


**METALS & MINING**

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**Expert call with Baosteel on China steel outlook**

- **Baosteel's CY22 steel outlook for China points to market stabilisation with modest 2% dip in consumption and lower net crude steel exports**
- **Outlook implies gradual steadying of steel margins as and when supply chain disruptions in the raw material market ease**
- **Transformation in China's steel industry anticipated over the medium term with a move away from investment and an end to capacity expansion**

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We hosted a call with Ying Zhao, IR Manager of Baosteel (Not Rated), a listed arm of China Baowu Group, the world's largest steel producer. Key takeaways:

**Near-term outlook for China points to market stabilisation...:** Baosteel expects China's steel demand to decline by a modest 2% in CY22 cushioned by gradual stabilisation in the country's real estate sector through the year, albeit at a significantly slower growth rate than historical levels. Infrastructure investment is forecast to grow 5% (per CISA) to partially offset weakness in real estate, with the accelerated issuance of special bonds since Nov'21. China also aims to control net crude steel exports through CY22. Baosteel expects net exports to decline by 3mt YoY to 36mt. Near-term, the Chinese industry is attempting to capitalise on the surge in demand for hot rolled products from the EU post the Russia-Ukraine conflict.

**... translating to gradual stabilisation of steel margins:** Baosteel acknowledged pressure on margins from high raw material prices. However, with the steadying of demand in China and the absence of demand pull on raw material markets, steel margins should gradually stabilise as and when raw material supply chain constraints ease. Further, the control on steel exports will ensure no material disruption in market balance outside China.

**Medium-term outlook points to industry transformation:** China's steel industry is undergoing a transformation with a decarbonisation focus. Given government curbs on housing speculation, steel demand for construction is likely to decline whereas that for use in consumer sectors will rise. The demand driver in the domestic steel market will shift from investment to innovation. However, demand from new applications will take time to develop and the real estate slowdown will weigh on the medium-term outlook.

**Dual control policy to limit production, raise consumer steel prices:** The dual control policy in pursuit of decarbonisation will restrain both steel supply and demand in China. The policy will also raise unit energy cost as well as alloying cost and, in turn, steel production cost. This will feed through the chain and drive up consumer steel prices over the medium term.



## China steel market to stabilise over near term

Baosteel expects China's steel demand to decline by a modest 2% in CY22 cushioned by gradual stabilisation in the country's real estate sector through the year. Crude steel net exports are also expected to decrease by 3mt YoY to 36mt. This implies that China will neither materially impact the external steel market balance nor exert significant pressure on raw material markets. Baosteel's outlook supports stabilisation of steel margins as supply chain disruptions in the raw material market ease.

### Sector-wise demand outlook

- **Real estate to stabilise but not return to historical growth levels:** Baosteel expects real estate demand to stabilise through CY22. CISA, China's local steel industry association, forecasts 2% investment growth in the sector. While the government is supporting real estate, there is unlikely to be any material change in the 'no housing speculation' policy. Baosteel estimates that real estate area under construction will shrink by 5% YoY and sales will shrink 7% YoY in CY22.
- **Infrastructure to partly offset weakness in real estate demand:** Since Nov'21, the government has advanced and accelerated the issuance of special bonds which mainly fund infrastructure projects, the slowdown of which had impacted growth of the segment in CY21. CISA forecasts 5% YoY growth in infrastructure investment for CY22.
- **Positive on specific segments:** Baosteel is positive on steel demand from automobiles, oriented silicon steel for transformers, high-grade non-oriented silicon steel for new energy vehicles, and thick plates for shipbuilding. However, the outlook for cold-rolled steel, steel pipes and other products is relatively flat. In the hot rolled segment, the Chinese industry is attempting to capitalise on the surge in demand from the EU post the Russia-Ukraine conflict.

### Pressure on margins from high raw material prices

Costs have been impacted by low-carbon and environment protection policies as well as higher alloy and energy prices stemming from supply disruptions amid the Russia-Ukraine war. Coking coal supply, particularly from Mongolia, has not returned to pre-Covid levels. Normalisation will follow control over the global pandemic situation and may extend into next year.

## Medium-term outlook points to industry transformation

China's steel industry is undergoing a transformation with a decarbonisation focus. Given government curbs on housing speculation, steel demand for construction is likely to decline whereas that for use in consumer sectors will rise. The demand driver in the domestic steel market will thus shift from investment to innovation. Medium-term drivers will include new infrastructure, new energy, and the application of advanced steel materials such as silicon steel. However, demand from new sectors is currently significantly lower than that from real estate where a sharp slowdown will weigh on the market till new drivers gain hold.

### **China's steel production to decline given focus on dual control policy**

The focus of government regulation has already shifted from limiting steel plant capacity to limiting output. The dual control policy will restrain both supply and demand in the Chinese steel industry.

### **Decarbonisation policy to feed through to consumer steel prices**

China's dual control policy in pursuit of decarbonisation will raise unit energy cost as well as alloying cost and, in turn, steel production cost. This will feed through the chain and drive up consumer steel prices. It is too early to estimate the increase in costs as this will depend upon the paths chosen for decarbonisation. China is evaluating and developing several paths in different directions such as (1) extreme carbon reduction in the traditional blast furnace process, (2) green hydrogen DRI +EAF, and (3) carbon capture and utilisation.

### **Government emphasises decarbonisation goal**

At the 75<sup>th</sup> United Nations General Assembly, China announced a long-term plan for containing carbon emissions wherein it will strive to achieve peak emissions by 2030 and carbon neutrality by 2060. Further, the "Guiding Opinions on Promoting the High-Quality Development of the Iron and Steel Industry" issued by the government in Feb'22 clearly state that the carbon peak of the iron and steel industry should be ensured by 2030.

Baosteel's parent company, China Baowu, has set a goal of achieving carbon peak by 2023. It aims to have the technological capacity to reduce its carbon footprint by 30% in 2025 and thereafter achieve an actual 30% reduction in emissions in 2035, followed by carbon neutrality in 2050.

China has six pilot carbon markets and will launch its national carbon emission trading market in different cities in 2021. Power generation will be included first and the steel industry will follow in the foreseeable future. Key regions and enterprises are being encouraged to implement carbon policies ahead of the country's target of achieving peak emissions by 2030 and neutrality by 2060.

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