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CHINA STEEL INTELLIGENCE REPORT

Are markets too confident?

IN THIS MONTH'S ISSUE

Are markets too confident?

ARE MARKETS TOO CONFIDENT?

BY TOMAS GUTIERREZ

Steel markets have started 2022 on a strong note in China, with confidence recovering from late 2022, although real demand remains frozen in the winter snows. Higher steel output has driven iron ore back to $130/tonne levels, while steel export offers are being hiked despite limited buying interest.

Chinese steel and other commodity markets are pricing in significant Chinese stimulus to stabilise the struggling economy this year. Are they right to do so? How much stimulus can really be expected? And does this mean an end to tightening the belt and real estate reform?

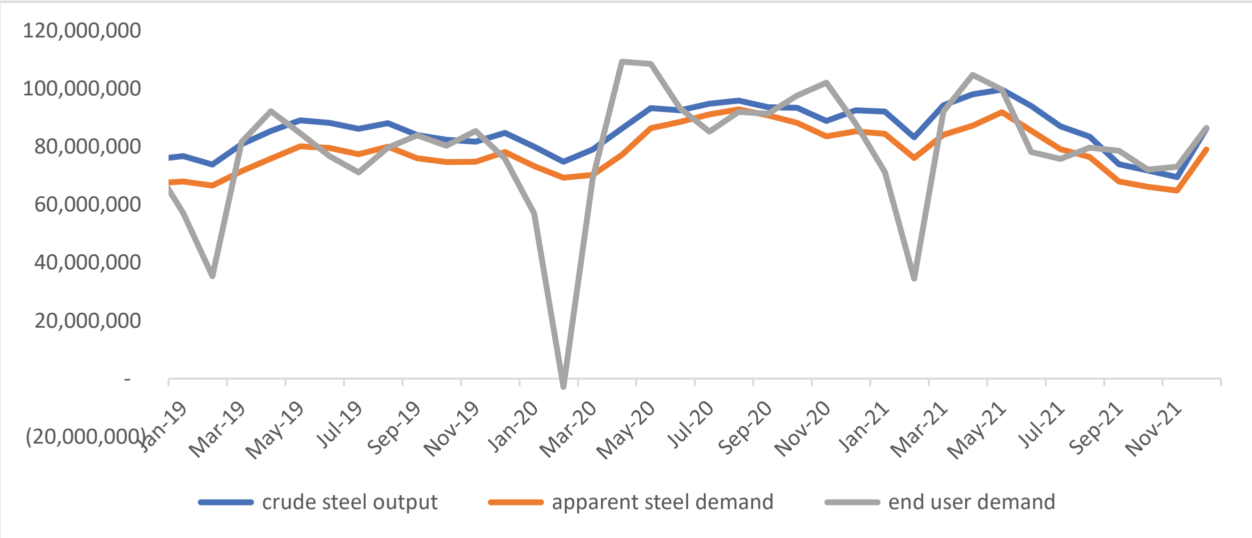
December 2021 saw the beginning of a shift in government policy towards giving greater support to the economy. After cracking down on developer debts over much of last year and accepting the slowdown in the economy as the price to pay for making progress on key reforms, China is now looking for stability before it pushes further ahead with its big picture agenda. The first signs of easing were an increase in mortgage issuance which helped the real estate sector pull out of its free-fall dive. Although still weak, the sector saw a steadier performance in December than in the prior five months (see below).

TABLE 1. SUPPLY AND DEMAND

	2020	Jan-Dec 2021	Y-o-y	2022 Outlook	Y-o-y
Official Crude Steel Output	1,115	1,033	-3.00%	1,016	-1.60%
Apparent consumption	1,035	943	-5.43%	913	-3.10%
End user demand	1,031	946	-4.47%	913	-3.50%

Source: Kallanish. Million Tonnes

FIGURE 1. STEEL PRODUCTION AND DEMAND 2016-2021



Source: Kallanish. Million Tonnes

FIGURE 2: MANUFACTURING PMIS SLIDE AGAIN

Source: NBS, Markit Economics

The slowdown, however, is already spreading into the new year, with China's manufacturing purchasing managers' indices (PMIs) slumping back in January. The official PMI published by the National Bureau of Statistics (NBS) sank to 50.1 after recovering to 50.3 in December. New orders were contracting for the sixth consecutive month, and while output was still expanding, it was doing so at the slowest rate since a decline in October. The privately-compiled Caixin manufacturing PMI fell even further to 49.1 in January, indicating a contraction, from 50.9 in December. Caixin noted that several Covid flare-ups have further disrupted the economy this year. It also noted that external demand is weak, with export orders declining. What has also been seeing this year is the early closure of factories and construction projects ahead of the Lunar New Year. This has in part been due to Covid and other issues, but is also due to uncertainty over demand and weak financing. This may mean that January's figures are weaker than the rest of the year, or it may mean that the economic slowdown is deepening.

FIGURE 3: LOCAL GOVERNMENT BOND ISSUANCE RECOVERS

Source: PBoC, Kallanish

A more concerted attempt to support economic activity was seen with local government special purpose bonds. Net issuance of these bonds in December increased to the highest amount since August 2020 as the central government rushed to ensure that local governments had sufficient funding in place to support growth at the start of the new year. Net issuance over the whole year saw its first ever year-on-year decline in 2021, falling 15.7% to just over CNY 7 trillion ($1.1 trillion), according to the People's Bank of China. December net issuance, however, was up 67.4% y-o-y.

China has also been using other tools to reduce the cost of lending. In January it lowered the one-year and five-year Loan Prime Rate by ten and five basis points to 3.8% and 4.6% respectively. This benchmark rate is used to set a variety of commercial loan rates, as well as mortgage rates. As a result of these moves, China's overall credit growth, which stabilised in December, is expected by economists to recover after the holiday. Analysts are expecting further rate cuts in the coming months. Capital Economics expects the one-year rate to be cut by another 20bp by the end of H1. Any further moves to boost credit flow would force an upward revision of steel demand expectations this year, especially as China has yet to make much progress on restructuring its economy away from steel-intensive construction and infrastructure.

Markets appear to be assuming that the trend towards loosening the economy will continue. This may be reasonable, as stability will be an important priority in a very political year. The overarching policy objectives of China's leaders have not changed and those objectives require further reform and limits on credit growth. Looking at some more detailed targets suggests the central government is supporting short term sentiment but is not returning to the old cycle of borrowing heavily to invest in low-return projects.

China Railway Group plans to put into operation about 3,300km of new railways in 2022, which is slightly lower than the confirmed new track length in 2021. In 2021, China's railway fixed asset investment reached CNY 748.9 billion ($117.58 billion). 4,208km of new railways were put into operation last year, including 2,168km of high-speed railways. Railway fixed asset investment last year declined by 4.22% from 2020, reaching its lowest in eight years. From 2018 to 2020, China commissioned 4,683km, 8,489km and 4,933km respectively of new rail. Based on historical data and research by the China Metallurgical Industry Planning and Research Institute (MPI), a CNY 50 billion investment would add on average some 1.5 million tonnes of steel demand. The investment in 2021 is thus expected to have directly generated over 22.5mt of steel demand. China's long-term plan is to build 53,700km of railways over 2021-2035, or an average of 3,580km per year. Therefore, there may be some scope for recovery in steel demand in the coming years from the multi-year low this year, but any recovery is likely to be limited.

FIGURE 4: RAILWAY INVESTMENT RETREATS

Source: NBS, CRG, Kallanish

Meanwhile, China's social housing policy meanwhile is also likely to be less supportive in the current five-year plan compared to the previous five years. An announcement early in January that China's Ministry of Housing and Urban-Rural Development planned to build 6.5 million apartments for affordable renting was taken as a sign that social housing construction policies were making a comeback. These were significant for steel demand during the previous five-year plans, especially as they accounted for a significant proportion of total construction activity during the last real estate crisis in 2015. During the last five years however, China has made around 80m units of housing available, partly through construction and partly by absorbing unsold housing from developers. Although this is not directly comparable to the 6.5m units specifically for affordable renting, the scale of the plan does not seem particularly large in comparison with previous policies.

With infrastructure and state-led construction unlikely to make up for a decline in real estate construction, financing to developers remains the key crutch for steel demand in the short term. Developers remain under pressure even with an easier credit situation. China Index Academy data shows that the transacted area of new commercial residential buildings in key monitored cities dropped by 51% compared with last year's Spring Festival. This is unlikely to help the widespread stalling of house prices or the ability of developers to sustain their debts. Increases in credit flows are as likely to go into industry consolidation and servicing existing debts as into real construction activity. The markets are expecting stimulus to be sufficient to both service most debts and to support a recovery in construction activity.

SUPPLY & DEMAND OVERVIEW

The end of 2021 saw crude steel output begin to recover from November lows, but steel demand remained weak. Crude steel output in December leapt 24.1% higher from November to 86.193mt, but this was still down 6.8% y-o-y, according to NBS. That left crude steel output over the full year down 3% at 1.032 billion tonnes. The recovery in December came as steelmakers had already guaranteed y-o-y decreases in output by the end of November, and so were allowed to increase production as long as 2021 output did not exceed 2020 levels. Overall, however, China has more than met its target of lower output over the full year, after it turned serious about meeting the goal in the summer.

Apparent steel demand in December recovered a little more slowly, although it was boosted by the easing of credit flowing into real estate construction. December apparent demand was up 21.8% m-o-m but down 7.3% y-o-y at 79.024mt. Full year apparent steel demand was down 5.4% at 942.538mt. The decrease was faster than for output because of China's shifting trade balance, which saw exports up 24.7% and imports down 29.5% over the year. Net exports were up 57.4% at 52.641mt.

Inventories meanwhile continued to draw down in December, but more slowly than in November because of the increase in supply. As a result, implied end user demand increased less rapidly than apparent demand in December, but was not far lower than in December 2020, when inventories decreased very slowly. End user demand was up 18.1% m-o-m but down 1.85% y-o-y in December at 86.451mt. Over 2021, end user demand was down 4.5% at 945.914mt. The inventory rate meanwhile fell to 59.5% at the end of December, the lowest level since November 2020. This has helped support the recovery in sentiment at the start of 2022.

FIGURE 5: DECEMBER OUTPUT RECOVERS

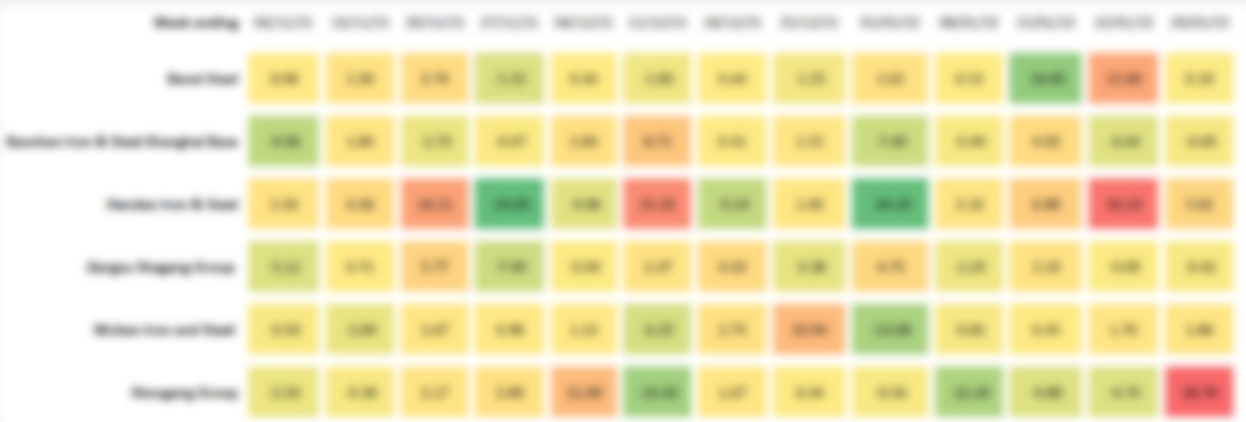
Source: CISA, Kallanish

FIGURE 6. INVENTORY RATE RETREATS TO SUPPORTIVE LEVELS

Source: Kallanish

Some of the higher frequency data available suggests supply cutbacks are easing, although not dramatically. According to the China Iron and Steel Association (CISA) its member mills have seen output remain fairly steady since the end of December through the first twenty days of January. This would suggest higher output in January than December overall, but not much further uptick. Satellite monitoring of mills in Tangshan, however, suggests that since the latest CISA data output may have increased. In the last week of January, a composite reading taken from 16 steelworks in Tangshan showed a spike from a fairly weak early January. Tangshan has seen greater restrictions than many other steelmaking areas and so had been lagging behind the recovery in output, although mill iron ore restocking suggested that they were planning further production increases. Data for selected mills outside Tangshan show some significant boosts to output in mid-January as Handan Iron and Steel and Benxi Steel Plate. Now that the Winter Olympics opening ceremony is over, mills may soon be increasing output further to take advantage of the short period between the Olympics and important political meetings in Beijing in March.

FIGURE 7. OUTPUT RECOVERY IS UNEVEN BUT ACCELERATING



Source: Kallanish, [illegible]

POLICY WATCH

2022 is a year of Politics with a capital P with the 20th Communist Party Congress in the autumn. This marks the start of what is almost certainly going to be Xi Jinping's third term in office, and the end of Li Keqiang's term as premier. Before that, the "Two Sessions" meeting in March will help to clarify the direction of travel for the year. With politicians doing what they do best – jockeying for position – will policy aim for background stability? Or is Xi so confident in his position that he feels able to push ahead with difficult reforms regardless, putting pressure back on real estate?

A State Council meeting in January focussed on energy security just months after a crisis in coal pricing led to widespread power cuts across the country. This was followed by the release of an outline of China's planned energy market reforms, which included a national integrated energy market by 2025. The move means that provincial power generators should be able to sell power at market prices across the country, rather than being forced to sell at a discount locally. Local governments have already been told that local preferential power tariffs should be discontinued, although power surcharges for highly polluting companies should remain in place. A key goal of the policy is to avoid the chaos of late 2021, when electricity prices were too cheap for coal fired power plants to operate. The consequence for consumers however will be higher electricity prices. As the state still aims to protect the cost of living, cost increases will be channelled to industrial users. EAFs, already burdened with higher steelmaking costs than BF-BoF producers, will be put at a further disadvantage. What this means for the large new EAF capacity commissioned in recent years, and planned in the coming years, remains to be seen. One thing is clear however: low EAF utilisation rates are more likely because of this reform.

END USERS

REAL ESTATE

China's real estate sector remains thoroughly troubled, according to the latest data from the National Bureau of Statistics (NBS). It received some benefit from easier mortgage issuance in December, but continued reform of the sector doesn't bode well for steel demand. Total completed investment in the sector was up 4.4% on-year to CNY 14.76 trillion ($2.3 trillion) in 2021, the slowest annual growth since 2015. In December alone, investment was down 13.9% year-on-year at CNY 1.029 trillion, the lowest monthly figure since February. Investment has now been down y-o-y for each of the previous four months.

Sales have also seen a slowdown. Full-year 2021 sales were up just 1.9% at 1.794 billion square metres, and December sales were down 15.6% at 213.02m sqm, the sixth straight month of y-o-y declines. The decline has come despite developers continuing to discount properties. Average realised prices were down for the fifth month in a row to CNY 9,512/sqm, the lowest since March 2020.
This has also led to a slowdown in activity. New starts over 2021 were down 11.4% at 1.989 billion sqm, while in December alone they slumped 31.2% y-o-y to 160.75m sqm and have been down y-o-y every month since March. Completions meanwhile finished the year up 11.2% at 1.014 billion sqm as developers moved projects to market to secure funds. However, even this activity has slowed and was up just 1.9% y-o-y in December at 326.58m sqm.

The only positive note came from a survey of house prices in 70 cities conducted by NBS. It showed that prices were falling in 50 of those cities and rising in 15. While that suggests the drop in the market is widespread, it was stronger than the 59 cities with falling prices compared to just nine rising that were recorded in November.

The tightness in the sector has been engineered from Beijing as it seeks to divert investment away from real estate towards more productive sectors of the economy. The risk of a severe economic crisis, however, forced China to allow a greater flow of credit into mortgages in December, resulting in the slowdown of price cuts. The policy direction is expected to fluctuate as China still needs to restructure the sector but is concerned about a crisis. Around $117 billion of debt held by developers is due to mature in 2022.

FIGURE 6. REAL ESTATE INVESTMENT GROWTH

Source: NBS, Kallanish (% y-o-y)

AUTOMOTIVE

Due to an acceleration in production during the traditional peak season in December, Chinese monthly automobile output achieved year-on-year growth for the first time since April. December output stood at 2.91 million units, according to data from the China Association of Automobile Manufacturers (CAAM). Annual car output was boosted to 26.08m units, with an increase of 3.4% y-o-y, ending three consecutive years of decline since 2018. However, 3.4% is the lowest year-on-year increase in year-to-date production volumes recorded in any month last year, compared to the 88.9% growth registered after February.

Both production and sales of new energy vehicles (NEVs) again set new historical record highs. The penetration rate of NEVs in the entire market reached 19.1% in December. Implied finished steel demand calculated by Kallanish from CAAM data rose 10.4% from the prior month to 4.36 million tonnes in December. Annual demand reached 43.36mt, inching up 1.75% y-o-y. Last year, Chinese auto production was hit by the shortage of chips in the third quarter, before a better-than-expected rebound in Q4. The supply of chips remains tight, but is expected to gradually ease this year, the Ministry of Industry and Information Technology says.

Looking ahead to 2022, CAAM expects Chinese auto sales to rise 5.4% to 27.5m units. Of that, passenger cars and commercial cars would increase 8% to 23m units and decline 6% to 4.5m units, respectively.

FIGURE 8: AUTOMOTIVE STEEL DEMAND

Source: CAAM, Kallanish (tonnes/month)

SHIPBUILDING

China's shipbuilding completions achieved a 3% year-on-year increase in 2021 to 39.7 million deadweight tonnes. Officials expect shipbuilding completions to continue growing this year, exceeding 40m dwt in 2022. In December, shipbuilding completions basically remained stable from 3.87m dwt in November at 3.82m dwt, which suggests around 1.32 million tonnes of finished steel was consumed that month.

A doubling of new orders also resulted in a substantial year-on-year increase in orders-in-hand. According to China Association of the National Shipbuilding Industry (CANSI) data, new orders last year were 67.07m dwt, surging 131.8% on-year. At the end of December 2021, orders in hand were 95.84m dwt, an increase of 34.8% from the end of 2020. Kallanish estimates steel demand in the shipbuilding sector was 13.72 million tonnes last year, around 400,000t higher than in 2020. In 2021, China's shipbuilding completions, new orders and orders-in-hand accounted for 47.2%, 53.8% and 47.6% respectively of the world's total in deadweight tonnes.

CANSI itself estimates that China's shipbuilding steel consumption increased by 3.2% on-year in 2021 to 9.8 million tonnes last year. This is believed to be only consumption at the major producers however, and also to exclude yield loss at processors. CANSI data suggests that around 8.2mt of flat steel were consumed last year, reaching an increase of 2.5%. Sections consumption was up 12.5% to 0.9mt, while other steel demand was flat at 0.7mt. CANSI expects that China's shipbuilding steel consumption will continue to increase steadily in the next five years, with its count for steel consumption in 2022 rising to 11mt. Meanwhile, CANSI says the prices of shipbuilding steel are not likely to decline due to growing demand.

FIGURE 10. SHIPBUILDING COMPLETIONS

Source: CANSI (tonnes/month)

WHITE GOODS

Chinese white goods output saw its traditional end of year uptick in December, but output remained below levels from a year earlier. Production levels have been down y-o-y every month since June last year, although year-to-date output remained higher y-o-y thanks to the very weak base in Q1 2020.

December only saw higher output on-year for freezers, but washing machine and refrigerator output fell both y-o-y and m-o-m. Air conditioner output was the key driver of y-o-y growth in 2021 however with a 9.4% increase to 218m units. Kallanish estimates December finished steel demand was down 3% y-o-y at 1.43mt, but up from 1.33mt in November. Full year steel demand was around 16.11mt, up 6.7% y-o-y and slightly lower than our forecast of 16.2mt.

FIGURE 11. WHITE GOODS DEMAND

Source: NBS, Kallanish (tonnes/day)

TRADE

In December, China's net steel exports leapt 161% higher m-o-m and 11% y-o-y to 2.884mt, as reported by the general Administration of Customs. Production restrictions had helped push exports lower through November despite weak demand. An increase in short selling opportunities and recovering steel output however helped to boost exports again in December. Over the whole of 2021, total net exports reached 38.913mt, up 158% y-o-y. This was due to both exports, which recovered from 2020 lows, and imports, which could not replicate the surge they saw in H2 2020. In December, China's exports reached 5.058mt, rising 16% m-o-m and 4% y-o-y. Meanwhile, exports were up 25% to 66.946mt over 12 months.

FIGURE 12: CHINESE EXPORTS BY REGION

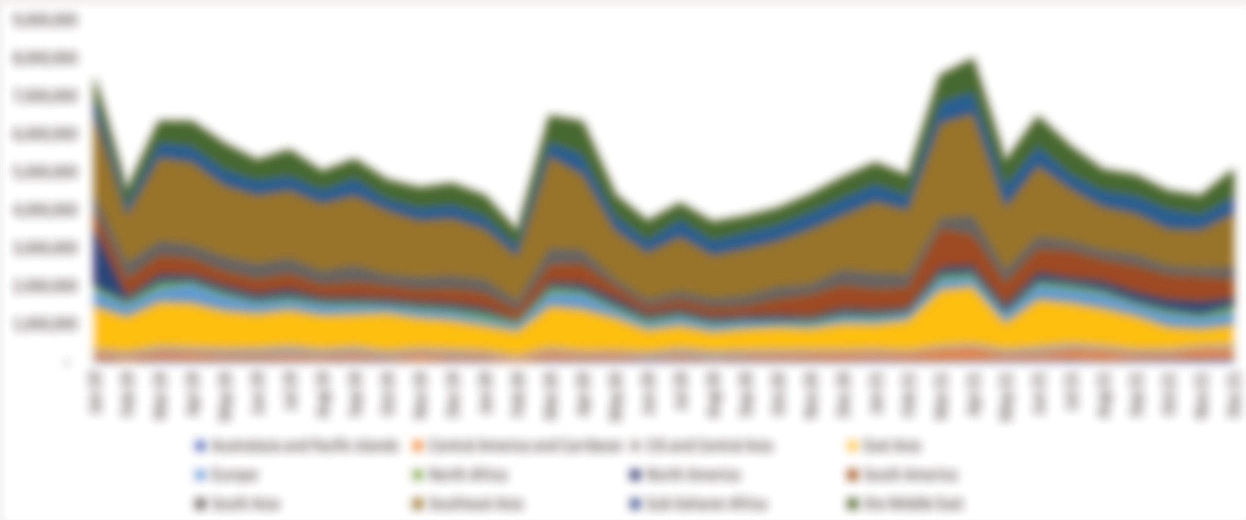
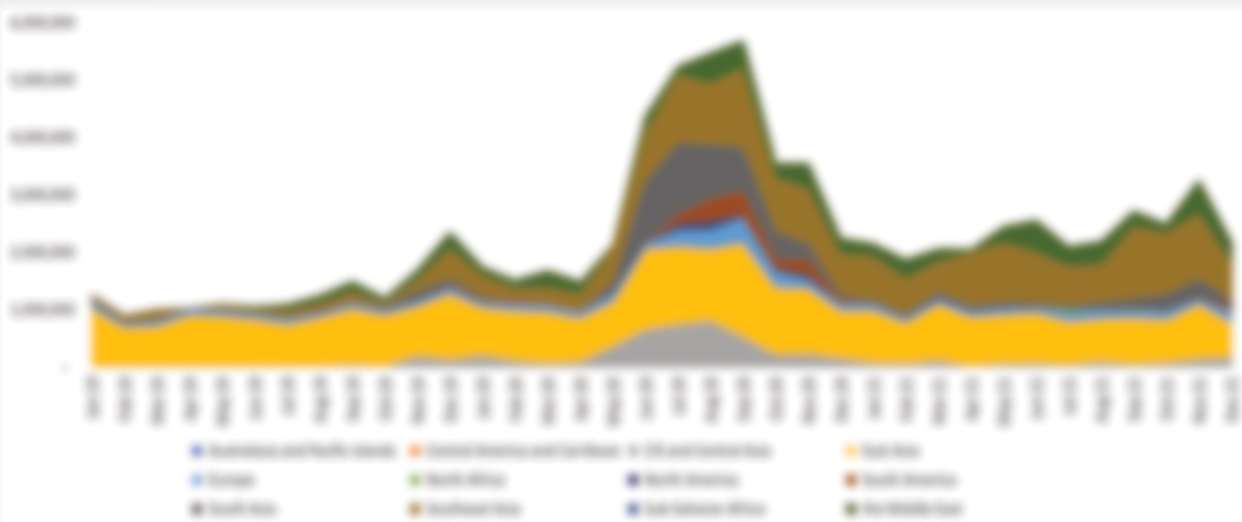
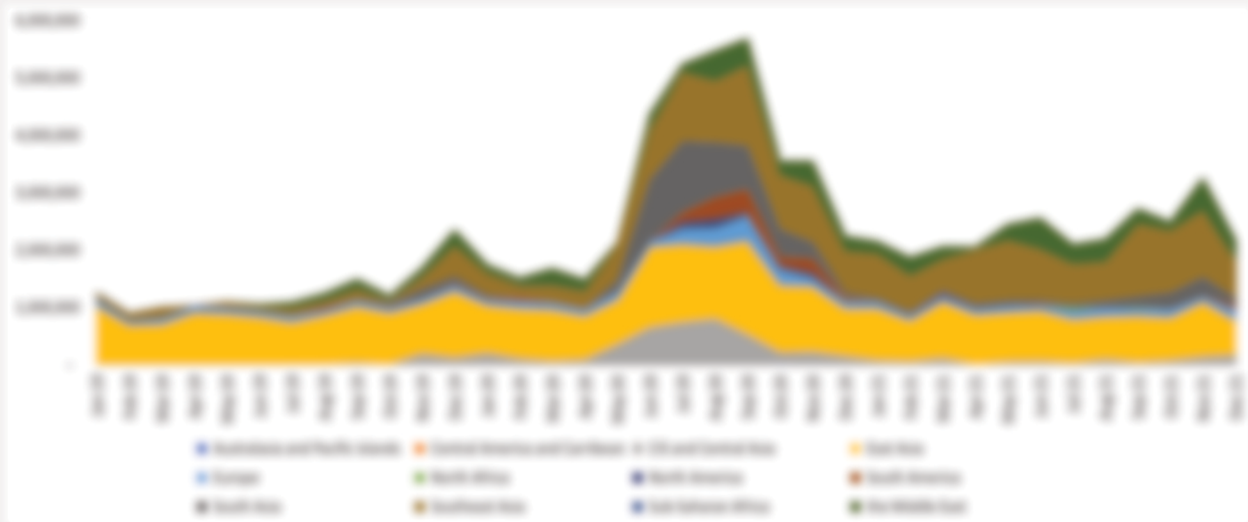


FIGURE 13: CHINESE EXPORTS BY PRODUCT

Source: GTT, Kallanish





The main product group imported by China in December was semis, which fell 36% m-o-m but increased 35% y-o-y to 1.172mt. Total semis imports were 13.765mt over 12 months, down 25% y-o-y. While volumes overall fell, spot carbon steel imports from Vietnam fell while stainless imports from Indonesia were firm. China imported just 95,011t of semis from Vietnam in December, a decrease of 70% m-o-m and a 61% y-o-y. Through 2021, semis imports from Vietnam hit 2.776mt, down 8%. In December China also sourced 228,039t of Indonesian semis, a m-o-m fall of 26%, but a y-o-y rise of 57%. Over 2021, these imports reached 3.048mt, up 73% y-o-y. In December, the Middle East supplied another 347,532t of semis to China, a m-o-m reduction of 38%, but a y-o-y growth of 53%. Over 2021 to December, imports of Middle Eastern semis reached 3.58mt, up 32%.

The volume of flats China imported dipped 38% m-o-m and 42% y-o-y to 589,340t in December, driven by volumes from Japan. Flats imports were 9.949mt over 12 months, down 38%. Japan supplied 112,785t of carbon and alloy steel HRC to China in December, down 54% m-o-m and 36% y-o-y. Over 12 months, meanwhile, China imported 2.331mt of Japanese carbon and alloy steel HRC, down 13% y-o-y.

The volume of longs imported by China fell 16% m-o-m increased 20% y-o-y to 376,188t, and 12-month imports were up 6% y-o-y to 3.928mt. The volume of pipes China imported was 35,924t in December, an increase of 30% on-month but down 15% on-year, while imports through January-December were down 8% to 391,794t.

MARKETS

LONGS

FIGURE 17: LONGS PRICES

Source: Kallanish

FLATS

Chinese flat steel prices fared a little better than rebar as they escaped the seasonal hit to construction activity. 5.5x1,500mm Q235 HRC meanwhile was traded at around CNY 4,960-4,980/t at the end of January, flat on-week but up CNY 80/t from the end of 2021. End users however have seen activity decline with the lunar new year holiday. Firm manufacturing activity will be a key goal if China needs to keep the economy stable, and so traders do expect strong demand in the coming weeks. They also expect higher prices, and are willing to take on a certain amount of inventory.

Offers in export markets also continued to rise due to support from spot prices, futures and the demand outlook. Meanwhile, increases in Indian offers also boosted expectations of a seller's market after the holiday. The main buyers in Vietnam also left markets for the Lunar New Year. SAE 1006 HRC offers given by Chinese mills/traders were last heard at over $790/t fob China, and as high as $820/t fob. Kallanish assessed 2mm SAE 1006 HRC at $775-785/t fob China on 28 January, ending more than a month of stability and rising $20/t on-week. The gap between Chinese and Indian offers to Vietnam have narrowed, although Chinese material is still higher-priced. This has left sellers firm in their offers and unwilling to negotiate lower.

TABLE 3: FLATS PRICES

	2021	y-o-y	Dec-21	Jan-22	M-o-m	Y-o-y
HRC (CNY/t)	5,339	40.9%	4,898	4,963	1.3%	8.4%
HRC fob ($/t)	834	70.4%	771	765	-0.8%	14.2%

FIGURE 16: FLATS PRICES

Source: Kallanish

RAW MATERIALS

Seaborne iron ore prices have supported steel prices so far this year. The Kallanish KORE 62% Fe index increased $18.15/t from the end of December to $137.16/dry metric tonne cfr Qingdao, after retreating slightly from the highest level since September last year. The Kallanish KORE 65% Fe index gained $26.49/t on-month to $166.31/dmt cfr, and the KORE 58% Fe index grew $18.23/t to $111.06/dmt cfr. Supply uncertainty was one reason for the higher spot and futures prices. Covid restrictions have made it increasingly difficult for miners to transport sufficient workers to their mines to maintain normal operations. Combined with mill restocking ahead of the New Year holiday and a recovery in steel output, this brought port stocks lower by the end of the month. Across 35 ports, iron ore stocks dropped another 1.07 million tonnes in the last week of January to 149.02mt, according to SMM, down from 152.07mt at the end of 2021.

Scrap prices however have not enjoyed the same support. EAFs have been shutting down production even as blast furnaces have been ramping up. They already faced higher costs before changes in China's energy markets drove electricity costs sharply higher over recent months.

Kallanish assessed Chinese 6mm+ heavy scrap delivered to mills in eastern China's Yangtze River Delta at CNY 3,627/tonne ($571/t) on 28 January, the last trading day before the holiday. This was CNY 69/t up from the end of December but down CNY 39/t from a mid-month peak. Scrap continues to be disadvantaged by the fact that EAFs are the marginal production in China, and are the first to cut output in difficult times.

Chinese scrap import markets have meanwhile also been quiet despite falling prices. Imported HRS101 heavy melting scrap was assessed at $550/t at the end of January, down $20/t from a month earlier. Supplying countries however have been hiking offers on the back of tight availability for export. This applies to both US and Japanese scrap, and offers have been resilient despite severe difficulties in the Turkish economy.

TABLE 4. RAW MATERIALS PRICES

	2021	y-o-y	Dec-21	Jan-22	M-o-m	Y-o-y
KORE 62% Fe iron ore ($/dmt)	159	71.4%	112	131	17.3%	-21.4%
KORE 65% Fe iron ore	185	76.9%	130	158	21.1%	-15.6%
KORE 58% Fe iron ore	136	62.3%	84	103	22.0%	-33.4%
Yangtze delta heavy scrap	3,526	34.2%	3,467	3,629	4.7%	15.7%

Source: Kallanish

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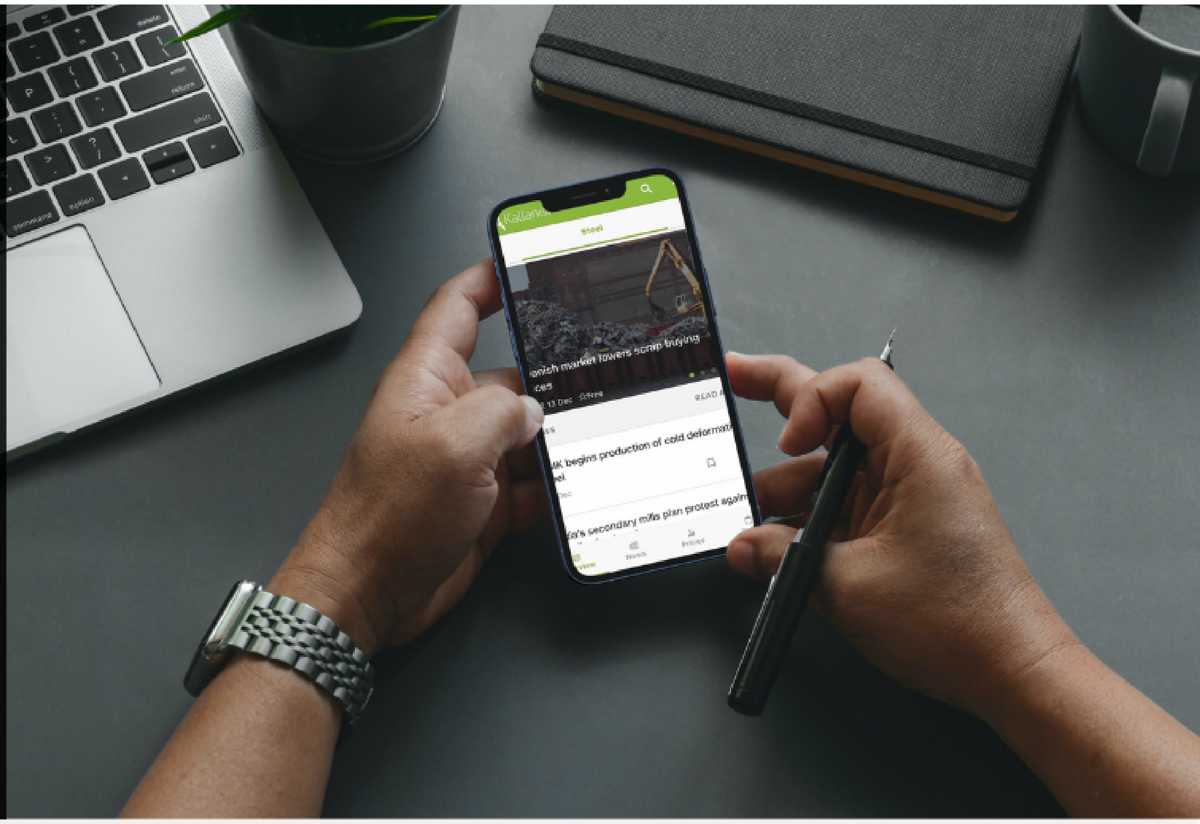

View full dataset in attached datafile (subscribers only)

Steel Data:	Sept	Oct	Nov	Dec
Crude steel production	73.75	71.58	69.31	86.19
Steel exports	4.92	4.50	4.36	5.06
Steel imports	2.72	2.49	3.26	2.17
Apparent steel consumption	67.99	66.12	64.74	79.02
Calculated real demand	78.54	72.08	72.91	86.45

INFLATION

Source: NBS

Macro data:	Sept	Oct	Nov	Dec
Manufacturing PMI (NBS)	49.60	49.20	50.10	50.30
Manufacturing PMI (Caixin)	50.00	50.60	49.90	50.90
CPI	0.70%	1.50%	2.30%	1.50%
PPI	10.70%	13.50%	12.90%	10.30%
FAI (CNY trillion)	39.78	44.58	49.41	54.45
Industrial Value-added	3.10%	3.50%	3.80%	4.30%

MANUFACTURING PMIS

Source: NBS, Caixin

Downstream data:	Sept	Oct	Nov	Dec
Real estate investment *	11,267	12,493	13,731	14,760
New Construction starts ytd**	1,529	1,667	1,828	1,989
Completed construction ytd**	510	573	688	1,014
Real estate sales ytd**	1,303	1,430	1,581	1,794

*(CNY billion) **million square metres

IN NEXT MONTH'S ISSUE

Next issue we will be looking at the implications of China's wavering environmental targets.

CONTACT KALLANISH

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