



## CHINA STEEL INTELLIGENCE REPORT

# Volatility masks structural shifts

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### Volatility masks structural shifts



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# VOLATILITY MASKS STRUCTURAL SHIFTS

BY TOMAS GUTIERREZ

Market volatility is easing slightly but has likely not gone very far. As the dust of the last month settles however, there are some structural changes which will influence global steel markets in the medium term. The changes are largely good news for overseas steelmakers, while Chinese steelmakers, especially the smaller private players, will bear the brunt of China's shift in focus towards economic reforms.

China's steel market became extremely volatile in May, as did global steel markets. Prices became detached from the fundamental supply-demand balance, while markets are also adjusting to the fact that China is no longer the key driver of the recovery. Fundamentals are coming back into play however, while Chinese policy remains deeply influential for global steel pricing.

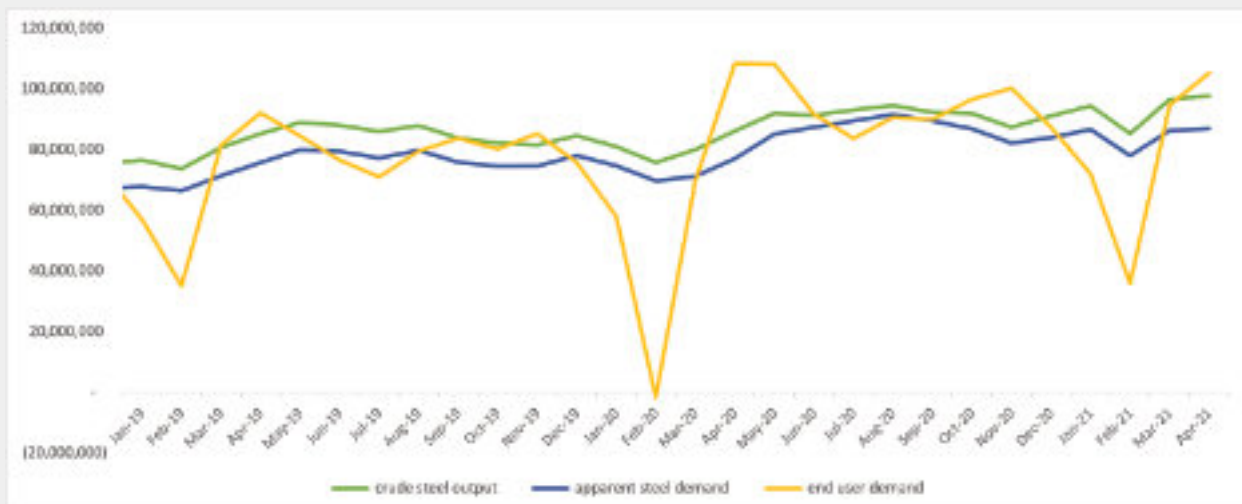
One factor that came into play at the end of the month is how the same policies can have different impacts in different situations. In the bullish market earlier in the year, China's attempts to control production simply encouraged expectations of tight markets through much of the year. Controlling production sent prices

TABLE 1. SUPPLY AND DEMAND

	2020	Y-o-y	Jan-Apr 2021	Y-o-y	2021 Outlook	Y-o-y
Official Crude Steel Output	1,058	5.72%	374.6	15.80%	1080.0	2.60%
Apparent consumption	990	9.75%	338.4	15.40%	976	-0.90%
End user demand	985	8.93%	308.4	31.20%	978	-0.20%

Source: Kallanish. Million Tonnes

FIGURE 1. STEEL PRODUCTION AND DEMAND 2018-2021



Source: Kallanish. Million Tonnes

starting. At the end of May however, furnace prices pulled out of a dive and began a rebound for the opposite reason. Tangshan planned to ease restrictions on production and the centre government suggested it would take a balanced approach between controlling prices and reducing production. The key difference is in eliminating margins. As prices spiked earlier in the year, steel and raw materials prices became detached, and downstream saw their margins halved. For hot rolled coil and sheet, margins even exceeded the period of supply-side reform, while other margins improved less dramatically.

Industry profits over the last four years have followed key policy changes closely. In 2017 profit margins were pushed higher in the period of 'supply-side reform'. This was due largely to the elimination of induction furnace eliminators, which created a deficit in domestic supply, especially for construction longs. Once this impact faded however, profits were squeezed in 2018 as the focus of China's economic reforms shifted. Supporting steel industry profits was a priority four years ago when high debt levels risked sparking a wider debt crisis. Now however, strong margins will only hamper further industry consolidation. As the economic focus has shifted to promoting consumer demand, industrial profits have taken a back seat. Profit data shows that margins have surged from the second half of 2020, but unlike in 2017 this has not been a policy goal. Strong margins are a side-effect of Covid. China felt it had to stimulate heavily in 2020, against the direction of underlying policy. Now that Covid is not an immediate risk to the Chinese economy, Beijing has no incentive to support excessive profits for heavy industry.

**FIGURE 1. STEELMAKING MARGINS SET MULTI-YEAR RECORD** Source: Pathstream, price less raw materials cost, 2010Q1



**FIGURE 2. STEEL INDUSTRY PROFITS SET RECORD** Source: IHS, Pathstream, gross profits as % of revenue



This lack of regard for downstream profit margins extends also to other policies. China is expected to fill in some of the gaps in its new barriers to steel exports. Traders suggest that the rebate on exports of cold rolled coil and a new export tax on hot rolled steels could come in as early as 1 July, although some expect further delays. The policy of restricting steel exports fits with two broader policy goals. The first is environmental. China wants to begin reducing emissions of greenhouse gases and other pollutants and will need to reduce output of heavily polluting materials. The second is the dual circulation framework. China's steel industry is primarily there to support domestic manufacturing and construction. That is, it is part of the first, domestic circulation, while the second circulation is preserved for higher value added products that are essential in global supply chains. The result of China's location of imports is to create another fragmentation of global markets. Donald Trump's import tariffs on steel artificially inflated US steel prices 20% above global prices. China's export tariffs will work in the opposite direction, leaving Chinese steel prices 10% or more below international equivalents on a pre-tax basis. This does not mean that Chinese steel will never be competitive in global markets, although it will be harder to export. It does however mean that mills will see little profit from exporting and will be largely focused on domestic markets, especially for commodity products.

The key additional feature in the Chinese case however is China's dominant position in iron ore imports. China still accounts for around two thirds of iron ore consumption and it will be importing on tight margins. This means that iron ore prices should come under pressure relative to steel prices. That is likely very good news for overseas downstreams, who will benefit not only from less competition from China, but also China's weakened ability to push up the cost of downstreaming. Volatility in global steel prices is likely to stay for some time. The continuing spread of new variants of Covid, the dependence of steel demand on stimulus policies and their vulnerability to domestic politics, and economic risks around inflation, currency and other issues could all generate surprises in the medium term. A post-Covid world is developing however in which the steel sector outside China has a number of positive structural factors supporting it. It will be the Chinese steel industry which comes under greater pressure as margins ease back, forced investment continues and overall demand in the country peaks.

FIGURE 4. GLOBAL PRICES SPREAD AMONG STEEL TRADES



Source: National Steel



The design is given the name of an owl, and the species is now referred to as owl distribution. Production values compared from specific images by "owl" and "owl" are as follows: the owl is produced in the west of the world, it is produced in the west of the world, and it is produced in the west of the world.

Handan Iron and Steel, which has seen some production restrictions in place. Output at the plant rebounded after that however. In the last week of May, the satellite imagery suggests higher output at Handan Iron and Steel, Wuhan Iron and Steel, and at Shougang, Jingang. Part of this may be offset by lower production in southern China, especially as disruptive summer weather begins to have an impact. May overall however looks as though it may see peak Chinese steel production.

Reversing export volumes so far this year (before the tax changes) mean that, domestically, apparent demand has been increasing less quickly than production. Apparent steel demand in April melted another 5.1% higher than March and was up 15.8% y-o-y at 67.0Mtpa. Over January-April meanwhile, apparent demand was up 15.8% at 186.0Mtpa. First user demand meanwhile may have already peaked in April as inventory levels have since begun to build up. In April, end user demand after inventory change was up 11.3% m-o-m, but was down 2.8% y-o-y at 105.0Mtpa. April 2020 was when China's recovery began to kick in, and combined with pent up demand from the lockdown in Q1, and user demand hit its all-time high of 106.0Mtpa. Over January-April, end user demand is still strongly high due to comparison with the lockdown, but these growth rates are expected to fade through the year. Four month end user demand was up 31.3% at 186.0Mtpa, but this was slower than the 40.3% jump in demand put in Q1.

Figure 11: China's domestic steel demand (mtpa)



Source: IHS Markit, The Steel Index



China is reportedly accelerating progress in implementing a tax on real estate. Trade could be undertaken in the near future as early as late 2021, according to sources quoted in Caixin. The policy steps an important role in reforming government finances, but there are fears that a fall in house prices could cause wider economic problems.

China is continuing to legislate to support demographic growth. China is now allowing families to have a third child. The move comes as China struggles with a population which is aging more rapidly than its official projections, and a work force which is shrinking. China's latest census results were also released last month after a delay. Although there had been fears that China's population had shrunk, the official data says population increased to 1.411 billion in 2020 from 1.4 billion in 2019. Fertility rates however stood at just 1.2 births per woman. 2.1 births are necessary to sustain population levels. The working age population accounts for only 65% of the total, down from around 70% in 2010. The census also showed that people are moving out of the southeast, where the industrial economy has been flagging for some time, and from the centre, and into the west. Economic migration will be another key tool to boost productivity as China's southeast shrinks.

The provinces of Guangdong, Guangxi and Yunnan in south and southwest China have begun rationing industrial electricity supply. Guangxi have impacted hydropower supply, and high coal prices have impacted thermal power plants. Thermal plants have also been shut down due to environmental policies. Meanwhile, electricity demand has jumped on the back of hot weather and the economic recovery. Almost half of manufacturers in Guangdong have reported some impact on production from power shortages.

China is continuing to boost rules on building high speed railways as it attempts to steer local governments off spending scarce funds on unprofitable infrastructure. New guidelines issued by the National Development and Reform Commission, Ministry of Transport, National Railway Administration and China National Railway Group have linked speed limits to passenger flows for the first time. Lines between provincial capitals or large cities with a daily passenger flow of over 20 million annually can build high speed lines with speeds up to 350kmh. Lines with a passenger flow of over 10m annually can adopt lines of 250kmh. The rules are intended to stop every city from attempting to build its own high speed rail connections to every other city.





END USERS

REAL ESTATE

Chinese real estate sales for April showed a steady sales market but a concerning slowdown in new starts. Real estate sales in volume showed a 10% increase from March but were still up 15.2% year-on-year at 142.8bn square metres in April, and up 48.1% year-on-year at 150.8bn sqm. Completed investment also continued to recover with the January-April total up 21.8% year-on-year at 128.1 billion dollars. Average house prices also increased slightly in April, although they remained slightly below the start of the year at 128.1 buildings.

China is still getting its real estate market price inflation, although there is a balance as it is getting developers to deliver more at the same time. However, the fact that one of the highest property markets and the local government has set a maximum price per flat for new apartments. It is illegal for estate agents to advertise any price above the stated maximum. But agents are finding ways around this. The example in the image shows how agents can quote a price, without using numbers, thereby avoiding regulation.

New starts and completions were both negative in April. New starts were up 12.8% year-on-year from March at 150.8bn sqm, but in April were down 5.2% year-on-year at 147.8bn sqm. Completions meanwhile were up 17.8% year-on-year at 127.8bn sqm, but were down 5.1% in April at 124.8bn sqm. In part this is due to competition with a good weather when China was coming out of its pandemic lockdown. April levels however are far below average levels recorded in recent years. New starts and the market April since 2015.

Figure 1: Chinese real estate market price inflation



Source: Kallanish

Figure 1: Real estate market price inflation (Source: Kallanish, February 2021)



## AUTOMOTIVE

Due to the lack of chips, Chinese monthly automobile production fell in April, although new energy vehicle output remained strong. 2.27 million units were produced, up 4.3% year-on-year, but down 4.3% month-on-month, according to data from the China Association of Automobile Manufacturers (CAAM). The total production in January-April was boosted to 8.58m units, up 15.4% year. The annual growth rate dropped rapidly from last month's 21.7%. Commercial vehicles underperformed due to the decline in pickups, for which sales dropped 23.5% year to 17,000 units.

Monthly input/output showed demand calculated by Kallanish from the CAAM data was down 12% in April to 1.85 million tonnes, pushing up demand from January to April to 15.05m, up 11.28% year. Many companies have been forced to reduce production

because of insufficient chip supply, and CAAM expects the worst consequences to come in the second quarter. However, industry professionals and Kallanish believe that the problem may not be resolved until early next year.

Chinese automobile exports remained flat a record high in April. Chinese automobile companies reported 101,000 units, up 15.7% month and 115% year.

FIGURE 10: AUTOMOTIVE VEHICLE DEMAND



Source: CAAM, Kallanish Intelligence



## SHIPBUILDING

China's shipbuilding industry continued to recover in April this year, further supporting the growth of shipbuilding completions in the first four months of the year. According to data of the China Association of the National Shipbuilding Industry (CANSI), China's shipbuilding completions reached 11.81 million deadweight tonnes in January-April, an increase of 16.8% year-on-year. In April only, the shipbuilding completions increased by 17.82% month-on-month to 3.03m dwt. New orders over the first four months totaling 180.1% on-year to 27.87m dwt.

Total orders in hand by the end of April reached 64.15m dwt, an increase of 6.3% on-year and 16.8% compared with the end of

2020. During the reporting period, about 6.65m of dwt were consumed by shipbuilding sector, including 1.65m consumed in April only. Moreover, estimated China's shipbuilding completions, new orders and orders in hand accounted for 31.1%, 16.3% and 48.6% of the global market respectively in January to April.

Figure 11: Shipbuilding completions



Source: CANSI Announcement



## WHITE GOODS

Chinese white goods sector remains high levels of activity through April, 1995 data show. Year growth rates however were slowing as the base for comparison in 2020 increased sharply.

Overall output of key white goods were still up strongly in year however 28.27 million air conditioners were produced in April for example, up 20% year. Growth rates had been exaggerated at 60% at the start of the year due to the weak base for comparison.

As conditioner output over the first four months of the year was up 40% to 750m units, higher finished steel demand from the

sector calculated by Kallanish was up 20% year in April at 1.05m, and up 40.8% over January-April to 5.05m.

FIGURE 12: WHITE GOODS OUTPUT



Source: Kallanish International



TRADE

Chinese net steel exports increased again in April as exports held at high levels and imports continued to ease back. May data is likely to see export volumes retreat, however, due to tax changes. In April, Chinese net steel exports increased 8% month-on-month and 22.4% year-on-year to 5.92 million tonnes. Chinese customs data shows that January-April, net exports were up 25.4% y-o-y at 17.66Mtn. Exports in April were up 5.7% month and 26.2% y-o-y at 7.06Mtn, the highest level since November 2016, and over January-April were up 26.4% at 26.6Mtn. The removal of the rebate on most Chinese steel exports effective 1 May means that the month is expected to be a turning point for export volumes. Q120 exports have increased since the start of the month, but for most other products Chinese material has been priced out of the market. (Figure 15.1)

FIGURE 15.1: CHINESE EXPORTS BY MONTH

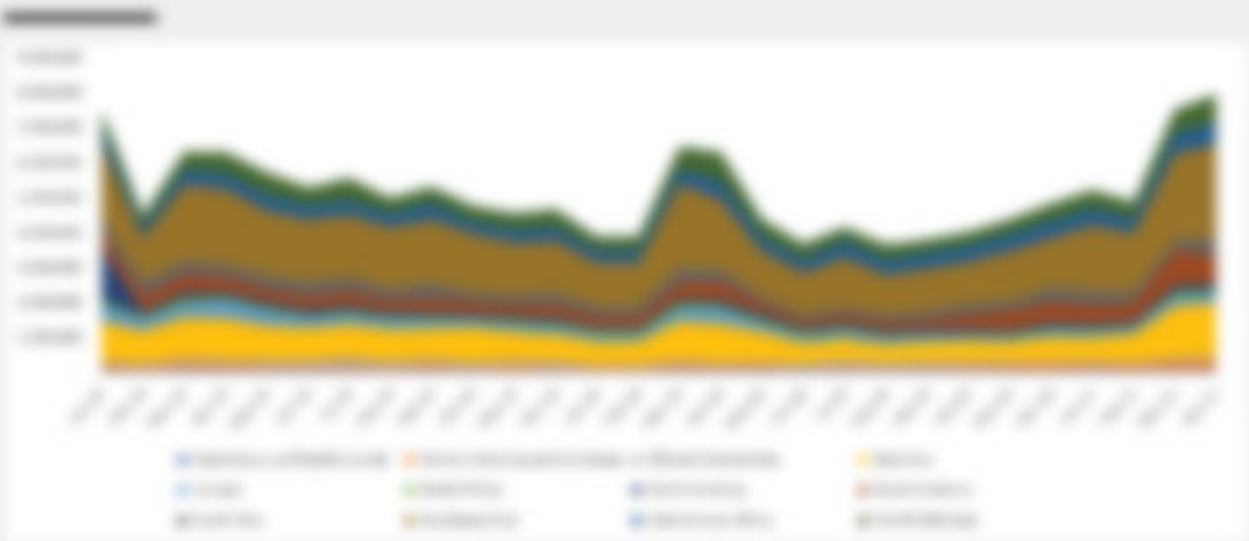
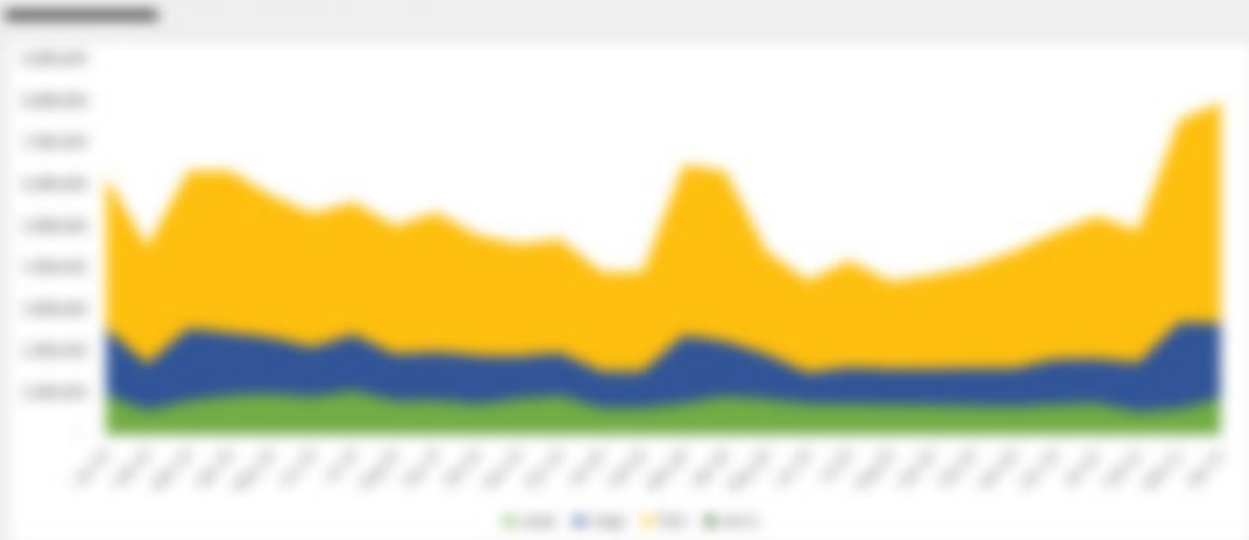


FIGURE 15.2: CHINESE EXPORTS BY MONTH



Source: Kallanish

Exports to traditional markets such as Southeast Asia followed the same trend, growing 26.6% year on to 4.7 billion over the four months. Exports to East Asia were also up 26.6% to 4.3 billion. The fastest growth so far has been to South America, where volumes were up 42.1% year on to 2.6 billion over four months. In April, exports were down 21.6% month on to 155.5 million but this was still 55.7% higher year on.

By product, China imported 16.7 times as many products in the first four months of 2021, up 26.6% year on. It also imported 4.1 billion of large, up 26.6% year on, and 2.6 billion of paper, down 5.1% year on.

China also imported 2 billion of steel in April, down 5.6% month on but up 36.1% year on. Over January-April imports were up 26.7% at 5.1 billion, customs figures show. Imports remain dominated by Asia. Imports from East Asia were fairly steady, increasing only 3% year on to 1.6 billion over January-April. Imports from Southeast Asia meanwhile surged 101.1% year on to 2.6 billion.

By product, large have seen the fastest growth this year. Large imports were up 76.1% over the four months to 1.1 billion. Small imports were up 45.6% to 1.2 billion. They remained the largest single group however with volumes up 5.6% to 5.3 billion. China also imported 145.4 million of paper, up 5.6% year on.

Figure 16: Imports by month and region

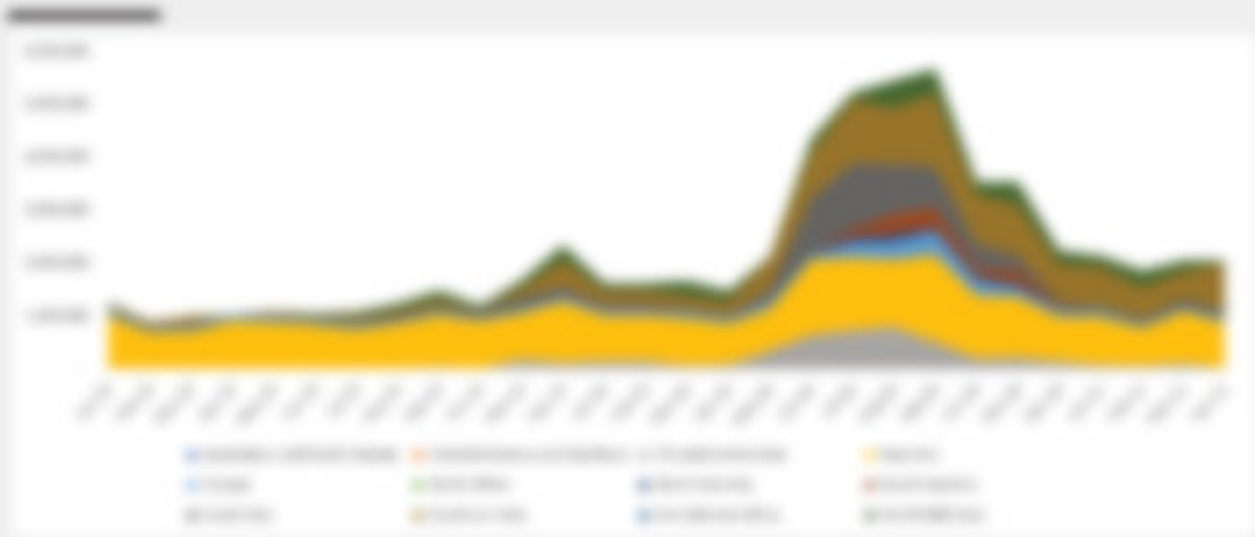


Figure 17: Imports by month and product



Source: KPMG Network



## MARKETS

Chinese steel prices fluctuated wildly in May, hitting record highs before plunging sharply. Right at the end of the month however, prices pulled out of their dive and rising up another rally. Although steel demand is expected to weaken in the summer, demand is still generally high. Inventories meanwhile are not high, although there has been a build-up in inventories at mills. Export offers moved in line with the domestic market, but are also quiet because of uncertainty over another change in tax rates (see above). Free materials markets meanwhile remain highly volatile, but are also starting a rebound.

## LONGS

In Shanghai at the end of May, three different steel was trading at CN¥ 4,735, 4,735/tonne (2741/ton), down by CN¥ 200 from a week before and CN¥ 500 from the end of April. Rebar had hit a high of CN¥ 5,075/tonne in early May. Spot market transaction volumes jumped at the end of the month, when prices bottomed and began to recover. Buyers actively placed orders after prices showed an upward trend, supported by increasing futures prices after several consecutive days of declines. Market participants are looking for a rebound in prices in early June. However, the increase in market confidence is limited.

Buyers are only placing orders based on actual demand and have not brought transactions forward. Most buyers are waiting for the market trend to decide

whether to continue buying in the coming week. The recent sharp decline in prices has made market participants more conservative.

Exports were not export market has also been increasingly sluggish due to the sharp decline in domestic prices. Rebar exports decreased 4,000 tonnes month-on-month and fell to 200,000 tonnes for China at the end of the month, down by 5000 from a week earlier but still 5000 higher on-month. Chinese manufacturers steel mills were selling at 2075/tonne for China for alloy steel exports in late May, and steel mills were accepting a discount of about \$200 in order to facilitate orders. Some Shanghai futures can lower their offers by about \$200 to around \$200/ton. However, buyers were standing off even at lower prices, largely due to the uncertainty over export taxes.

TABLE 1: CHINA PRICES

\*\*\*\*\*

	2020	2021	Apr-21	May-21	Week	YTD
Rebar (CN¥/t)	3,587	4,375	4,300	5,106	4,375	48.1%
Hot-rolled coil (CN¥/t)	401	2,475	754	908	20,475	116.7%

Source: Kallanish

FIGURE 11: LONDON PRICES



Source: Kallanish



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## FLATS

China's May 2020 HSC inventory was noted at around CN¥ 5,400-5,600,000 (US\$740-760), down CN¥ 200 from the previous Friday and CN¥ 200 from the end of April. HSC markets CN¥ 4,070-4,200. Domestic HSC markets were becoming concerned about a build up in roll inventories. This has already begun to encourage a slight decline in output, although production remains near to historic highs. Manufacturing demand remains high, but a slowdown over the summer is likely to mean higher inventories.

Export markets also experienced a huge decline in the second half of May, but most mills and traders chose to wait and see where prices would settle before issuing new offers, especially after domestic markets rebounded at the end of the month. Two secondary destinations in

China were reported to have sold some 20,000 HSC at \$2000 all inclusive in the last week of May. The lowest available offers for 2020 HSC are now around \$2000-2100 for China levels, while some destinations were still holding on to offers close to \$1,200 all inclusive, or stopped offering altogether. The offers have such a big range because the whole market is full of 'cheap' or 'market' metal sales. Vietnamese buyers are holding at below \$2000 all inclusive for Chinese origin HSC. Some mills received much lower bids because buyers did not want to take the risk of the possible 10-15% export tax on HSC. Ralston announced from 2020 HSC at \$2150-2200 for China at the end of May, down \$1000 on-week but only \$200 down from the end of April. HSC peaked at \$1,270-1,300 for a week May.

TABLE 1: FLATS MARKET

	2020	2019	Apr 21	May 21	Week	Top
HSC 2020/19	0.00%	0.1%	0.00%	0.00%	0.0%	00.0%
HSC 2020/21	000	-1.2%	001	000	10.0%	100.0%

FIGURE 1: FLATS MARKET



Source: Kallanish

traders are not prices followed the same trend as steel, but even more dramatically. The futures 10000 10% Fe index ended the month at \$100.0000, more than 40% higher, up just \$10.00 from the end of May. That was down \$27.0000 from a peak of \$127.0000 at 10 May. However, the futures 10000 10% Fe index ended the month at \$101.0000, up \$10.0000 a month but down \$20.0000 from its mid-month peak. The 10000 10% Fe index down \$10 a month and \$10.0000 from its peak at \$110.0000 at lower grade than 10% Fe result from a drive towards higher values over an escalation enough to maintain output with lower emissions, but we think at Chinese ports rebounded in the last week of May. 10000's month end up \$20.0000 versus over the week is 10.00 million tonnes. Arrivals at ports are picking up, while price fluctuations have made mills slow down their purchasing. 10000 steel inventories are increasing, they are also slowing down their production. Inventories remain down from the 120.000 at the end of April however.

May, National Customs Chinese border forces were deployed to help in southern Chinese Yangtze River Delta as 100,000 tonnes (220,000) including 100,000 tonnes (220,000) more than its peak in 12 May but up 100,000 tonnes from the end of April. Chinese crop importers have refused to accept higher overseas offers since prices started dropping in the second half of the month. A person responsible for the import of crop at a southern coast told that National Customs by Chinese rules are at least 50000 of China, while current Japanese crop offers are 500,000 higher. Since importers by Chinese Customs also make importing more difficult. Some European traders have provided buyers with heavy crop that adhere from most Chinese standards, but Chinese importers are still worried the quality will not meet customs requirements, so they hesitate to book. Last week, about 1,000 of crop arrived at Chinese Customs and passed inspection. These crops were ordered in March and April. At the end of May, National Customs Chinese 100,000 tonnes (220,000) of China, down by 50,000 tonnes.

	2009	2010	May 11	May 11	2010	2010
Volume sold, by month (thousands)	100	95.4%	170	200	17.7%	125.3%
Volume sold, by month	100	95.4%	207	200	95.7%	125.4%
Volume sold, by month	97	96.3%	190	170	94.3%	122.3%
Weighted average price	2,600	9.4%	2,400	2,700	9.2%	99.2%





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Item Code	2019	2020	2021	2022
Trade receivable	97.00	99.00	99.00	97.00
Bank deposits	5.00	6.00	7.00	7.00
Bank deposits	2.00	3.00	3.00	3.00
Prepaid rent - commercial	88.00	75.00	88.00	87.00
Prepaid rent - personal	75.00	88.00	88.00	100.00

Year 2000	2001	2002	2003	2004
Non-Residential (M) (2000)	21.30	20.90	21.30	21.30
Non-Residential (M) (2000)	21.30	20.90		
2000	21.30%	21.30%	21.30%	21.30%
2000	21.30%	21.30%	21.30%	21.30%
2000 (2000)	200	200	200	200
2000 (2000)	200	200 (2000)	200 (2000)	200 (2000)

Investment type	2015	2016	2017	2018
Real estate investment	500	1,000,000	2,700,000	6,000,000
Real estate investment - 2015-2017	500	1,000,000	2,700,000	6,000,000
Real estate investment - 2017-2018	500	1,000,000	2,700,000	6,000,000
Real estate investment - 2015-2018	500	1,000,000	2,700,000	6,000,000



## CHINA STEEL INTELLIGENCE

### IN NEXT MONTH'S ISSUE

As Chinese demand slows into the summer, next month we will begin to review the assumptions which underpin our supply and demand forecasts for the year. After so much volatility in prices, have fundamentals changed beyond expectation?

## CONTACT KALLANISH

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