

Economy growth slightly slows

2.2.2 Macro Economy

U.S. : Continued Recovery

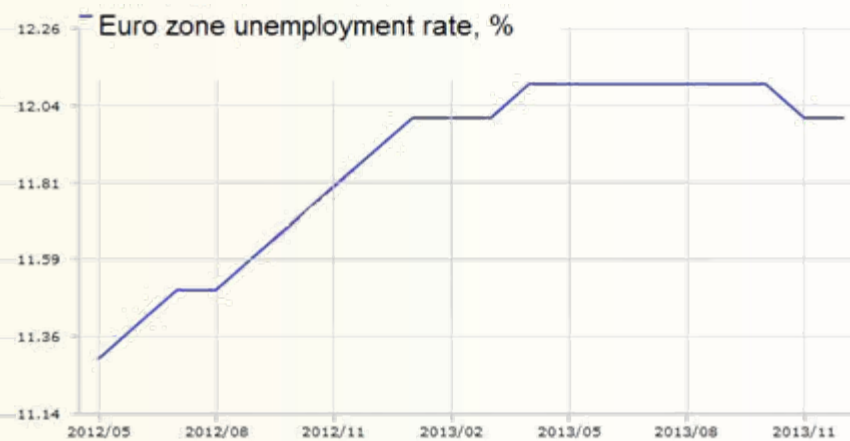
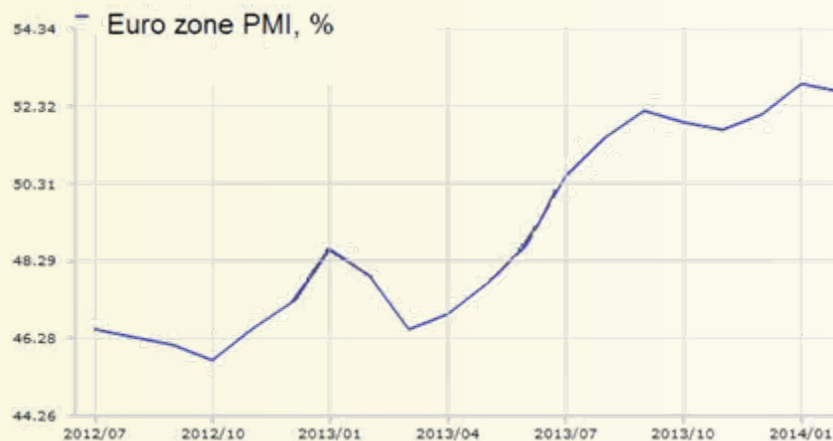
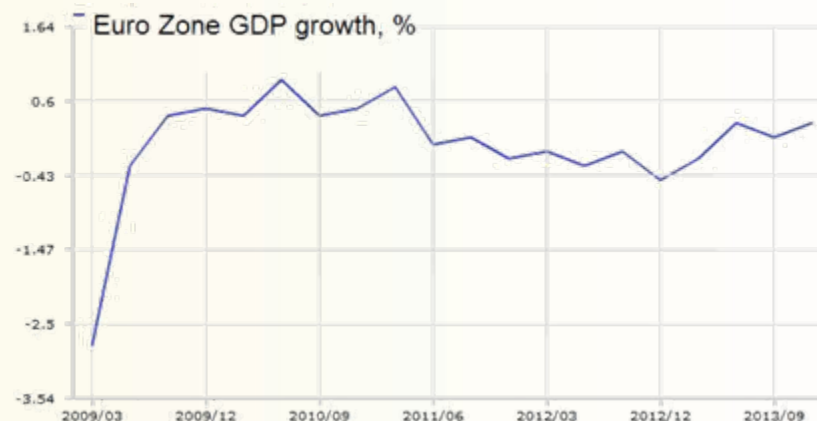
- GDP growth
- Expanding PMI
- Declining unemployment rate



2.2.2 Macro Economy

Euro zone: gradual recovery

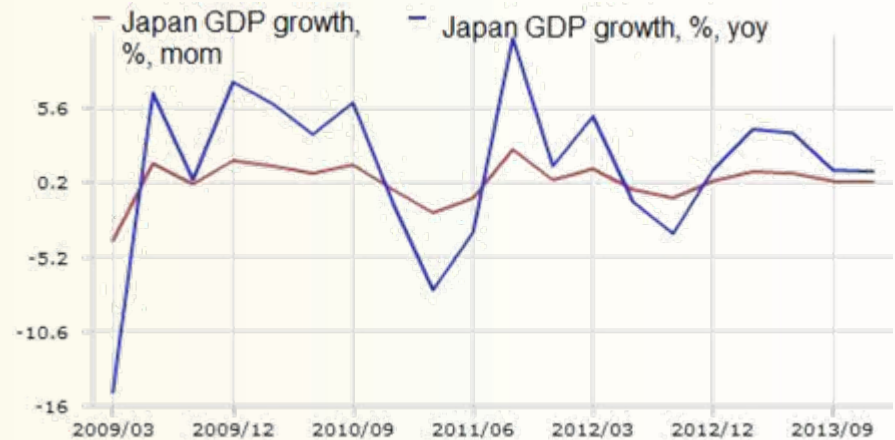
- GDP growth
- PMI over 50
- Unemployment Rate still high



2.2.2 Macro Economy

Japan: “Abenomics” works

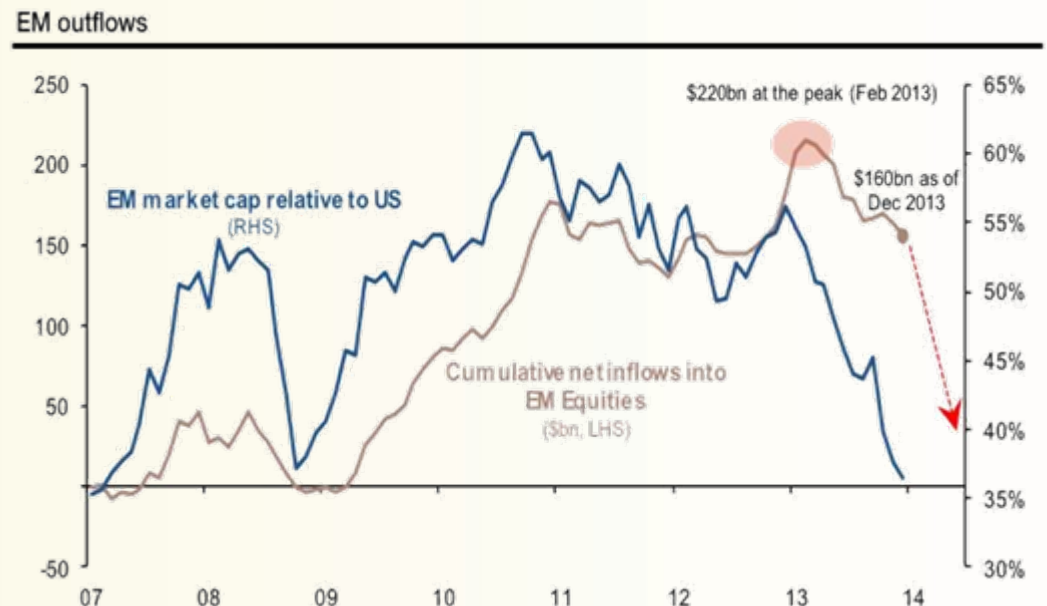
- GDP growth
- Positive CPI
- Unemployment rate declines



2. 2. 2 Macro Economy

Emerging Market countries:

- Economy growth slows
- Funds outflow
- Currency depreciates
- Interest rate goes up



2.2.3 Monetary Policy

U.S.: QE tapering is the main theme of FED policy in 2014

- FOMC December 2013 meeting decided that beginning in January 2014, it would add holdings of agency mortgage-backed securities at a pace of \$35 billion per month rather than \$40 billion per month, and would add to its holdings of longer-term Treasury securities at a pace of \$40 billion per month rather than \$45 billion per month.
- FOMC January Meeting decided to slow its bond purchase pace by an additional reduce of \$10 billion from February.
- FOMC March Meeting decided to slow its bond purchase pace again by an reduce of \$10 billion from April. Then, it will add holdings of agency mortgage-backed securities at a pace of \$25 billion per month, and would add to its holdings of longer-term Treasury securities at a pace of \$30 billion per month.

Euro Zone: stand pat

- Maintain low interest rate
- Current benchmark interest rate at 0.25%.

Japan: “Abenomics”, super QE

- Maintain interest rate at 0.10%
- Mid term and long term inflation target at 2%

China: Moderate monetary policy

- The 4th Quarter Monetary Report shows the PBC will follow the overall arrangements of the State Council and the principle of seeking macro-economic stability, enhancing vitality at the micro level, making progress and taking actions while maintaining stability, and improving quality amidst stability. Monetary policy will seek to maintain aggregate stability and structural optimization. The sound monetary policy will continue, policy stability and continuity will be maintained, and the focus and coordination of policy measures will be enhanced to allow policies to be well-targeted and with appropriate strength. Fine-tunings and preemptive adjustments will be conducted when necessary.

2.3 Forecast for 2014 Rubber Market

SHFE Rubber Contract

沪胶指数 (SHFE 2300) 日线

MA5 16090.00 ↑ MA10 15943.00 ↑ MA20 16258.50 ↓ MA60 17859.17 ↓



2.3 Forecast for 2014 Rubber Market

❑ Fundamentals:

Domestic rubber demand continues to grow, but the global natural rubber production grows more in quantity. The oversupply condition persists and global rubber stock keeps on flowing into China market because of rubber import by arbitrage trading, therefore domestic rubber stock will be constantly high and weigh on rubber price.

❑ Macro Economy:

Euro and U.S. Economy tends to continue recovery in 2014, particularly U.S. recovery may be stronger; “Abenomics” continues to work in Japan, the economy is getting out of deflation; Emerging Market countries are experiencing funds outflow, currency depreciation, interest rates rise and economy slowdown; domestic economy keeps stable and tends to improve. In general, 2014 Macro Economy tends to support the global rubber demand, but the strength is slight.

❑ Monetary Policy:

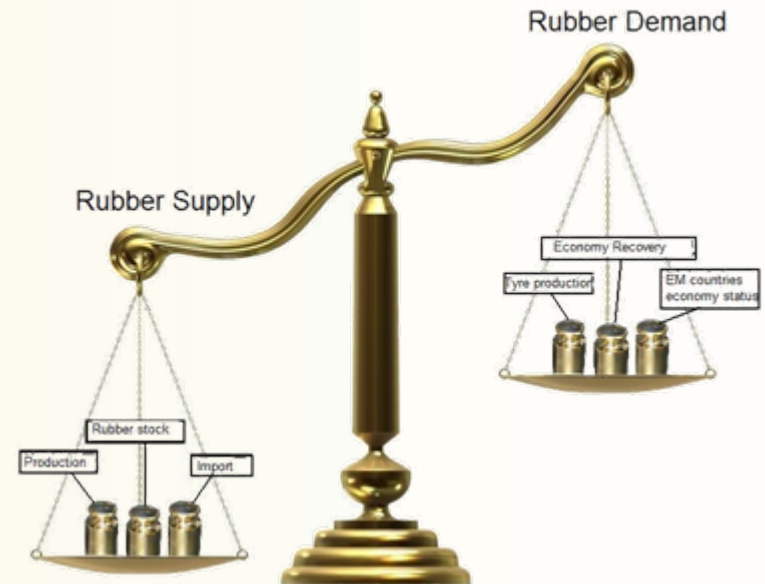
QE tapering is the main theme of FED monetary policy in 2014. The move will weigh on rubber prices.

In conclusion, the 2014 rubber market faces more pressure than support. We estimate the rubber price tends to fall down and fluctuate within a narrow interval at the bottom. Firm price rise won't appear until the rebalance of supply against demand.

2.3 Forecast for 2014 Rubber Market

Because China domestic rubber stock almost equals the global rubber stock, overseas rubber price may jump up rapidly due to shortage of rubber stock when Euro and U.S. recovery accelerates. This will pull the domestic price up. Watch closely on QDFTZ rubber inventory and RMB exchange rate fluctuations, which can reflect the change in advance.

The current rubber price is already below total production cost and slightly above the variable cost. If the price continues to fall, farmers and owners of rubber estate will stop tapping or even cut down rubber trees for planting other economic crops, which will strongly support the price. After the rebalance of supply against demand, the rubber price will break away from the bottom and enter into a fresh rising cycle.



For more QDFTZ rubber news, please visit Qinrex website

[Http://www.qinrex.cn](http://www.qinrex.cn)

QDFTZ Rubber Inventory

QDFTZ Rubber Price

Rubber Industry News

Statistical Data

Monthly Rubber Report

Supply and Demand

Thank you !