



is a leading steel information service in Englewood Cliffs, N.J., USA

WSD's steel experience, steel database and availability of steel statistics are the principles for performing steel forecasts, studies and analysis for international clients. WSD seeks to understand how the "pricing power" of steel companies the world over will be impacted by changes in the steel industry's structure. The views and opinions expressed in this article are solely those of World Steel Dynamics and not necessarily those of AIST.



Authors

Peter Marcus (left)
managing partner,
World Steel Dynamics
pmarcus@worldsteeldynamics.com
+1.201.503.0902

John Villa (right)
research strategist,
World Steel Dynamics
jvilla@worldsteeldynamics.com
+1.201.503.0911

China in Zugzwang: Part 1

Note: Zugzwang is a condition in which a chess player has a solid position; but, once he or she makes the next move, the consequence is a lost position.

As WSD sees it, the Chinese economy and its steel industry are in zugzwang because, almost no matter what their next move is, the outcome is a losing position. For example:

- China is near its upper limit in promoting fixed asset investment (FAI) as a share of GDP. Already, adjusted FAI is close to 45% of GDP. It appears that high-returning projects are less available due to overbuilding, and municipalities' debt is rising substantially as a consequence of the massive spending.
- The country is suffering from massive capital outflow because of the loss of confidence on the country's growth rate, the lessened competitiveness of its manufacturing sector, worries about anti-Chinese trade measures in other countries, a weakening RMB and the increased attractiveness of U.S. treasury securities due to rising interest rates in the United States. China's reserves tied to foreign exchange factors are now only about US\$3.0 trillion versus US\$3.9 trillion in June 2014.
- A weakened Chinese RMB/U.S. dollar will lead to worries that inflation in the country is about to accelerate as China needs to import raw materials from overseas markets. As more information becomes available about the inner workings of the Chinese economy, such as the 20% overstatement of GDP by Liaoning Province several years ago, China's "country risk factor" will continue to rise in the eyes of both its domestic and foreign investors.
- The country's housing investment sector is in the process of turning down sharply — as it also did several years ago — due to the recent rapid run-up in prices — in effect, a Chinese housing price bubble. As a share of adjusted FAI, housing investment accounts for about 23% of the total; manufacturing about 32%; and infrastructure spending about 25%.
- The country's air and water pollution problems accelerate policymakers' desire to lessen the emphasis on heavy industry growth in China — which has been the largest source of the economic growth, by far, in the past decade.
- President Trump seems likely to impose sizable tariffs on a number of China's manufactured goods. In general, at the present time, it seems correct to say that China is the world's greatest beneficiary of mercantilistic practices by its government's policymakers; and, conversely, the U.S. is probably the biggest loser. This situation seems about to end.
- China's steel industry has huge excess capacity. For example, 123 blast furnaces have been built since 2012 with 163 million metric tons of capacity. Moreover, Chinese steel demand seems almost certain to decline 10–15% in the next half-decade as: (a) GDP grows more slowly, which means that services account for a greater share of GDP growth; and (b) steel-intensive FAI declines as a share of GDP as only moderate steel-intensive household spending rises as a share of GDP. To make matters even worse for the Chinese steel mills, steel product exports of about 110–115 million metric tons per year are far from sustainable because of

Table 1

China GDP Forecast: 2000–2010** (billion RMB, %)

Year	Gross fixed capital formation (CFCF)	Chg %	Consumption expenditure				Inv. and net export	Total GDP*		Real GDP (1990)	GDP current less real	GFCF			Consumption		Inv. chg and net export	Total GDP
			Gov't		Household			Current	Chg (%)			Total (%)	Infra-structure	Other	Gov't	Household		
				Chg (%)		Chg (%)												
2000	3,453		1,668		4,699		238	10,058				34.3	14.0	20.3	16.6	46.7	2.4	100
2001	4,038	16.9	1,784	7.0	5,071	7.9	232	11,125	10.6	8.3	2.3	36.3	14.6	21.7	16.0	45.6	2.1	100
2002	4,513	11.8	1,899	6.4	5,508	8.6	309	12,229	9.9	9.1	0.8	36.9	15.2	21.7	15.5	45.0	2.5	100
2003	5,584	23.7	2,017	6.2	5,935	7.8	296	13,832	13.1	10.0	3.1	40.4	15.6	24.8	14.6	42.9	2.1	100
2004	6,942	24.3	2,250	11.6	6,658	12.2	424	16,274	17.7	10.1	7.6	42.7	16.0	26.7	13.8	40.9	2.6	100
2005	7,753	11.7	2,622	16.5	7,523	13.0	1,021	18,919	16.3	10.4	5.9	41.0	16.8	24.2	13.9	39.8	5.4	100
2006	8,982	15.9	3,061	16.7	8,413	11.8	1,665	22,121	16.9	11.1	5.8	40.6	17.8	22.8	13.8	38.0	7.5	100
2007	11,205	24.7	3,644	19.0	9,979	18.6	2,342	27,170	22.8	11.4	11.4	41.2	16.3	24.9	13.4	36.7	8.6	100
2008	13,824	23.4	4,213	15.6	11,534	15.6	2,423	31,994	17.8	9.6	8.2	43.2	16.3	26.9	13.2	36.1	7.6	100
2009	16,212	17.3	4,607	9.4	12,665	9.8	1,504	34,988	9.4	8.7	0.7	46.3	19.2	27.1	13.2	36.2	4.3	100
2010	19,665	21.3	5,294	14.9	14,606	15.3	1,506	41,071	17.4	10.4	7.0	47.9	20.6	27.3	12.9	35.6	3.7	100
2011	23,333	18.7	6,449	21.8	17,653	20.9	1,169	48,604	18.3	9.2	9.1	48.0	20.2	27.8	13.3	36.3	2.4	100
2012	25,524	9.4	7,258	12.5	19,853	12.5	1,464	54,099	11.3	7.7	3.6	47.2	18.0	29.2	13.4	36.7	2.7	100
2013	28,207	10.5	8,058	11.0	21,976	10.7	1,455	59,696	10.3	7.7	2.6	47.3	17.2	30.1	13.5	36.8	2.4	100
2014	30,272	7.3	8,577	6.4	24,254	10.4	1,615	64,718	8.4	7.3	1.1	46.8	16.8	30.0	13.3	37.5	2.5	100
2015	31,307	3.4	9,476	10.5	26,475	9.2	2,401	69,659	7.6	6.9	0.7	44.9	16.3	28.6	13.6	38.0	3.4	100
2016e	32,460	3.7	10,518	11.0	30,382	14.8	1,800	75,160	7.9	6.7	1.2	43.2	16.0	27.2	14.0	40.4	2.4	100
2017e	33,600	3.5	11,633	10.6	34,427	13.3	1,300	80,960	7.7	6.5	1.2	41.5	16.0	25.5	14.4	42.5	1.6	100
2018e	34,760	3.5	12,797	10.0	38,443	11.7	900	86,900	7.3	6.3	1.0	40.0	16.0	24.0	14.7	44.2	1.0	100
2019e	35,860	3.2	14,076	10.0	42,354	10.2	600	92,890	6.9	6.0	0.9	38.6	16.0	22.6	15.2	45.6	0.6	100
2020e	37,000	3.2	13,360	10.0	48,340	14.1	200	98,900	6.5	6.0	0.5	37.4	16.0	21.4	13.5	48.9	0.2	100

*International GDP definition by Expenditure Approach, data available annually.
Source: WSD estimates

the avalanche of trade suits filed against the Chinese mills since 2015.

- Regarding mercantilism, it is a broad-based version of protectionism designed to promote the growth of selected manufactured products via the practice

of imposing high import tariffs or quotas on these products. In effect, mercantilism can be practiced only when a country's policymakers have the power to place its key trading partners at a disadvantage.

This report includes forward-looking statements that are based on current expectations about future events and are subject to uncertainties and factors relating to operations and the business environment, all of which are difficult to predict. Although WSD believes that the expectations reflected in its forward-looking statements are reasonable, they can be affected by inaccurate assumptions made or by known or unknown risks and uncertainties, including, among other things, changes in prices, shifts in demand, variations in supply, movements in international currency, developments in technology, actions by governments and/or other factors. ◆