August Steel Survey

Minor Steel Rally Belies Falling Demand

- Steel prices will fall back to recent lows by the end of September.
- August steel production was flat MoM and down 4 – 5% YoY.
- We expect steel production to fall by 7% in the second half of 2015 and 4% for the full year (we previously estimated 2%) due to falling industrial demand and negative export growth.
- Iron ore prices will trend back toward USD 45 in September.

Tim Murray

Steel market trading rallied in August, as reduced production improved prices, but end demand for steel continued its downward trend. Overproduction of steel, particularly construction steel, in May and June saw prices fall to 15-year lows while inventories at steel mills rose. In July, steel mills reacted by reducing production across the board by 3.6%. Construction steel production volumes fell by closer to 5-6%. Those cuts meant that, by August, the price of construction steel increased sharply due to perceived shortages. Steel traders became more willing to hold steel inventory.

Steel futures indicate that prices will fall back to the lows of July.

And yet end demand did not improve in the month. That has led to an inevitable decline in steel prices now, as production of construction steel increased. Steel futures indicate that steel prices will fall back to the lows of July. We expect steel prices to fall in September and production to fall further in October.

We expect steel production in August to be around 66 MMT, which is flat on July and down 4–5% YoY.

Production to decline 7% in H2: We now expect production to fall 7% in H2 2015 for two key reasons:

1. **Manufacturing demand is falling rapidly.** Key sectors are sharpening their decline. Demand from autos was down by around 2% in the first half but will fall by around 8% in the second half. We see similar declines across manufacturing sectors.
2. **Exports will flatten:** Exports grew 26% in the first seven months of 2015, adding around 12 MMT of demand and almost replacing the 16 MMT in decline from construction. In the last four months of the year, exports face a high 2014 base, as steel export growth in the last four months of 2014 grew by more than 80%. Due to the higher base and slowing global demand, we expect export growth to go negative. Additionally, Southeast Asia, particularly Malaysia, has been the key destination for incremental Chinese exports this year, and Malaysia is considering anti-dumping measures against China. Without steel export

Tim Murray +852 2534 7405 tim@jcapitalresearch.com

growth, the fall in domestic demand will lead to falling production.

Pockets of Improvement

Harbin property up: Our survey showed some mild improvement in real estate and property development in Harbin, Wuhan, and Qingdao, but Harbin was the only city to see an increase in new construction projects started YoY; the other cities experienced just sequential improvement.

Better funding to existing infrastructure projects in half the cities: Traders in Wuhan, Shenyang, Qingdao, and Chongqing all said that infrastructure demand had improved due to better funding of current projects. Urban rail projects were the best performers.

Only Chongqing recorded growth YoY in new infrastructure projects; the other cities had none despite many announced plans for 2015. Sentiment in the cities that saw improved sequential demand from construction, representing half our sample, improved in August.

The biggest markets continued slowing: The key property construction markets of East and South China continued to slow rapidly. Suzhou saw construction sales slow 60%, and Guangzhou 20% in the month. The markets that had lower falls or slight increases in sales are markets that had seen demand fall 30-40% for the last 18 months. East and South China only started to fall this year.

Manufacturing demand down sharply: The steel trader in Wuhan claimed that manufacturing demand for steel was down 50% YoY in the month. Prices for plate steel, normally a few hundred RMB above construction steel, are now a few hundred RMB below. Demand from the auto sector is down sharply.

Autos declining: The Hangzhou trader does not expect steel sales to the auto sector to improve over the next six months, nor do we: we expect many auto dealers, already running on razor-thin margins, to collapse before the end of the year.

Industry weakest in Hunan: In Changsha, manufacturing defaults continue with yet another going under with debts of RMB 200 million. Increased accounts receivables, lack of access to finance and defaults are the trend.

Table 1. Steel Forecast

MMT	2014	2015	Growth
Domestic Steel Consumption	706	632	-10.5%
Construction Steel (60%)	424	391	-7.8%
Construction Property (75%)	318	285	-10.4%
Construction Infrastructure (25%)	106	106	0.0%
Manufacturing Steel (40%)	282	272	-3.5%
Exports of Steel	94	105	11.7%
Total Production	800	768	-4.0%

Source: J Capital

Table 2. Steel Trader New Construction Project Sales August 2015 vs. August 2014

City	Trader % of Sales to New Property Construction August 2015	Trader % of Sales to New Property Construction August 2014	Trader % of Sales to New Infrastructure August 2015	Trader % of Sales to New Infrastructure August 2014
Harbin North	20%	15%	0%	0%
Shenyang North	8%	0%	0%	35%

Tim Murray +852 2534 7405 tim@jcapitalresearch.com

Qingdao North	0%	0%	0%	0%
Chongqing West	10%	12%	22%	20%
Chengdu West	1%	5%	0%	8%
Suzhou East	0%	45%	0%	0%
Guangzhou South	0%	5%	0%	5%
Changsha South	0%	12%	7%	11%

Source: J Capital survey conducted by telephone 26-28 Aug 2015

Table 3. Steel Trader Sales August 2015

City	MoM Aug	YoY Aug	YoY July	Est YoY Next 3 Mon 2015	Est Regional Sales YoY Aug 2015	Trader Notes
Harbin North	13%	4%	10%	0%	5%	Prices have improved. Steel mills have run down inventory and stopped making retail sales. Sales are unexpectedly good. Property projects started late this year.
Shenyang North	15%	-35%	-40%	-35%	-40%	Signed all the available construction projects. Demand a lot softer than last year.
Qingdao North	5%	0%	-10%	10%	10%	End demand remains unchanged. Sales are only good as rising prices and shut down due to the parade caused traders to restock. Some projects, with low stock have restocked. We have been doing well because of export growth. We could have done better, however, our stock was destroyed in Tianjin explosion.
Wuhan Central	-5%	-7%	-10%	-10%	-10%	Demand for construction steel was high in this month as prices surged 20%. Prices have fallen back 10%. Flat steel is normally more expensive than construction steel, is now about 15% less. Manufacturing steel demand is down 50%.
Chongqing West	-3%	-10%	-12%	10%	-5%	We had to cut off 12% of clients due to unpaid bills, reduced sales by 8%. Auto steel orders down reducing sales by 5%. Military orders are up increasing sales 6%. Sales are weak in the region partly because customers have poor finances and cannot purchase. We are expecting to be down 20% for 2015.

Chengdu West	110%	64%	-19%	-30%	10%	Rising steel prices improved sales. It was mainly distributors buying stocks. End demand did not improve. We were lucky this month as we had a lot of inventory and so could catch the sales when they took off.
Hangzhou East	-8%	-33%	-50%	-30%	-40%	We are concerned about receivable risks and restricting our sales.
Suzhou East	-22%	-60%	-62%	-60%	-60%	Construction demand is terrible. Developers are not buying land so no end in sight.
Guangzhou South	0%	-6%	-10%	-10%	-20%	Demand is slack and a lot of price competition for sales. Demand is down around 20%. Few larges property projects. Infrastructure okay. Seasonally sales should pick up in September. We expect full year sales down 10%.
Changsha South	8%	-5%	-8%	-5%	-5%	

Source: J Capital survey conducted by telephone 26-28 Aug 2015

Table 4. Steel Trader Inventory August 2015

City	Aug MoM%	Aug YoY%	Outlook	Notes
Harbin North	-20%	0%	-10%	We drew down inventory due to good sales and we have slowed purchasing stock as October is the start of the low season and some steel types hard to get.
Shenyang North	0%	-100%	0%	We have no stock as we can purchase in the market at the same prices as from steel mills.
Qingdao North	-30%	-8%	10%	Good sales enabled us to sell down inventory we had accumulated. We are considering restocking. A lot of steel mills have slowed or stopped producing. It will be hard to have good sales in September as we will not have the stock.
Wuhan Central	-20%	0%	-10%	Sales are poor and so we want to run down stocks.
Chongqing West	60%	30%	-25%	We restocked in August and will not purchase in September.

Chengdu West	-60%	-70%	0%	We used good sales to run down inventory.
Hangzhou East	4%	-43%	0%	Holding less as sales outlook poor.
Suzhou East	-20%	-90%	0%	We will sell deliver from steel mill inventory.
Guangzhou South	-25%	60%	-10%	Good sales have helped reduce our high levels of inventory, we will continue to reduce.
Changsha South	-10%	-75%	15%	Prices for steel rose as inventory of stock tightened. Our stock levels are very low now and we will restock.

Source: J Capital survey conducted by telephone 26-28 Aug 2015

Table 5. Steel Mill Steel Inventory August 2015

City	YoY Aug	Notes
Harbin North	-20%	Steel mills were caught off guard by rise in sales and sold down inventory
Shenyang North	-50%	Steel mills are focused on export orders
Qingdao North	-10%	Sales were good and production was low
Wuhan Central	9%	Inventory still at high levels as manufacturing demand is weak.
Chongqing West	20%	Construction steel prices were good and sold well but all other types of steel did not sell well and inventory built up.
Chengdu West	-8%	Sales were good and a blast furnace was idled.
Hangzhou East	-10%	Steel mills was slowing production and selling down inventory
Suzhou East	-60%	Steel mill was at low utilization.
Guangzhou South	20%	Steel distributors were destocking
Changsha South	-10%	Distributors reducing stock so steel mills building stock

Source: J Capital survey conducted by telephone 26-28 Aug 2015

UPCOMING J CAP EVENTS

September Trips

Property Completions: Elevators, Ceramics, and Copper Demand

Shunde, Guangzhou, Hangzhou, Wuhan. We will focus on declining completions and the demand for the late cycle building materials like elevators, ceramics and copper. We will visit south, east and central China. We will meet with property developers, distributors, agents and producers of equipment to understand what is happening with orders and sales in the peak construction period. For copper we will speak with traders and processors of copper to get an understanding of the end demand for copper this year.

- **Led by Tim Murray, September 14-16.**

Coal Supply

Baotou, Ordos, Taiyan. Poor demand and oversupply of coal in China has pushed down demand and volume of seaborne thermal and metallurgical coal. We aim to understand the Chinese domestic supply response and the outlook for demand.

We will first visit the key coal mining areas of Baotou and Ordos in Inner Mongolia to look at supply response.

We will then visit the core coal mining region of Shanxi and visit met coal miners and coke processors.

We want to find out what is driving coking exports and how miners are eking out marginal profits from met coal. Susannah Kroeber, commodities analyst, will lead the trip.

- **Led by Susannah Kroeber, September 16-18.**

Finance: How Deep Are the Stresses?

Hebei, Shanghai, Shenzhen. Meetings with brokerages, banks, shadow banks, and LGFVs to understand current credit conditions and stresses on the currency.

- **Led by Anne Stevenson-Yang, September 21-25.**

October Trips

E-Commerce

Hangzhou, Wuhan, Tianjin. We will be taking clients to take a closer look at the e-commerce ecosystem to have an update on profitability level, revenue overstatement and what the real businesses of these players actually are.

- **Led by Anne Stevenson-Yang, October 12-15.**

Thermal Coal

Ordos, Xian, Tianjin. This trip aims to understand the current state of thermal coal mining and imports in China. We will visit the key mining areas of Ordos, Inner Mongolia and Xian, Shaanxi and the key trading port of Tianjin. We will visit miners, traders, power companies and importers.

- **Led by Susannah Kroeber, October 19-21.**

Methanol and Olefins

Inner Mongolia, Shandong, Zhejiang. China is the key growth market for methanol and olefins. We will look closely at how Chinese domestic production of these key petrochemicals is displacing imports. We will visit companies that operate or are planning coal to olefins projects. We will also visit methanol to olefins projects in coastal China that are using imported feedstock.

- **Led by Tim Murray, October 26-28.**

November Trips

Infrastructure

Urumuqi, Chongqing, Tianjin. China has announced enormous infrastructure spending over the last 9 months. We are yet to see a substantial increase in new infrastructure projects. We will visit Chongqing where there are new projects, Urumuqi where there should be OBOR projecs and Tianjin to see how much of the RMB 42 trillion is signed up and ready to go. Financing of infrastructure has been slow. We will check actual progress on infrastructure projects as we expect finance to projects to improve dramatically by Q4 2015.

- **November 2-5.**

Political Power Struggles

Beijing, Guangzhou, Hong Kong. We will explore the current state of the anti-corruption campaign, SOE reform, and proposals for structural change.

- **Led by Anne Stevenson-Yang, November 10-14.**

Please email Brian Emanuelson (brian@jcapitalresearch.com) if you'd like to see a preliminary agenda for any of the listed trips, or share with us any trip bespoke ideas you might be thinking about.

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