Chinese Steel Mills Outperforming the Others — Forever Strong? Part I

Looking ahead to 2030, WSD's answer to the above question is "less strong." China's steel demand on a crude steel equivalent basis in 2030 is likely to be down 50–100 million metric tons from 950 million metric tons in 2019. The "driving force" will be the economy's lessened steel intensity due to a lower gross domestic product (GDP) growth rate and rising household spending (that, due to its nature, is not steel-intensive) as a share of GDP. Fixed asset investment (FAI), which is highly steel-intensive, is forecast to decline as a share of GDP. Overcapacity and intense price competition in the Chinese domestic market will persist for hot-rolled band although the industry will be far more concentrated as Baowu — now the world's largest steelmaker with a capacity of about 100 million metric tons per year — and some others strive to double their output largely via acquisitions. More countries will have implemented trade actions against the Chinese mills, limiting their exports. The Chinese steel companies will continue to be aggressive purchasers of distressed offshore steel mill assets.

In 2020, China's mid-sized and larger steel mills — the principal members of the Chinese Iron and Steel Association (CISA) — are enjoying probably a record variation in performance versus steel mills in most countries (although not the leading Russians mills that benefit from: (a) low-cost company-owned iron ore and coking coal mines in some cases; (b) ever more modern plants; and (c) cost benefits in U.S. dollar terms due to the weakened Russian ruble). Many non-Chinese mills at present are suffering from deep production cuts, weak prices and losses.

In Part I of this report, WSD comments on some positives for the Chinese economy and its steel mills. Part II, to be published in the next issue of *Iron & Steel Technology*, will be a discussion of the negatives.

The Chinese Economy

- As of June 2020, the economy is already recovering strongly.
- The country's savings rate remains high at about 45–48% of GDP.
- China's FAI is currently running at about 45% of GDP.
- Specialized governmental policymaking groups are experienced in quickly implementing new policies when needed.
- If China's per annum GDP growth rate in several years slows to 4%, this will still be one of the higher expansion rates among the advanced countries.
- The education system is strong from kindergarten to graduate schools.
- The Chinese middle class has grown sharply. Also, a sizable number of entrepreneurs have become millionaires given the success of their own private companies.
- The Asian Infrastructure Investment Bank is outperforming the World Bank. It's taking forward the country's "Belt and Road" investments.
- The current inflation rate is moderate — about 4.5% per annum.
- The country's holding of foreign exchange reserves is immense — at about US$3.4 trillion.
- Sizable prior foreign direct investment (FDI) has made countless offshore

WORLD STEEL DYNAMICS

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

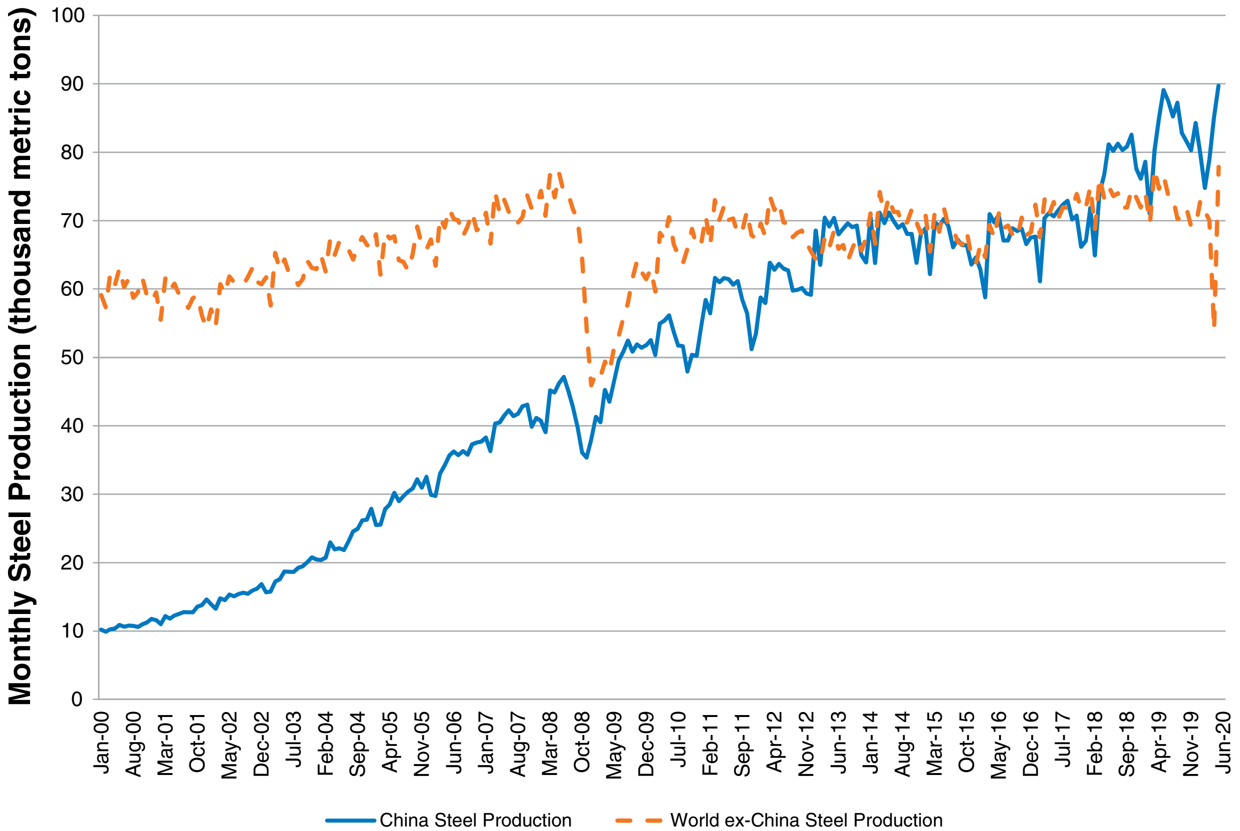
WSD's steel experience, steel database and availability of steel statistics are the principles for performing steel forecasts, studies and analysis for international clients. WSD seeks to understand how the "pricing power" of steel companies the world over will be impacted by changes in the steel industry's 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

Figure 1



China vs. world ex-China monthly steel production (thousand metric tons). Sources: World Steel Association, WSD estimates.

manufacturers and retail establishments dependent on Chinese merchandise.

- Municipal debt is sizable, but it can easily be refinanced.
- No political strife.
- A stable Communist Party structure, with wealthy families owning it.
- The massive rise in the kilometers of railroad track for high-speed bullet trains.
- A sizable number of deepwater ports.
- Parents seek to save sizable funds for their single child when needed.

Positives for the Chinese Steel Mills

The Chinese steel industry's production performance in 2020 has similarities to what happened in 2009 during the global financial crisis. Chinese steel production in 2009 versus 2008 rose 13.6% to 568 million metric tons. By 2011, it was up to 683 million metric tons, or 88 million metric tons more than in 2007. Rest of World output in 2009 versus 2008 fell 20.5% to 659 million metric tons. In 2011, output at 835 million metric tons was still 16 million metric tons, or 1.9%, less than in 2007.

Other positives:

- Chinese steel production in April 2020, year to year, was up 0.2% to 85.0 million metric tons (62% of global output). Rest of World output fell 31% to 52.1 million metric tons (see the accompanying figure).
- Chinese pig iron production in April 2020 was annualized at 835 million metric tons, up 3.2% from full-year 2019 output of 809 million metric tons — or, temporarily, in April this year, more than 70% of global output.
- Steel demand in 2019 rose about 8%. A further minor gain seems possible in 2020.
- China's obsolete steel scrap recovery is accelerating.
- M&A activity is surging as the industry concentrates.
- Capital spending by Chinese steel has been running at about US$80 billion annually.
- Migrant workers for most mid-sized and larger steel mills are only a minor share of the workforce.

- Since the second half of 2017, booming demand for rebar, combined with mid-2017 capacity reductions, have been positively impacting the industry's supply/demand balance for some other products including hot-rolled band.
- Municipalities have a sizable ownership position in, and provide strong financial support to, local mid-sized and larger steel mills.
- Several Chinese steel mills own sizable nearby medium-cost iron ore operations.
- Chinese mills have been acquiring distressed offshore mills.
- In May 2020, the median-cost Chinese steel mill had a hot-rolled band ex-works marginal cost of about US$408/metric ton, prior to the expense to deliver the steel to the marketplace.
- The quality of Chinese steel products continues to broaden and improve.
- The construction cost to build a new steel plant in China is 40% lower than is the case in many foreign countries.
- Hebei Steel, the No. 2 producer, owns a sizable stake in Duferco, the world's leading steel trading company.
- Chinese steel mills have not had the lowest prices for hot-rolled band on the world market because of good volumes and high prices in their home market. Wide hot strip mill capacity has been close to fully utilized.
- Chinese steel traders in recent months have purchased 2–4 million metric tons of offshore lower-priced steel products, including pig iron, billet, slab and hot-rolled band.
- The Chinese steel mills have good access to bank funds.

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. ✦