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 October 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 Q3

Faltering Steel Demand

All About Infrastructure Spending

- **China's central government panicked in July and hit the infrastructure button.** Fearing downturn, in mid-summer, the Central Committee of the CPC, the State Council, and the NDRC all downplayed local debt and actively encouraged regions to spend big. This drove a surge in commodity prices, as infrastructure projects picked up in August and September.
- **There's a major uptick—but no year-to-date growth.** Steel demand picked up in Q3 but mainly in the fiscally stronger eastern and southern provinces that can afford big infrastructure projects. Other provinces saw an upturn in infrastructure but not YoY growth. Our recent trips to Xinjiang, Gansu, and Sichuan confirm these trends.
- **Demand from property construction is poor throughout the country.** The outlook for this sector is grim.
- **Industrial demand for steel, particularly white goods and automobiles, is poor.** The central government would like to have industry drag along demand for steel, but it's just not happening.
- **Trade war messing with minds.** The US-China trade war has yet to impact steel sales, but it is a drag on confidence.

Q3 Survey Results

- **Q3 Steel Demand improved.** 80% of distributors reported sales growth in Q3, compared with 50% in Q2. 30% of distributors in our survey outperformed the market. Coastal southern and eastern provinces had stronger sales than other regions.

- **Q4 demand outlook neutral.** Coastal southern and eastern provinces expect sales to grow, while other provinces expect sales to be flat or down. Of those surveyed, 60% will destock, as they are pessimistic or uncertain about demand.

- **Property demand down:** Every distributor stated that total property construction was down.

- **Infrastructure demand steady:** Half of the provinces surveyed experienced growth in infrastructure and half said infrastructure demand was steady or declining. The coastal southern and eastern provinces had good steel sales almost entirely due to infrastructure. These are the rich provinces that can still afford the big projects.

- **Steel mills holding steel prices high:** Areas with stronger demand, the East and South, appear also to have more "environmental" or other controls on production and are running down inventory. Other areas are seeing inventory build at steel plants.

- **Industrial steel demand is weak:** All automotive steel production regions have low demand for industrial steel. White goods demand is also low.

- **Steel sales little impacted by US-China trade war.** With the exception of Qingdao, a major steel-exporting region, other regions did not believe the US-China trade war has impacted sales significantly, but many expect it will be a negative for steel demand in the future.

- **Steel distributors see SOEs winning.** Steel distributors widely complained that only the big state-owned steel mills are making profits. Steel traders are not. There is a strong belief that SOE companies in general are dominating credit supply and the economy.

Xinjiang: Central Financing Restarts Infrastructure

We recently visited Xinjiang, one of China's poorest provinces, which has traditionally relied on state support to drive economic growth. Local debt was out of control in 2017, and, consequently, three of the five planned metro rail projects were halted, and holes in the ground were backfilled in early 2018. Economic activity in the province went into a tailspin, resulting in a central-government bailout to restart infrastructure projects in August.

We visited Xinjiang's largest steel manufacture, Bayi Steel, an SOE that has 10 MMTPA of capacity and is owned by Shanghai's Baosteel. Xinjiang has 13 MMTPA of production capacity and only 8 MMT of demand. Xinjiang exports its excess capacity to nearby provinces of Gansu, Tibet, and

Sichuan and dumps at low prices, maintaining high prices and solid profits at home. Capacity elimination in the province has shut down privately owned capacity, and SOEs now monopolize the market and set prices.

The Belt and Road Initiative (BRI) was intended to absorb some of the capacity, and Xinjiang borders and is rail linked to Pakistan, Uzbekistan, and Kazakhstan. But those exports have declined. Pakistan has anti-dumping tariffs of 30% imposed on Chinese steel. As for Kazakhstan and Uzbekistan, Bayi Steel was exporting 50,000-60,000 tons of steel to those countries but that has fallen to 10,000-20,000 tons per year.

Locals told us that the central government has relieved Xinjiang of some of its debt to enable infrastructure projects to restart. Large infrastructure projects were restarted in July and August. The focus of infrastructure is slum renovation. The slums were knocked down, and residents given cash compensation, but the slums were not redeveloped. Now there are funds to start rebuilding. High-speed rail projects in the province are restarting, as are other rail and expressway projects. This will provide growth into 2019.

Table 1. Steel Trader Demand Q3 2018

City	2018 Q2 Sales (Distributor)	Demand in Q2	2018 Q2 Sales YoY	2018 Q2 Sales Est. YoY (Region)	2018 Q3 Sales OutlookEst YoY	Outlook for Demand in Q3 2018
Harbin North	-8%	The city government is not approving new residential projects, and so there is little new construction	-8%	-6%	0%	Going into the winter period so sales are falling, and traders are destocking.
Shenyang North	25%	Demand from major projects picked up in August and September.	100%	25%	15%	This year, the NPC was held late and so we have been playing catch-up all year. We have 25 projects this year compared with 22 last year.
Qingdao North	5%	Regional demand is poor, but we have provided credit to manufacturers of oil pipes and therefore sold well.	-50%	-20%	0%	There is some restocking. The market is not good and so we expect no growth.
Wuhan Central	-3%	Demand is poor. Construction steel sales ok, industrial steel demand down sharply.	3%	0%	-5%	We are heading into the winter season, and construction and sales are in decline.

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City	2018 Q2 Sales (Distributor)	Demand in Q2	2018 Q2 Sales YoY	2018 Q2 Sales Est. YoY (Region)	2018 Q3 Sales OutlookEst YoY	Outlook for Demand in Q3 2018
Chongqing West	10%	There is more centralized purchasing, and we have supplied some major infrastructure projects	10%	-10%	-10%	Demand is falling, the property market is cooling. Infrastructure projects are not increasing, auto sector sales are declining. There may be an improvement in auto demand before yearend.
Chengdu West	11%	Sales have improved due to downstream wholesalers restocking	-46%	5%	0%	Q3 had some major projects, Q4 will not have as many. We expect demand to be flat.
Hangzhou East	7%	Auto sector demand is low. Our sales went up as we opened two major new accounts, Great Wall and Geely.	-6.5%	-5%	3%	Auto sales generally peak in Q4, but auto manufacturers have high inventory. We expect they will sell down inventory. We expect exports to the US will improve in December, as US high tariffs roll off.
Suzhou East	47%	Two major infrastructure projects started in September and October	10%	20%	30%	The demand from these major infrastructure projects will remain strong.
Guangzhou South	15%	End demand from infrastructure is good. Wholesales demand is low, as absolute steel prices are too high.	5%	15%	25%	Demand will continue to improve. This is the construction peak season, and sales are good.
Changsha South	3%	Property sector demand for construction steel has been good.	5%	3%	2%	New project demand improving. Steel prices are also falling.

Construction

Harbin

Property construction approvals have slowed significantly. There are no new infrastructure projects started. Only the No 3 Metro line will be completed. The remaining lines have all been cancelled. There is no increase in infrastructure in Heilongjiang.

Shenyang

Property is flat and trending down. Infrastructure demand is strong after being weak in the first half. There is a surge in Infrastructure demand.

Qingdao

Property construction is falling as are property prices. Large construction companies like China Rail and China Construction have liquidity problems and banks have restricted lending. Both property and infrastructure are falling due to lack of finance.

Wuhan

Property and infrastructure demand is falling. Property demand is falling, and construction is following demand down. Infrastructure demand in Wuhan is strong but weak outside the capital.

Chongqing

Demand is falling. Government policy is supporting property and infrastructure but after projects are approved there is no money for construction.

Chengdu

Property construction demand is falling. Everyone is very cautious about real estate projects. Evergrande's construction activity has ground to a halt, as its financial pressure is too high and the projects are too large. Their payments are very slow. We are very cautious about Evergrande. Infrastructure is relatively stable, and some projects are still doing well.

Suzhou

Property construction is down, and infrastructure is up. Land for property is being tightly controlled. No infrastructure projects have been halted.

Guangzhou

Property construction demand is clearly falling. Infrastructure demand is more positive.

Chongqing

Real estate demand is rising, because the suburban areas experienced increased demand in October. The automotive industry is particularly poor. Infrastructure is basically flat now, and some projects have not yet started and are expected to start next year. Infrastructure projects outside the capital are declining as the local governments have poor finances.

Table 2. New Property Construction Projects Q3 (% of sales)

	Harbin	Chengdu	Qingdao	Chongqing	Suzhou	Guangzhou	Changsha
Q3 2018	0%	0%	20%	30%	40%	0%	35%
Q3 2017	0%	3%	30%	15%	15%	50%	30%

Source: J Capital

Table 3. New Infrastructure Projects Q3 (% of sales)

	Shenyang	Qingdao	Chongqing	Guangzhou	Chengdu	Changsha
Q3 2018	10%	0%	10%	80%	0%	0%
Q3 2017	0%	15%	15%	50%	8%	9%

Source: J Capital

Table 4. Steel Trader Inventory Q3 2018

City	QoQ	YoY	Q4 Outlook	Notes	Could steel mills meet demand in Q4?
Harbin North	-30%	-6%	-50%	Sales are lower, so we will hold less stock. Everyone is uncertain about demand and unwilling to hold inventory.	No problem
Shenyang North	100%	20%	0%	Holding inventory to make sales to South China. No plans to increase inventory	No problem
Qingdao North	-15%	-20%	20%	Steel prices were more volatile in Q3 and we are concerned about a fall in demand. We will restock in Winter	No problem

City	QoQ	YoY	Q4 Outlook	Notes	Could steel mills meet demand in Q4?
Wuhan Central	0%	-2%	-10%	We cannot get supplied by steel mills. They can only fulfill half or less of our orders.	Supply of rebar and some industrial steel constrained. Steel mills have environmental restrictions. Steel mills are controlling supply to keep prices and profits high.
Chongqing West	20%	30%	20%	Our inventory of auto steel is high, as demand is poor. We had trouble getting supply in Q2 then we overstocked in Q3.	No problem
Chengdu West	0%	0%	-50%	We are holding the minimum amount of inventory. We will halve inventory in Nov	Steel can meet demand, they are reducing output to reduce inventory
Hangzhou East	5%	7%	5%	Much easier than last year to get orders filled.	No problem, steel mills are struggling to get orders for auto steel
Suzhou East	38%	64%	-50%	Needed more inventory to supply two major new projects. The demand of those projects is now declining, and we will destock.	Steel mills like Shagang cannot keep up with demand, and Yonggang has shut down a blast furnace.
Guangzhou South	-30%	-20%	-20%	High steel prices are causing us to hold less and turn over faster as well as be long steel futures. We will continue with this strategy.	Steel mills in Guangzhou are reducing output as prices are low in South China
Changsha South	-10%	-15%	-10%	Prices are high, so risk is high, so keeping inventory low. We do not have a positive outlook on property, so we are controlling risk. We expect prices to fall.	Steel mills have low inventory due to environmental restrictions on production

Source: J Capital

Table 5. Steel Mill Inventory Q3

City	Increase YoY	Reasons
Harbin North	10%	Mills are not slowing production, but demand is slackening, so inventory is building.
Shenyang North	20%	Steel mills are stocking up for sales to South China
Qingdao North	3%	Steel mills are accumulating inventory as prices are starting to fall. Demand is slack and so no one is keen to restock.
Wuhan Central	-15%	Steel mills are restricting supply and only producing to order and releasing stock when they are paid.

City	Increase YoY	Reasons
Chongqing West	20%	Steel mills are producing auto steel, but it is not selling and the distributors have full warehouses that are not moving product fast.
Chengdu West	-20%	Steel mills need to comply with higher technical standards by 1 Nov and so have been selling down inventory of old steel.
Hangzhou East	-9%	Infrastructure demand and environmental production controls have combined to reduce inventory.
Suzhou East	-80%	Due to the Expo, there has been a high level of environmental restrictions on production.
Guangzhou South	-50%	Local steel mills have been running out of certain specifications of steel frequently
Changsha South	-10%	Steel mills have less inventory as they have environmental controls on production.

Source: J Capital

Notable Quotes

"Shandong is facing fewer environmental restrictions this year than last year. Hebei is facing more restrictions, such as production limits and shutdowns. White goods and new energy vehicles have been positive for demand."

Shandong

"Central SOEs are dominating access to finance. First Auto Group has a line of credit for ¥1 trillion. This is crowding out private enterprises. We are pessimistic about the future demand for steel. All the profits in the steel sector are now being made by the steel mills. Steel traders are hardly making any money."

Wuhan

"Chongqing has suffered some negative events for the economy. Chongqing BAIC Yinxiang Auto Company stopped production in June. China Railway Construction Co. was unable to make payments, and that led to many infrastructure projects being halted. Chongqing property prices have been rising for a year and are now turning down. Everyone is uncertain about next year. We are not optimistic."

Chongqing

"The overall steel market has not been very good this year. Very few steel traders made money this year, and many will go out of business. The profits have all been earned by the steel mills. We are focusing on collecting money not on making sales. We are not optimistic about next year."

Chengdu

"We are very focused on the property market, and there are enough projects. We are worried about next year. Suzhou property sales have been poor in the second half of the year. Neither new nor second-hand houses are selling well. Small units are just not needed. A lot of migrant workers left Suzhou this year."

Suzhou

"A number of steel traders in Foshan have closed down. Real estate projects are facing a lot of financing difficulties."

Guangzhou

"Volume is very sluggish in the third quarter. Real estate and infrastructure are receiving support. The demand for cars this year is very poor.

"Construction steel has been selling well, due to good demand from property and infrastructure. Industrial steel demand is terrible, particularly for automobiles. The secondary market for real estate has frozen. There are no transactions. The local government has very high debt, and so new projects are hard to fund and old projects are being halted."

Changsha

US-China trade conflict

"Our exports have been hugely impacted our international trade is down 70%"

Qingdao

"Most of our customers are private enterprises, and their sales are not good this year. Car sales fell by 14.5%, and home appliances also fell. Our steel sales to manufacturing are bad. If there is not a good solution to the trade war, we expect demand to fall further."

Wuhan

"The impact is not large."

Chongqing

"Our export orders will not be impacted by tariffs until December. We expect the negative impact of the trade war to be much greater in 2019."

Hangzhou

"There is currently no impact. We predict that the overall economy will be worse next year."

Suzhou

"We believe the trade war is good for steel demand, as the government will spend more on infrastructure to compensate."

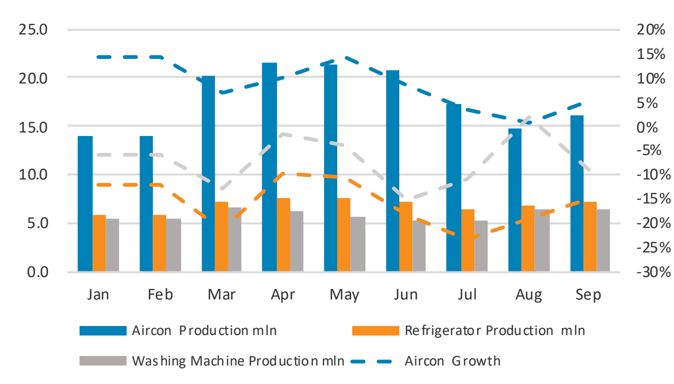
Guangzhou

Data Matters

Declining Demand for White Goods

Steel distributors in our survey indicated that industrial demand for steel was down, particularly for autos and white goods. Production of washing machines and refrigerators declined 10% and 19% YoY in September respectively. Exports of these items are still positive, up 3% and 5% respectively. Clearly domestic demand has declined. Refrigerator and washing machine demand is driven by people moving into a new home. Clearly property being completed this year is not being lived in at the same rate as previous years. We expect inventory of empty housing is growing.

Chart 1. White goods production units and growth



Source: NBS

UPCOMING J CAP EVENTS

November Trips

Banking, Insurance, & Regulation

Shanghai

We will meet with bankers, insurance executives, & policy experts to understand the current status of liquidity in the financial system and expectations for government stimulus for the beginning of 2019.

- **Led by Ada Wang, November 20-21**

December Trips

Payments in India: Paytm, Ebix, Wirecard, Western Union, Moneygram

Mumbai, Delhi, Ahmedabad, Jaipur

We will see companies working to digitize payments in India and understand the economics of the market.

- **Led by Pranav Bhavsar, December 3-6**

Steel: Is demand really up?

Shenyang, Tianjin, Guiyang, Chongqing

Steel data is not matching what we are hearing from the market. We will visit fiscally challenged provinces like Tianjin and Liaoning to learn the extent to which infrastructure can continue to pull along steel demand. Then we will visit Guiyang in Guizhou. We view this city as a basket case, yet it is being touted as one of the fastest-growing provinces due to all the infrastructure being built. Lastly, we will visit Chongqing, China's largest city, to gauge change in manufacturing and infrastructure. Visits will be to LGFVs, banks, trusts, steel mills, and steel traders.

- **Led by Tim Murray, December 3-6**

January Trips

Electric Vehicles in China: Nio, Tesla, BMW, Mercedes, etc..

Shanghai, Ningbo, Shenzhen

We will see supply chain companies, EV manufacturers, and policy experts in order to develop a better understanding of the supply/demand characteristics in the Chinese electric vehicle marketplace.
We will look at charging infrastructure, battery makers, the subsidy structure, fleet conversion, and consumer uptake.

- **Led by Anne Stevenson-Yang, January, 21-23**

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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