JCAP

Survey China

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Survey Structure

- Survey of 10 steel traders supplying:
  - 5 construction industry only
  - 2 manufacturing industry only
  - 3 construction and manufacturing
- Regional:
  - 2 East China
  - 1 South China
  - 2 Central China
  - 3 North China
  - 2 West China
- Ownership type:
  - 4 SOE
  - 6 Private
- The total amount of steel traded by the survey group is 2.5 mln tons or 0.3% of domestic steel consumption. Each survey participant is one of the top five steel traders in its respective province. The 10 provinces covered in this survey consume approximately 63% of all domestically consumed steel in China.
- Our past surveys have proven good predictors for industry trends on a quarterly aggregate basis but the respondents demonstrate high volatility and significant regional differences.
- Repeat sources: All
- Interviews conducted March 26-30, 2018

Objectives

- To understand the current demand and outlook for steel from construction and manufacturing endusers of steel. We survey sales, inventory, financing, and the industry environment to build a picture of demand and outlook.

Steel Survey Q1

Steel Prices to Decline 15% in Q2

Infrastructure Surprisingly Robust, but Property Tumbling

- **Production/consumption mismatch:** Steel consumption was down by about 2% through March and is set to fall further, but production was still clocking growth through March, meaning that inventories are building.
- **Downward pressure on prices:** We expect steel prices to fall a further 15% and iron ore prices at least 10% in Q2.
- **Infrastructure spend shifting to the center:** Infrastructure demand has held up better than we expected, as the government flows credit to central-level projects, even as rhetoric attacking local governments intensifies. Property construction is slumping. But infrastructure demand will make the slope of steel decline more gradual this year.
- **Destocking by traders:** Steel traders face declining sales in Q1, and most believe that will continue in Q2. Steel traders will largely continue to destock in Q2 putting further downward pressure on steel prices.
- **Property boom finally over?** Weak construction demand from property is the key driver of the fall in demand.
- **Infrastructure cushioning the fall:** Infrastructure demand is better than expected in many regions but not strong enough nationally to compensate for the decline in property construction.

Steel Demand in Decline

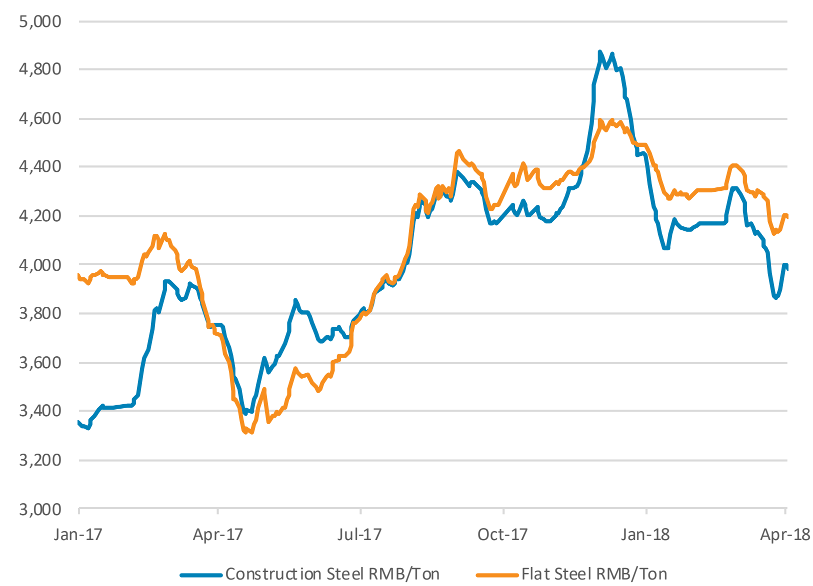
Poor demand from property construction in March smashed the optimism that had led steel traders to restock and steel mills to increase output in January. We believe steel demand is down by around 2% YTD March, and the outlook is for that to fall further.

Steel mills have slammed on the breaks, and construction steel inventory is piling up. Crude steel production increased 6% YTD February, but pig iron production was flat. Pig iron is produced with iron ore and crude steel is produced from pig iron and scrap steel. So despite an increase in steel production iron ore demand was flat.

Based on blast furnace utilization rates, we estimate that steel production in March will fall 10%, dragging down production growth to 1% YTD March. Construction steel inventory is 40% higher YoY at the end of March. When construction boomed in 2017, construction steel prices were either higher or the same as flat steel, which is more expensive to produce. This occurred because construction steel demand was greater than supply. Construction steel demand was supercharged by infrastructure stimulus. That trend clearly reversed in January, as construction steel demand dropped.

Steel mills have slammed on the breaks, and construction steel inventory is piling up.

Chart 1. Construction Steel vs Flat Steel



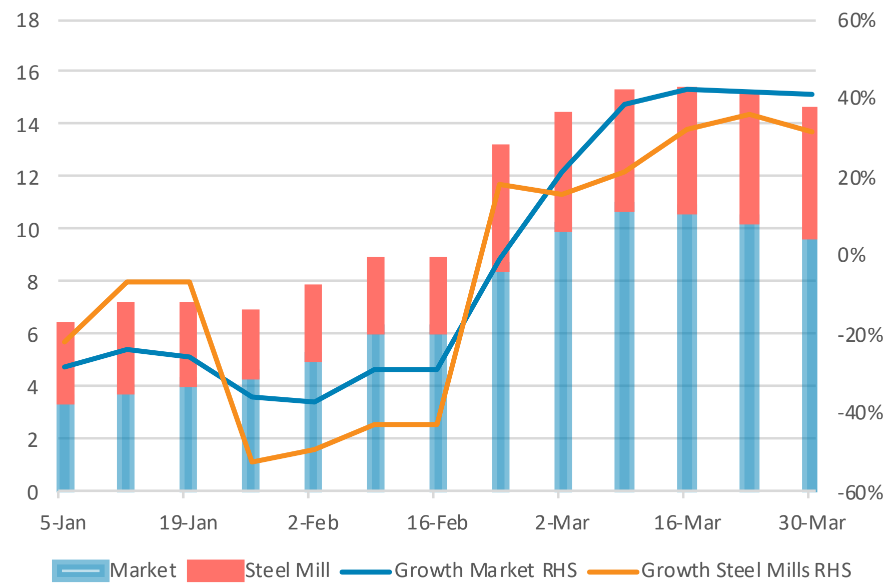
Source: Wind

Our survey clearly indicates that property construction is down this year. Property completions were down 22% YTD February and have been falling since September last year. New construction starts were up 2.9% YTD February, but that does not match what steel traders are telling us about new projects in Q1. Very few projects start in the winter months and so the new starts data YTD Feb is based on very low volume. March is the beginning of the construction season. We can expect new starts data to show a fall in growth in March.

Infrastructure demand has held up better than we expected.

Construction Steel Demand Leads Decline

Chart 2. Construction Steel Inventory MMT



Source: Wind

Infrastructure: more power to the center

Beijing has been demanding cancellation of local infrastructure projects, and cancellations or freezes have been announced in many cities in Inner Mongolia and Xinjiang. Meanwhile, the central government is accelerating its spend on national projects like the high-speed rail. This has buoyed steel demand from infrastructure even as it strengthens the central government at the expense of local governments, in accordance with Xi Jinping's other policies of great authoritarianism.

Rail spending, which is mostly from the central government, was planned to decline 8% in 2018, but instead it rose 18.6% YTD February, and our survey indicates good demand from rail. We speculate that this is part of the Xi government's greater centralization of power. The project cancellations appear to be concentrated in provinces where overall steel demand is relatively modest but where minority ethnic groups are concentrated.

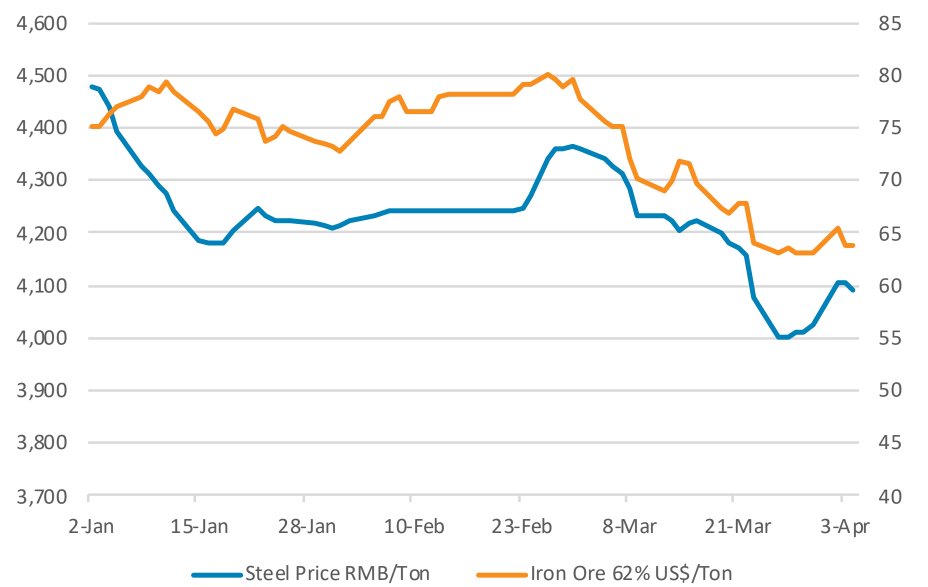
Iron ore is piling up

Iron ore imports grew in the first two months of the year, but the ore just piled up at port. Iron ore imports were up 5% YTD February 2018, an increase of 9.1 MMT, but inventory at ports increased 13 MT in the same period. Inventory in March grew by a further 3 MMT.

Weak construction demand from property is the key driver of the fall in demand.

Steel mills remain largely profitable, but we expect further steel price declines and steel mill profits to decline. We expect continued downward pressure on iron ore prices, as steel mills reduce production.

Chart 3. Iron Ore Vs Steel Price



Source: Platts, Wind

Q1 Survey Results

- **Q1 steel demand down:** 80% of steel traders saw lower Q1 sales YoY, and the two that had sales growth said sales rose in January and fell in February and March. Everyone reported poor sales in March.

- **Q2 outlook negative:** 70% of steel traders expect sales to decline. Of the three steel traders that have a positive outlook, only one planned to re-stock inventory the other two were destocking. Steel traders are clearly negative on Q2 sales.

- **Property construction demand collapses:** All steel traders said steel demand from the property sector declined, and they are selling less steel to new projects. We expect property construction demand to continue to weaken.

- **Infrastructure demand mildly positive:** 60% of steel traders indicated that demand from infrastructure was growing. Only 20% are seeing that growth from new projects, and 40% of traders said demand from infrastructure projects was down. It looks like infrastructure demand is strong in some regions from existing projects but that new projects are declining. We expect infrastructure growth to decline in Q2.

- **Destocking planned:** Steel traders destocked in March, and 70% plan to continue to destock in Q2. Only 30% of traders plan to restock. We do not see a risk of restocking to cause a price rally.

Table 1. Steel Trader Demand Q1 2018

City	2018 Q1 Sales (Distributor)	Demand in Q1	2018 Q1 Sales YoY	2018 Q1 Sales Est. YoY (Region)	2018 Q2 Sales OutlookEst YoY	Outlook for Demand in Q2 2018
Harbin North	-50%	Spring sales were slower start this year, as the weather was colder and prices were falling. Demand not as good as last year. Construction steel demand down. Not necessarily an indicator for demand this year.		NA	0%	Construction steel demand was stronger last year than the year before. There is no room for growth. We expect construction steel demand to fall this year. Flat steel prices are now much higher than construction steel. We expect industrial demand for steel to be good.
Shenyang North	60%	January sales were strong, as we sold steel to South China when prices were rising. Spring construction season is slow to start, and prices are falling. Infrastructure demand is stronger this year than the past two years. There is no sign of infrastructure demand slowing.		-30%	30%	Property construction decline has been rapid. There is to much real estate inventory that has to be sold off before demand improves. Inventory levels are high, so we are dropping prices to sell. Hard to tell were prices are going.
Qingdao North	-10%	Late CNY and falling prices have had a large impact on sales. Sales in February and March are way below last year.		-10%	-15%	Winter restock in January was large, and there is a lot of inventory in the market. Infrastructure project approvals are very difficult now. There are a lot of international and domestic meetings that will slow demand, as construction will be halted.

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City	2018 Q1 Sales (Distributor)	Demand in Q1	2018 Q1 Sales YoY	2018 Q1 Sales Est. YoY (Region)	2018 Q2 Sales OutlookEst YoY	Outlook for Demand in Q2 2018
Wuhan Central	-8%	CNY was late. Overall market, infrastructure, auto, property orders have been good so far.		3-5%	-10%	All infrastructure projects, including metro, still continuing. Property construction is slowing fast. Q2 sales will clearly be lower. We do not know how far prices will fall.
Chongqing West	15%	We signed up two new infrastructure projects. Manufacturing orders also good. Construction steel orders have fallen sharply. Steel for industry orders are okay.		10%	-10%	We expect a decline due to the fall in new construction projects. Infrastructure projects are increasing. We are expecting flat steel to go down or be flat.
Chengdu West	-60%	Sales were good in January. No sales in February, and they have started to pick up again in March. Prices are falling. Restocking in January was high. End demand is okay, just working through inventory.		5%	0%	Infrastructure projects are increasing due to the new airport and associated projects. Property construction is slowing due to property restrictions. It is hard to predict this year's sales. People restocked a lot in January as they were optimistic. But demand was slow, and prices fell RMB600/ ton
Hangzhou East	-4%	Auto sales are down as the tax rebates for small cars have been removed. Prices are falling and there are always less sales when prices fall. Uncertainty about trade sanctions is bad for sales.		-5%	-7%	The outlook for infrastructure is negative as the local government is trying to reduce debt. Property construction is falling, there is a roll out of property tax which is negative for property construction. Auto clients want price reductions. Auto parts orders are down. US trade sanction have but a 13.7% tax on auto parts.

City	2018 Q1 Sales (Distributor)	Demand in Q1	2018 Q1 Sales YoY	2018 Q1 Sales Est. YoY (Region)	2018 Q2 Sales OutlookEst YoY	Outlook for Demand in Q2 2018
Suzhou East	-15%	Most sales came after mid-March. Prices began to rise form mid-March. Land sales have been slow. There is only one new property construction project in Suzhou. Infrastructure is up a little on last year.		10%	15-20%	We have new clients and so we expect sales to improve.
Guangzhou South	-20%	CNY was late, and prices fell. There was too much inventory in the market and financing was tight. Many traders that had financed inventory became forced sellers.		-20%	20%	Property construction demand is clearly down, and infrastructure demand is up. Overstocking remains a problem and sentiment is negative. We are negative for the first half of the year.
Changsha South	-15%	Sales dropped dramatically. Property construction was slow to start. Everyone restocked a lot in Q4. Demand is weak.		-15%	-5%	Tier 1 and 2 city property markets have slowed. Infrastructure is flat. Tier 3 and 4 city property sales are still strong, as there are no sales restrictions, and migrants are buying in their home towns. Some local infrastructure projects are slowing. Lower tier distributors are holding a lot of inventory of construction steel. We expect construction steel prices to fall further and sales to slow.

Source: J Capital

Table 2. New Property Construction Projects Q1 (% of sales)

	Harbin	Chengdu	Qingdao	Chongqing	Suzhou	Guangzhou	Changsha
Q1 2018	0%	0%	0%	10%	20%	30%	28%
Q1 2017	10%	0%	0%	15%	25%	50%	30%

Source: J Capital

Table 3. New Infrastructure Projects Q1 (% of sales)

	Shenyang	Qingdao	Chongqing	Guangzhou	Chengdu	Changsha
Q1 2018	20%	0%	25%	60%	8%	10%
Q1 2017	40%	8%	20%	70%	0%	9%

Source: J Capital

Table 4. Steel Trader Inventory Q1 2018

City	QoQ	YoY	Q2 Outlook	Notes	Could steel mills meet demand in Q1?
Harbin North		-50%	-20%	We were conservative and did not restock in Winter. Others restocked and made huge losses as prices fell. We expect more distributors to destock at a loss in April.	Construction steel supply was fine. Flat steel was in short supply and prices relative to construction increased
Shenyang North	100%	100%	50%	Sold out all stock in December and started to restock in January. We have a long-term contract for supply, so we have to take inventory each month.	No problem
Qingdao North	30%	0%	0%	Last year we sold out our winter restock inventory immediately after CNY. This year we cannot sell as prices are falling and demand is weak. There is a lot of construction steel in the market. There are a lot of distributors forced to sell at a loss. We do not plan to restock in April maybe in May.	Some flat steel types are out of stock
Wuhan Central	3%	-5%	-5%	We believe price will keep falling and so we are not restocking.	Hard to buy flat steel. Prices are rising, and steel mills are releasing stocks slowly.
Chongqing West	-20%	-10%	10%	We sold out before CNY and we are now only ordering when we have an order.	Steel mills have huge inventory so can get supply very easily
Chengdu West	300%	0%	-50%	We are running down our inventory	No problem
Hangzhou East	10%	20%	-10%	Demand is weak and steel mill inventory is high. Contracted purchases with steel mills are higher than our sales to end users. So, our inventory and steel mill inventories are rising. With falling prices, we are too scared to restock. So, our orders to steel mills for April are down a lot.	No problem

City	QoQ	YoY	Q2 Outlook	Notes	Could steel mills meet demand in Q1?
Suzhou East	43%	100%	0%	We are holding a lot of inventory, as we have some big customers to whom we need to maintain supply. We do not have the financing to purchase any further inventory	No problem
Guangzhou South	20%	100%	-30%	Everyone was positive before CNY and inventory levels were at historic highs. There was a huge amount of inventory in the market after CNY. Prices have been falling and so we expect destocking to continue.	Steel mills are slowing production, as they have too much inventory
Changsha South	-30%	-13%	15%	We were rapidly destocking, as we saw that demand was terrible. We did not care if we made a loss. We have a low level of stock now, and so we need to purchase.	No problem

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Table 5. Steel Mill Inventory Q1

City	Increase YoY	Reasons
Harbin North	7%	With prices falling, distributors cannot afford to purchase stock and so inventory at mills is rising.
Shenyang North	0%	Normal levels
Qingdao North	5%	Construction steel inventory is high because of the poor property market
Wuhan Central	-5%	Environmental restrictions in North China have been positive for steel mills in this region.
Chongqing West	30%	Steel mills continue to produce at full capacity and demand has not increased, so inventory is accumulating.
Chengdu West	10%	Distributors restocked a lot over winter. Steel mills continue to produce, and distributors are not buying.
Hangzhou East	8%	Steel mills have their highest inventory levels in two years. Market outlook is very negative. Steel mill orders for April are very clearly down and deliveries of steel from inventory have slowed.
Suzhou East	20-30%	Inventory levels are very high. This is due to the fall in price in February, distributors do not want to hold inventory and so inventory at steel mills is rising.
Guangzhou South	-50%	Inventory levels are low as steel mills sold down inventory when prices were high in January
Changsha South	10%	Steel mills are still making profits and they are selling directly to projects with special discounts.

Source: J Capital

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See final page for disclaimers.

Notable Quotes

All steel traders said steel demand from the property sector declined.

“Government market intervention to continue to control output in Hebei is impacting the price of profile steel [steel used for steel frame building]. The price is rising as the main manufactures are in Tangshan where production restrictions have been extended beyond March. The government is de facto setting steel prices now.”

Harbin

“Steel exports are not doing well this year. Steel exporters are losing money as tax and shipping costs rise. We could still make money in the H1 2017, but we were losing money from 2H2017. We have stopped exporting altogether.”

Qingdao

“There are too many important conferences that we have stop construction and production of steel and this is having a big impact on the sector.”

Qingdao

“Credit to steel traders has tightened again. Now we can only secure loans mortgaged against shareholders homes.”

Wuhan

“US interest rates increased, and increased tariffs had a big impact on the steel sector. After the US announced an interest rate increase the steel price fell for three consecutive days falling RMB500 (13%). These types of large price movements are more common this year.”

Wuhan

“Manufacturing sector is buying more steel as prices fall”

Wuhan

“When the US announced tariffs on $60 billion in goods the futures for steel and iron ore collapsed the next day. The spot price is still set by supply and demand in China.“

Hangzhou

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“Steel traders were excessively optimistic and overstocked in Winter. The past two years steel trading has been so good that everyone became complacent. Steel traders’ losses are very significant. Steel mills are doing ok. “

Guangzhou

“Everyone was excessively optimistic, and many have made large losses in Q1. It is hard to see how this year will go. Maybe this is the beginning of a major downturn.“

Chengdu

“If the government can continue to restrict supply for environmental reason, inventory “will fall and then we should be able to make money this year.”

Changsha

There is a lot of anxiety about a trade war.”

Changsha

“Steel traders that purchased steel with finance got hit very badly in Q1.”

Changsha

“Everyone is very positive about the market this year. The weather warmed early, and construction is moving quickly. We expect prices to rise rapidly. Developers are buying land in our area and we are supplying some big property projects.”

Suzhou

“The auto parts sector is in trouble this year. Auto production is declining. 4 large auto parts companies in Chongqing went bankrupt recently”

Chongqing

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