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CHINA LIGHTS A FIRE

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CHINA STEEL INTELLIGENCE

JUNE 2019

China lights a fire

Chinese steel market sentiment turned on a dime in June and sent prices of both steel and iron ore soaring at the end of the month. Support for local government spending and increasing restrictions on production sent steel prices sharply higher, while iron ore hit new highs as port stocks continued to fall.

So far these measures have mainly impacted sentiment however. The real impact on the market of production restrictions will be revealed this month, while the impact of increased local government spending will be felt more strongly from the autumn.

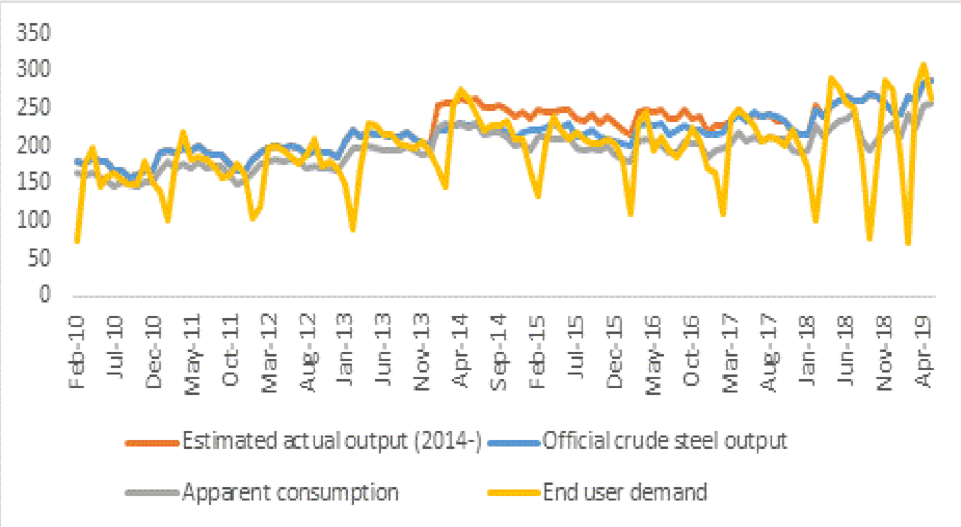
The question now is, is the rally sustainable or just a flash in the pan?

Table 1: Supply and Demand (million tonnes)

	2018	2019 ytd	Yoy	2019 outlook	Yoy
Crude Steel Production	928.3	404.9	10.20%	947.0	1.30%
Apparent Steel Demand	825.5	360.4	10.50%	844	1.60%
Real Demand Est	827.6	338.9	9.50%	845	1.00%

Source: NBS, Kallanish

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

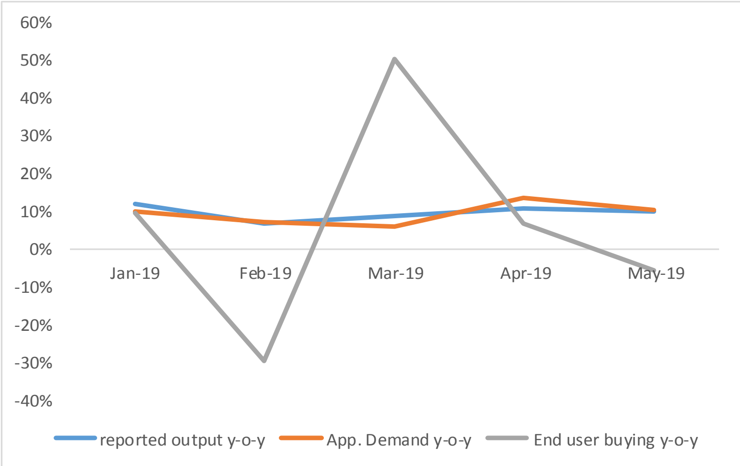


Source: NBS, Kallanish

What a difference a month makes

At the end of May, the Chinese steel markets were nervously eyeing the summer slowdown in demand as production hit record levels and inventories looked set to start increasing. Demand in fact had already begun to slow in May and that trend is expected to have deepened in June. A sharp turnaround in sentiment was engineered however and the market is now working on the assumption of strong investment and steel demand in the second half of the year.

Fig. 2 Demand growth rates reversed in May



Source: NBS, Kallanish

The situation at the end of May was supported by data released last month. Even with crude steel output in May at a record 89.09 million tonnes, officially up 10% year-on-year, the implications for demand were negative. Apparent steel consumption was roughly flat month-on-month and gained strongly year-on-year, but inventory drawdown stalled. Total inventories estimated from third-party data by Kallanish were down just 2.5% over the month, compared to an 18.3% decline in April and a 17% drop in May 2018. That left implied end user buying over May down 12% m-o-m and 4.5% y-o-y at 81.77mt. Wider economic data was also indicating a slowdown, with construction, manufacturing and credit data all disappointing and the trade war showing no signs of abating.

Inventory drawdown meanwhile continued to sputter out at the start of June, while production levels hit new highs. Trader inventories across rebar and HRC fell only marginally in the first week of June, while HRC inventories had already been increasing slowly since late May. Major mill crude steel output meanwhile hit a new record high in the first ten days of June, according to the China Iron and Steel Association. These mills were producing crude steel at 2.06 million tonnes/day, another 1.5% higher than the average for May and an annualised 752m t/y. That trend would certainly have seen official crude steel output see its first ever 90mt month in June.

In the second week of June however the beginnings of a turnaround were engineered. Marking the shift was a notice on local government special bond issuance and supporting project financing released by the general office of the Communist Party central committee and the general office of the State Council. "... Guided by Xi Jinping's new era of socialism with Chinese characteristics..." both the party and the state now appear committed to increasing the quota for local government bonds this year. This had been a major concern for demand as the surge in issuance in the first quarter had left monthly issuance on a downtrend, with potential to limit spending by the end of the year. The document also states that local governments can now

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