



# Chinese steel industry in consolidation mode

- Steelworld Research Team

Steel industry in China is currently passing through a consolidation phase. The Communist government of the world's largest steel producing nation has framed the policy in favour of steel industry's re-orientation through closure of environment un-friendly smaller mills which analysts believe will help bigger players to consolidate their business for future growth.

Early this month, the Chinese government had announced to shut down all steel blast furnaces of less than 400 cubic metres each to be closed by the end of 2011. This means, at least by 20-25 per cent of steel mills with less than 4,00,000 – 5,00,000 tons are currently facing threat of closure. The country also aims to shut down more than 50 gigawatts of small coal-fired power generators and 8,000 small coal mines this year.

## The Industry

Chinese steelmakers, which idled dozens of mills and cut production as the global economy slowed, are now ramping up their production capacities. Rio Tinto, which sells the most iron ore to China, is restarting production in anticipation of higher Chinese demand. China also is trying to unify a fragmented and sprawling domestic industry to present a strong, unified voice in price negotiations for sales and purchases of raw materials. The idea behind it to capitalise better on the country's huge appetite for the materials that make everything from refrigerators to bridges. The country's continued resilience was the dim light in an otherwise dreary year for miners and steelmakers, marked by layoffs, mine closings and production and investment pullbacks as prices for commodities tumbled. And it looks to be the beacon going forward, along with India, to a lesser extent. While other economies are strengthening, they don't offer the same potential for growth as China, which makes penetrating that market critical. Chinese steel production and demand is likely to continue its inexorable rise.

China's steel output rose 13.5 percent to 567.84 million tons in 2009. The country's share in global crude steel output continued to rise. It's steel production occupied 46.6 percent in 2009, up 8.9 percent over 2008. The next biggest producer, Japan, will make just one-sixth of what China is expected to produce. The US was fourth in production, behind Russia, last year. Its 68 large and medium-sized iron and steel companies reaped 55.39 billion yuan (US\$8.12 billion) in profit in 2009 backed by enormous infrastructure development. Although, the profit was down by 31.43 percent from a year earlier, yet analysts say it is a good

recovery this year despite numerous policy decisions that may put negative impact on the industry. The country's crude steel production capacity was forecast at 700 million ton at the end of 2009, compared with 660 million tons at the end of 2008. Industry expects the country to achieve 600 million tons of output this year. To achieve this target, steel mills require about 700 million tons of iron ore and over and over 300 million tons of coking coal.

China's consumption of the steelmaking material coking coal is expected to grow 11 percent this year to about 600 million tons. The country's coking coal production, meanwhile, is likely to grow 9 percent this year from last year's 500 million





tons. Coking coal imports by China are projected at 25.5 million tons this year, a 269.6 percent jump over 2008. Back home, the Indian government is targeting 200 million tons of steel production by 2020 from the current level of about 60 million tons, which would require additional coking coal. India produces 22 million tons of metallurgical coke against the annual consumption of 28 million tons, while the rest is met through import.

### Staggering demand

Massive government stimulus and infrastructure plans—including for rails, roads and bridges in eastern China and for general construction and factory building in the western part of the country—are fueling demand. Most of the steel production will be consumed internally, says the China Iron and Steel Association, the main steel trade group in the country. China's exports have dropped between 10 percent and 50 percent, depending on the product and country in the last year, which is welcome news for ArcelorMittal Chief Executive Lakshmi Mittal. Mittal says that last fall, China's steelmakers remained fairly disciplined about keeping their steel from flooding foreign markets, which has helped steelmakers around the world raise prices.

BHP Billiton, the world's largest miner, Rio Tinto, Australia's Fortescue Metals Group Ltd. and Brazil's Vale all are increasing production of iron ore, and in some cases coal, to meet the expected increased demand in China. Gradually, Australian ports are becoming congested again, with coal ships in line on the ocean, waiting to load and unload. Analysts are raising their forecasts for Chinese demand to rise in coming months. Therefore, the outlook of China's steel industry will be better this year than 2009 as the impact of the stimulus package continues, the Ministry of Industry and Information Technology (MIIT) said. A strong increase in new investment plans would help boost domestic demand for steel while improving external demand following world economic recovery would encourage steel exports. The implementation of a proactive fiscal policy and moderately

easy monetary policy injected ample liquidity into the market and provided the steel enterprises with easy access for fund. However, excess capacity, still weak external demand and rising production costs would all impose pressure on the development of the industry.

### Fresh investment under cloud

Senior Chinese steel industry officials are still sensing uncertainties to challenges in 2010 including domestic tightened credit policy, price gap between domestic and overseas market, export difficulty under international trade protectionism, newly released 50 million tons capacity and cost hike which is to be settled in iron ore talk. Experts said that 567.8 million tons of crude steel output in 2009 or a surge of 13.5 percent Y-o-Y in China, sharply compared with the tumble of as much as 30 percent in other regions of the globe is mainly owing to the impetus of domestic investments. But a mild adjustment which has been made in the credit policy by government recently is expected to damp down new investments in steel industry. Also export is expected to be squeezed by higher prices at home against overseas markets, coupled with the growing momentum of global trade protectionism. Besides, the newly acquired capacity of some 50 million tons will exert pressure on domestic prices and the hard talk is likely to push up the ore price. All of these uncertainties will be faced and tackled by China.

### Ore import restriction

China's iron ore trading association, the China Chamber of Commerce of Metals, Minerals and Chemicals Importers and Exporters (CCCME), has banned its members from importing iron ore with less than 60 percent iron content. The ban covered trading firms but not steel mills and their licensed agents. It was part of a joint effort with the China Iron and Steel Association to 'rectify' the sector, an Indian ore exporter said. Supporting industry views, the government of China has asked iron ore traders not to import low grade iron ore, steelmaking ingredient, in a move to clamp down on





speculative purchases. The 'self-discipline' rule not to import iron ore less than 60 per cent of Fe content, was agreed to by the China Iron and Steel Association, and the China Chamber of Commerce of Metals, Minerals and Chemicals Importers and Exporters, according to reports. The measure is understood a prelude to more formal government regulations being introduced later in the year to drive traders from the import scene altogether. Vale SA, the world's largest iron ore producer, and BHP this year ended a four-decade system of setting annual prices by signing short-term contracts with Asian mills, with the Brazilian company winning a 90 percent increase. The China Iron and Steel Association, representing steelmakers, have declined to accept the move to quarterly contracts or the price increase. India and Australia ship iron ore with less than 60 percent content to China.

China's iron ore imports surged 42 percent to a record 628 million tons last year. Importers handling less than 1 million tons of ore in 2009 will be disqualified from obtaining future import licenses, Credit Suisse said, as part of the agreement by the metals chamber and the steel association. The measures are designed to help the steel association eliminate 'rampant industry speculation,' Credit Suisse said in a report.

### China's back to basic

Chinese steel mills are wrestling to negotiate iron ore price from the three global mining major; Brazil's Vale and Anglo-Australian BHP Bilton and Rio Tinto that extracted hefty price rises in the past few years. The first salvo, which China fired as ore price negotiations for the season starting April 2009 began recently, must have wracked the nerves of the triumvirate of miners. Favouring the price rise China Iron and Steel Association (CISA) Secretary General Shan Shanghua said: "Since steel prices have sunk to 1994-levels in the wake of global financial crisis and demand fall, iron ore prices should be calibrated accordingly." However, the

argument that ore prices should stay in alignment with steel prices is unarguable. As 1.6 unit of ore will be used for making one unit of steel, the mineral is the single biggest element in the metal's production cost. Incidentally, the benchmark grade iron ore contract price has advanced from US\$24.40 a ton in 1994 to over US\$100 a ton now.

Chinese importers, according to RK Sharma, Secretary General of the Federation of Indian Mineral Industries, are now buying fines from India at spot prices ranging from US\$70-80 a ton. At this stage, no one will risk forecasting where iron ore spot prices will be a quarter or two hence as steel mills everywhere are cutting production so that inventories at their end don't rise. China over the last few years has been stepping up ore procurement from India to reduce its dependence on the likes of Vale, BHP and Rio. Sharma is confident that China will step up ore procurement later this year, now that India has done away with duty on ore fine exports. China shared over 88 percent in India's iron ore exports of 106 million tons in 2008-09. The country largely buys fines from India for which there is still little local use in the absence of sufficient pelletisation capacity.

### Growth to slowdown

The rating agency Fitch expects Chinese steel demand to grow by 5 percent to 8 percent in 2010, slowing from 19 percent in the first nine months of last year. Unless export demand for Chinese steel products starts to pick up, industry crude steel capacity will remain in excess of demand in 2010, putting pressure on steel product prices. Meanwhile, inventories of imported iron ore at China's major ports fell to 66.64 million tons by the end of first week of April. The volume of stocks imported from Australia stood at 20.45 million tons, down 820,000 tons and represented 30.7 percent of the total. Ore originating from Brazil stood at 17.30 million tons, down 430,000 tons, and made up 26.0 percent of the total. Indian ores totaled 16.40 million tons, down 570,000 tons consisting 24.6 percent of the total.

