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CHINA'S CURBS FORCING MARKETS OUT OF BALANCE

CHINA'S FUTURES TRIGGERED A SUDDEN DROP IN PRICES LAST MONTH BUT NOW THE MARKET IS TURNING BACK TO FUNDAMENTALS. WITH THE NEXT PEAK DEMAND SEASON UPON US HOWEVER, RESTRICTIONS ON BOTH INDUSTRIAL OUTPUT AND STEEL CONSUMING SECTORS HAVE PUT MARKET BALANCE IN DOUBT.

AT THE RECENT CISA CONFERENCE IN QINGDAO PARTICIPANTS GAVE WILDLY VARYING VIEWS ON PRICE DIRECTION, ALL BASED ON ESSENTIALLY THE SAME REASON. SOME SAID LOWER STEEL OUTPUT WOULD DRIVE STEEL PRICES UP, FOLLOWED BY IRON ORE. SOME SAID LOWER STEEL OUTPUT WOULD DRAG IRON ORE DOWN, FOLLOWED BY STEEL. SOME SAID LOWER STEEL OUTPUT WOULD PRESSURE IRON ORE BUT SUPPORT STEEL PRICES. IN THIS ISSUE WE TAKE A MORE DETAILED LOOK AT BOTH THE STEEL RESTRICTIONS AND UNDERLYING DEMAND TO DETERMINE WHICH VIEW BEST FITS THE FACTS AS WE KNOW THEM SO FAR.



China's forcing markets out of balance

China's futures triggered a sudden drop in prices last month but now the market is turning back to fundamentals. With the next peak demand season upon us however, restrictions on both industrial output and steel consuming sectors have put market balance in doubt.

At the recent CISA conference in Qingdao participants gave wildly varying views on price direction, all based on essentially the same reason. Some said lower steel output would drive steel prices up, followed by iron ore. Some said lower steel output would drag iron ore down, followed by steel. Some said lower steel output would pressure iron ore but support steel prices. In this issue we take a more detailed look at both the steel restrictions and underlying demand to determine which view best fits the facts as we know them so far.

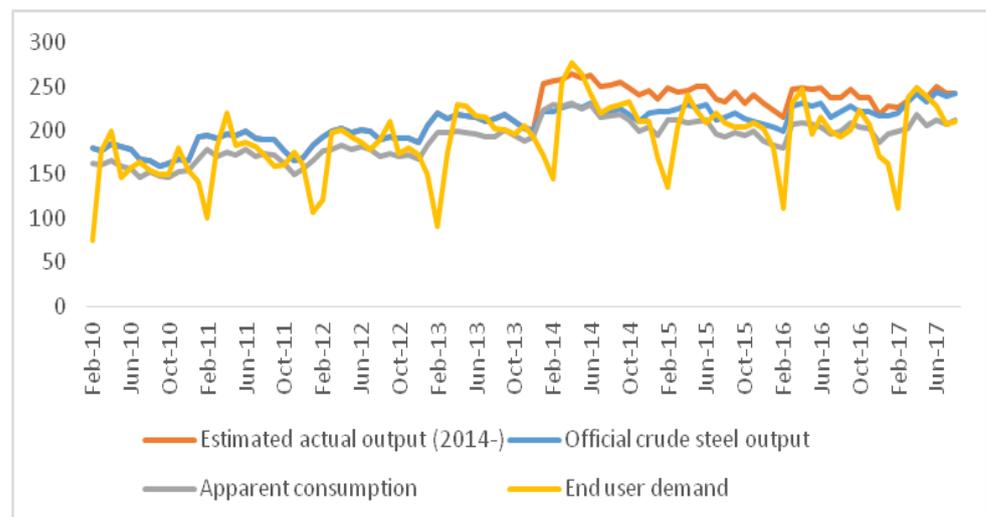
The question now is will falling steel output outpace demand, or vice versa ?

Table 1: Supply and Demand (million tonnes)

Source: NBS, Kallanish

| | 2016 | 2017 ytd | Y-o-y | 2017 outlook | Y-o-y |
|-----------------------------|-------|----------|--------|--------------|--------|
| Official crude steel output | 808.4 | 566.4 | 5.60% | 832.1 | 2.94% |
| Estimated real output | 868.1 | 576.5 | -0.50% | 842.1 | -3.00% |
| Apparent consumption | 728.9 | 499.8 | 3.57% | 728.9 | 0.00% |
| End user demand | 725.3 | 500.1 | 4.43% | 727.4 | 0.28% |

Fig. 1 Daily steel production and demand 2010-2017 (tonnes)



Source: NBS, Kallanish



SAMPLE VERSION

How will these policies shape the market?

China's restrictions on various forms of economic activity to prevent pollution are starting earlier this year, most are in place from October to mid-March, and are expected to be enforced more stringently. A key culprit is the 19th Communist Party of China National Congress in late October. At this meeting president Xi Jinping is expected to consolidate his power and enshrine his political thought into the constitution. More prosaically for the steel industry, he also wants blue skies over the 'big 19th' meetings and local authorities have been ordered to develop detailed plans to reduce pollution.

The level of detail made public has already far exceeded any previous such plan. After a central order for 28 northern Chinese cities to reduce steel output by 50% over the whole winter, cities have begun to release detailed plans mandating specific production plans for each individual blast furnace. Take a look at the details below for the city of Anyang in Henan province for example. Similar details have been released for different cities and different processes, including coking and graphite electrode production. <Table 2.>

Table 2: Anyang blast furnace schedule

Source: Kallanish, Anyang government

| Company information | Production arrangement |
|--|--|
| Five companies with one blast furnace each | Each mill to produce for three months and stop for three months divides by 3 phases (1 Oct-15 Nov; 16 Nov 2017-14 Feb 2018; 15 Feb-31 Mar). |
| Two companies with two similar BFs each | One BF to stop production over the period. |
| One company with two BFs of different capacity | Smaller BF to stop production. Bigger furnace to restrict its output by 3,000 tonnes/day. Roughly 50% output restriction. |
| One firm with three similar BFs | One BF to stop production, one normal production and one to produce only over 1 Oct -15 Nov, and over 15 Feb -31 Mar 2018. |
| Anyang Iron & Steel | stop #1 & #4 BFs. #3 to maintain production and #2 to restrict production. Daily output controlled at 12,500t, a cut of around 50% |
| Shagang Anyang Yongxing | stop #1 & #2 BFs. #3 BF to maintain normal production and #4 BF to restrict production. Daily output controlled up to 3,500t. total capacity cut by -50% |

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SAMPLE VERSION

| Series | Reported crude steel | Apparent steel consumption | Inventory-adjusted implied demand | Steel exports | Steel imports |
|--------------|----------------------|----------------------------|-----------------------------------|----------------|----------------|
| Unit | Million tonnes | Million tonnes | Million tonnes | Million tonnes | Million tonnes |
| Source | NBS | Kallanish | Kallanish | Customs | Customs |
| Dates | | | | | |
| Jan-06 | XXX | XXX | XXX | XXX | XXX |
| Feb-06 | XXX | XXX | XXX | XXX | XXX |
| Mar-06 | XXX | XXX | XXX | XXX | XXX |
| Apr-06 | XXX | XXX | XXX | XXX | XXX |
| May-06 | XXX | XXX | XXX | XXX | XXX |
| Jun-06 | XXX | XXX | XXX | XXX | XXX |
| Jul-06 | XXX | XXX | XXX | XXX | XXX |
| Aug-06 | XXX | XXX | XXX | XXX | XXX |
| Sep-06 | XXX | XXX | XXX | XXX | XXX |
| Oct-06 | XXX | XXX | XXX | XXX | XXX |
| Nov-06 | XXX | XXX | XXX | XXX | XXX |
| Dec-06 | XXX | XXX | XXX | XXX | XXX |
| Jan-07 | XXX | XXX | XXX | XXX | XXX |

| Data Series | Real estate investment | New construction starts | Completed construction | Real estate sales | Railway investment | Air transport FAI | Automotive production | Passenger vehicle production | Comm |
|--------------|------------------------|-------------------------|------------------------|-----------------------|--------------------|-------------------|-----------------------|------------------------------|---------|
| Unit | CNY billion | Million square metres | Million square metres | Million square metres | CNY billion Ytd | CNY billion Ytd | Million units | Million units | Million |
| Source | NBS | NBS | NBS | NBS | NBS | NBS | CAAM | CAAM | CAAM |
| Dates | | | | | | | | | |
| Jan-13 | XXX | XXX | XXX | XXX | XXX | XXX | XXX | XXX | XXX |
| Feb-13 | XXX | XXX | XXX | XXX | XXX | XXX | XXX | XXX | XXX |
| Mar-13 | XXX | XXX | XXX | XXX | XXX | XXX | XXX | XXX | XXX |
| Apr-13 | XXX | XXX | XXX | XXX | XXX | XXX | XXX | XXX | XXX |
| May-13 | XXX | XXX | XXX | XXX | XXX | XXX | XXX | XXX | XXX |
| Jun-13 | XXX | XXX | XXX | XXX | XXX | XXX | XXX | XXX | XXX |
| Jul-13 | XXX | XXX | XXX | XXX | XXX | XXX | XXX | XXX | XXX |
| Aug-13 | XXX | XXX | XXX | XXX | XXX | XXX | XXX | XXX | XXX |
| Sep-13 | XXX | XXX | XXX | XXX | XXX | XXX | XXX | XXX | XXX |
| Oct-13 | XXX | XXX | XXX | XXX | XXX | XXX | XXX | XXX | XXX |
| Nov-13 | XXX | XXX | XXX | XXX | XXX | XXX | XXX | XXX | XXX |
| Dec-13 | XXX | XXX | XXX | XXX | XXX | XXX | XXX | XXX | XXX |
| Jan-14 | xxx | xxx | xxx | xxx | xxx | xxx | xxx | xxx | xxx |

| Price series | Iron Ore 62% Fe Australian fines | HRC / Shanghai | CRC / Shanghai | Cold Rolled Sheet / Shanghai | HDG / Shanghai | Rebar / Shanghai | Rebar in Coil / Shanghai | High Spe |
|--------------|----------------------------------|---------------------|---------------------|------------------------------|---------------------|---------------------|--------------------------|----------|
| Source | Kallanish | Kallanish | SteelHome | SteelHome | SteelHome | Kallanish | SteelHome | |
| Unit | \$/dmt cfr Qingdao | CNY/t FOT warehouse | CNY/t FOT warehouse | CNY/t FOT warehouse | CNY/t FOT warehouse | CNY/t FOT warehouse | CNY/t FOT warehouse | CN |
| Dates | | | | | | | | |
| Nov-14 | | XX | XX | | | | XXXX | |
| Dec-14 | | XX | XX | | | | XXXX | |
| Jan-15 | | XX | XX | | | | XXXX | |
| Feb-15 | | XX | XX | | | | XXXX | |
| Mar-15 | | XX | XX | | | | XXXX | |
| Apr-15 | | XX | XX | XXXX | XXXX | | XXXX | XXXX |
| May-15 | | XX | XX | XXXX | XXXX | | XXXX | XXXX |
| Jun-15 | | XX | XX | XXXX | XXXX | | XXXX | XXXX |
| Jul-15 | | XX | XX | XXXX | XXXX | | XXXX | XXXX |
| Aug-15 | | XX | XX | XXXX | XXXX | | XXXX | XXXX |
| Sep-15 | | XX | XX | XXXX | XXXX | | XXXX | XXXX |
| Oct-15 | | XX | XX | XXXX | XXXX | | XXXX | XXXX |
| Nov-15 | | XX | XX | XXXX | XXXX | XXXX | XXXX | XXXX |
| Dec-15 | | XX | XX | XXXX | XXXX | XXXX | XXXX | XXXX |



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