

# **METALS & MINING**

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### India Ferrous Sector: Read-across from BHP Commodity Outlook

- We interpret the BHP outlook to mean continuing improvement in China's steel demand-supply balance through CY24...
- ...and resilient Chinese steel production extending support to iron ore while global supply trends would define coking coal prices
- We expect India's steel sector margin to remain at mid-cycle level, backed by gradually improving global demand but capped by surplus in China

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We summarise the readthrough for the Indian ferrous sector from BHP's February Economic and Commodity Outlook.

China steel exports to ease somewhat in CY24: BHP expects China's steel production to remain resilient at 1-1.1bn tonnes for the sixth consecutive year in CY24. Further, for CY24, it expects net steel exports to settle midway between the CY22 and CY23 levels of 54mt and 87mt respectively. This could imply lower pressure on the supply-demand balance outside China.

China steel demand drivers: In CY23, weak steel demand from China's real estate sector was offset by strong demand from non-housing sectors and a material jump in net exports, including for steel-contained finished goods. Per BHP, key drivers for CY24 include (a) continuing support from the infrastructure sector, (b) pace and scale of housing recovery and its steel demand intensity, (c) level of pick-up in machinery demand from recovery in non-housing sectors, and (d) momentum in exports of steel-contained finished goods.

**Real estate stabilisation:** The pickup in sales of completed projects and second-hand houses in China during CY23 confirms the importance of real estate as an asset class. However, confidence in private developers remains low. New measures underway include the relaxation of housing purchase restrictions at the city level, launch of the "three major projects" plan, better banking fund access for developers, and higher accountability of government officials to coordinate funding access for urban developers.

**Iron ore price drivers:** A resilient crude steel production outlook for China in CY24 and the need for high-cost iron ore should extend price support.

**Coking coal price drivers:** Global supply performance is now the key driver as China's influence has waned with most of its needs being met by Russia and Mongolia.

**Our sector view**: We expect Indian steel sector margins to remain at mid-cycle level over the next two years. While we expect gradual stabilisation of global steel demand, we believe supply pressure from a likely surplus in China will keep a lid on margins.





# **BHP Outlook: Additional takeaways**

### China's economic growth to slow marginally in CY24E

BHP expects a marginal slowdown in China's real GDP growth to 4.5-5% in CY24 from the 5.2% reported in CY23. Although the government is working on several measures to stabilise the economy, BHP continues to assume modest transmission of policies into the economy. Economic signals at the start of CY24 remain mixed.

- Credit supply is reasonable in the aggregate at the start of the year, but this was also the case in CY23.
- Customer confidence surveys are signalling a bottoming out of sentiment but not a
  genuine recovery. The household savings rate remains high, implying lower
  consumption spend. However, there have been early signs of pickup in
  discretionary spend during the recent holiday period.
- Business confidence remains soft overall, weighed down by the housing value chain, excess capacity, low profitability, a sagging equity market, and a challenging environment for traditional exporters.

### Real estate stabilisation measures keep evolving

Though there is clear interest in real estate investment as an asset class in China, BHP notes buyers' trust deficit in private developers. This is reflected in the pickup in sales of new homes in completed projects (+18% in CY23) as against a decline in sales of overall housing projects (-8.5%). Also, the head of the Ministry of Housing and Urban Development inferred that the combined volume of new and second-hand housing sales grew in CY23. The lack of confidence in private developers has been hampering the liquidation of housing inventories despite measures to improve access to mortgage funding for purchasers. China has been finetuning stabilisation measures to address these issues.

- Lifting of purchase restrictions: China has started removing housing purchase restrictions at the city level. Hangzhou, a tier-2 city, was the first to remove all buying restrictions and has seen subsequent improvement in housing sales. This was followed by the removal of curbs in Guangzhou amongst tier-1 cities. Subsequently Shanghai has removed restrictions for non-residents, Suzhou has removed restrictions on outright purchase whereas Beijing and Shenzhen have partially relaxed the restrictions.
- Launch of "three major projects": In H2CY23, China launched "three major projects" to revive demand, which involves urban village renovation, economic housing, and the creation of emergency facilities.
- Use of public balance sheet for demand creation: Recognising the continuing
  weak confidence in private developers, China seems to be moving towards
  extending support through public housing and shifting developers' inventory to the
  'public' balance sheet, through monetary/ fiscal financing.



- Encouraging investments in urban renovation: According to BHP, the opportunity to invest in urban renovation is equivalent to half the annual flow in real estate investment. The key would be to frontload investment from this opportunity.
- Improving banking fund access: China continues to work on measures to improve bank funding access for developers. Recently, central bank PBOC (People's Bank of China) approved banking fund support for repayments from suitably collateralised developers.
- Raising accountability of government officials: Coordination of the urban real estate financing system has now been included as a key performance indicator for local government officials, and progress is being measured on a weekly/ monthly basis.

## Non-commodity housing better off

As against commodity housing (housing available-for-sale), non-commodity housing (non-residential as well as non-market residential activity) has been faring relatively better. The non-commodity segment is meaningful from the perspective of steel demand from the housing sector as it is larger than the commodity segment in terms of floor space. However, its investment trends (i.e. starts, completions, under construction areas) are not apparent due to the unavailability of timely data.

As per BHP estimates, construction in the non-commodity housing segment grew by a modest 2.3% YoY in CY23 against a decline of 7.2% in commodity housing. Also, the decline in property starts has been far more modest at 2.3% YoY in CY23 as against a continuing sharp decline of 20.4% in commodity housing.

### Non-housing sectors supported China's steel demand

BHP indicates that the end-use demand picture for Chinese steel in CY23 was a combination of pronounced weakness in housing starts, strength in infrastructure, mixed outcomes for machinery (construction machinery weak, power machinery strong and machine tools in the middle), solid outcomes for transport (autos and shipbuilding) and consumer goods (e.g. washing machines), and weakness in metal goods (e.g. shipping containers). Points to note:

- The three "new" demand segments new energy vehicles (NEV), lithium-ion batteries and solar panels – collectively grew by 30% YoY in CY23.
- Exports of steel-contained finished goods (such as wind turbines or earth-moving machinery) accounted for ~12% of Chinese apparent steel demand on average in CY23 and maintained momentum.
- Auto production units grew 11.6% in CY23, with commercial vehicles bouncing back by 27% from a weak CY22 (-32%), passenger vehicles up 9.6% YoY, and NEVs up 35.8% YoY (following growth of 160% and 97% in CY21 and CY22 respectively).



## Infrastructure upswing remains well entrenched

BHP believes that China's infrastructure upswing remains well entrenched even after growing at 8.2% in CY23 and 11.5% in CY22. The momentum in infrastructure spending has been supported by a change in its composition over the years.

- Water conservancy and related infrastructure: This segment typically accounts for ~40% of infrastructure investments and slowed down in CY23 to flat growth from double-digit growth in CY22. With bond issuance doing better in the later part of CY23, there is a possibility that investments could revive in CY24.
- Power infrastructure: The power infrastructure segment accelerated notably in CY23, growing 23% YoY, led by renewable capacity additions and investments in conventional grids.
- Transport infrastructure: While this segment had lagged in CY22, investments
  accelerated by 11% YoY in H1CY23 and retained momentum through H2. Rail has
  been a particularly strong sub-sector.
- Manufacturing capacity: The manufacturing segment grew 6.5% in CY23 after a 9.1% uptick in CY22.

### Steel production potentially above official estimates

BHP flags the possibility of underlying steel production being stronger than official estimates. An alternate estimate based on feedstock consumption suggests that steel production could have been 30mt higher than the official figure for CY23.

### Iron ore to be supported by resilient China steel production

- Cost support remains at US\$ 80-100/t levels: The level of cost support depends on three wedges of marginal miners (a) higher-cost junior miners in traditional supply areas, (b) China's domestic mines, and (c) lower grade Indian exports. BHP observed marginal seaborne supply coming under pressure when prices approached US\$ 100/t, with dips below that threshold unable to hold for any meaningful length of time.
- cMore demand for high-cost supply: Iron ore industry narrative has significantly changed since 2018 due to series of unexpected developments. Cost support levels have not seen the earlier anticipated decline and instead have increased relative to CY18 due to greater recourse to higher-cost iron ore. As against CY18, while contestable demand has increased by 187mt in CY23, the supply from majors (low-cost suppliers) has reduced by 30mt. This has resulted in the need for more production from higher cost suppliers.
- Junior miners in Australia/ Brazil to set the long-term price for iron ore: BHP believes that the long-run iron ore price will likely be determined by the all-in 62% equivalent cost base of the least competitive seaborne exporters (higher operating cost and/or lower value-in-use) in either Australia or Brazil. BHP's assessment factors in the prospective entry of new supply from West Africa along with China prioritising the accelerated development of its domestic resources.



## Coking coal supply performance a key price driver

- H2CY23 volatility was attributable to supply under-performance: Metallurgical coal mines around the world once again struggled to meet supply guidance in H2CY23, a general trend that goes back at least half a decade. Per BHP, the average shortfall versus guidance midpoints among major seaborne exporters in the last five years is ~8.5% (a figure that changes modestly to 6.25% when the sample stretches back ten years).
- Supply has finally recovered above pre-Covid levels: While seaborne trade market is relevant for most commodity to determine global supply demand balance, it is important to also look at on-land imports by China to understand true picture of demand supply balance in global coking coal market. Seaborne supply of coking coal increased to 310mt in CY23, almost closing the gap with pre-pandemic levels. Adding in increasing on-land exports from Mongolia to China, coking coal supply was 18mt above CY19 levels. The sum of Chinese imports and ROW (rest of world ex-China) seaborne imports has finally surpassed pre-pandemic levels in CY23.

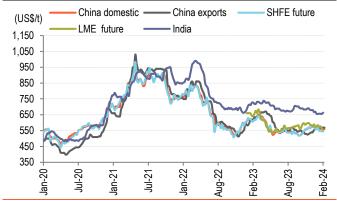
Looking at regional performance, while Australian supply has seen a drop of 30mt relative to CY19 levels, this has been offset by an increase in supply from Mongolia (+20mt), China (+14mt) and North America (+6mt).

### Novel electric smelter furnace

BHP is seeing interest in developing a pilot plant for the initial testing of an electric smelter furnace (ESF), a new concept. An ESF is more flexible in terms of using medium and lower grade iron ore through the DRI (Direct Reduced Iron) route and has the advantage of being integrated with the existing basic oxygen furnace.

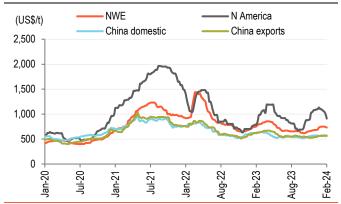


Fig 1 - HRC steel prices (China and India)



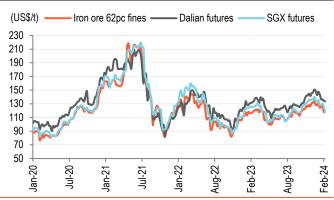
Source: Bloomberg, BOBCAPS Research | HRC: Hot Rolled Coil

Fig 2 - Regional HRC steel prices



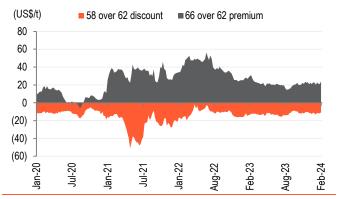
Source: Bloomberg, BOBCAPS Research

Fig 3 - Iron ore prices



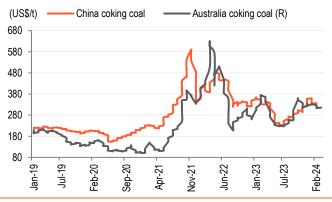
Source: Bloomberg, BOBCAPS Research

Fig 4 - Iron ore grade premium/discount



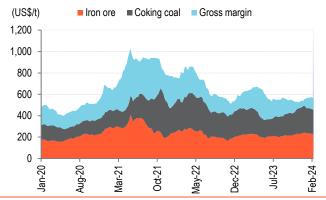
Source: Bloomberg, BOBCAPS Research

Fig 5 - Coking coal prices



Source: Bloomberg, BOBCAPS Research

Fig 6 – China HRC gross margin proxy (on export price)



Source: Bloomberg, BOBCAPS Research



Fig 7 - India HRC premium/discount

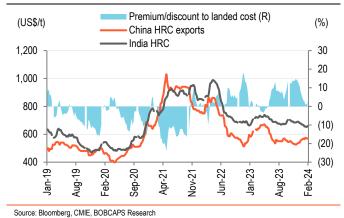


Fig 8 - India rebar premium/discount

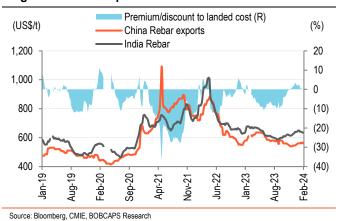
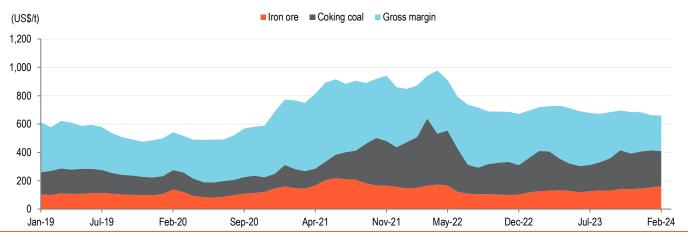


Fig 9 – India HRC gross margin proxy (monthly)



Source: Bloomberg, CMIE, Steelmint, BOBCAPS Research



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