

**RESEARCH**
**Metals & Mining**

Steel sector may face contagion risk from China property sector

**SUMMARY**
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- Credit event at Evergrande has potential to spread contagion risk to property sector, though China can possibly manage the situation
- Any material slowdown in China's property and infrastructure sector a key risk for global steel prices and margins
- We currently assume normalisation of steel prices over medium term; prefer TATA and JSP

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**Daily macro indicators**

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	1.36	2bps	10bps	67bps
India 10Y yield (%)	6.17	0bps	(7bps)	15bps
USD/INR	73.49	0.0	1.2	0.0
Brent Crude (US\$/bbl)	75.34	(0.4)	9.1	74.6
Dow	34,585	(0.5)	(2.1)	25.0
Shanghai	3,614	0.2	4.8	8.3
Sensex	59,016	(0.2)	5.8	51.9
<b>India FII (US\$ mn)</b>	<b>16-Sep</b>	<b>MTD</b>	<b>CYTD</b>	<b>FYTD</b>
FII-D	124.6	423.1	(990.8)	1,036.5
FII-E	250.5	1,154.1	8,544.7	1,218.3

Source: Bank of Baroda Economics Research

**BOBCAPS Research**  
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## METALS & MINING

20 September 2021

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**Potential contagion risk for China's property sector:** Evergrande, a top-3 property developer in China with outstanding liabilities of US\$ 300bn, could potentially miss an interest payment to lenders on 20 September. A default may snowball into a contagion risk for China's property sector if improperly managed. Evergrande is scrambling due to tight funding availability for the sector following the 'Three Red Lines' reforms initiated by China in Aug'20. At this stage, we need to monitor whether China can avert this threat given the scale and possible spread of default risk to other firms across the property sector.

**Material risk for global steel industry:** Evergrande's debt crisis has the potential to severely weaken global steel demand and induce a sharp correction in steel prices and, in turn, margins for India's steel industry. This event could have a significant impact on close to 60% of steel demand in China, which equates to ~30% of global steel demand in CY20. The concern is visible in the sharp correction in iron ore price to ~US\$ 90/t from a peak of US\$ 239/t in May'21.

**China can potentially avert contagion:** The risk of widespread defaults can possibly be avoided by managing consumer confidence, property prices and investor trust. This could involve protecting consumer deposits for incomplete properties, avoiding fire sale of properties and working out debt resolution plans. For Evergrande, a breakup or buyout solution would be perceived as a better route over bankruptcy or bailout.

**Expect normalisation of steel margins over medium term:** We currently factor in softening of margins over the next 6-12 months with steel prices easing to US\$ 650/t by FY23. Our estimates do not build in contagion risk to China's property sector.

**Prefer TATA, JSP:** With the steel cycle at a peak, we prioritise capital discipline over expansion projects. Accordingly, we are positive on Tata Steel (TATA) and Jindal Steel & Power (JSP) who are now focusing on responsible growth (see [Disciplined capital allocation key to improving payout](#), 16Aug21). Also refer to our [Ferrous Chartbook](#) which tracks global supply and demand drivers.

### Recommendation snapshot

Ticker	Price	Target	Rating
JSP IN	351	555	BUY
JSTL IN	633	795	HOLD
SAIL IN	106	150	HOLD
TATA IN	1,253	1,755	BUY

Price &amp; Target in Rupees | Price as of 20 Sep 2021



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### Recommendation scale: Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

**HOLD** – Expected return from -6% to +15%

**SELL** – Expected return <-6%

**Note:** Recommendation structure changed with effect from 21 June 2021

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