

Margins to gradually stabilise at healthy cycle average

- While demand deceleration in China has resulted in price correction, we expect sharper production cuts to constrain exports
- Global steel margins likely to stabilise as China demand gradually steadies and coking coal sees reversal to mean price over 6-9 months
- Indian steel margins to gradually revert to mean in medium term; we prefer TATA and JSP

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China exports likely to remain in check with large production cuts: The sharp demand deceleration in China driven by property weakness and energy shortage has continued into October. However, China's production cuts have been even sharper and are extending into November. Winter restrictions further extend curtailments into Q1CY22 with at least a 30% YoY cut for ~40% of production in China over 1 Jan to 15 Mar 2022. While an intermittent rise is possible, we believe the cuts will keep exports in check. A seasonal recovery in Q2CY22 coupled with stabilising real estate demand could support the market thereafter.

Healthy demand outside China continues to provide support: Construction demand in developed markets has been offsetting the weakness in automobiles. On the lines of the WSA forecast in Oct'21, AMNS also expects ex-China demand to hold up and retained its CY21 forecast of 12-13% YoY growth.

Coking coal shows initial signs of correction: While Australia coking coal prices have dropped to US\$ 364/t (from US\$ 400), China prices have eased to US\$ 440 (from US\$ 540), as per SteelMint. This is led by steep contraction in Chinese demand and better supply post plant maintenance. Though the upcoming wet season in Australia poses a near-term risk, we expect prices to revert to mean over 6-12 months. Increased exports from Mongolia and production in China will be key drivers.

Indian steel margins to normalise over medium term: Steel margins have started softening, with the latest guidance from Tata Steel (TATA) implying a Rs 4-5k/t decline from its Q2FY22 EBITDA margin of Rs 30.7k/t for standalone operations. We believe steel margins will soften over the next 6-12 months as prices ease to an estimated US\$ 650/t by FY23.

Prefer TATA, JSP: With the steel cycle peaking out, we prioritise capital discipline over expansion projects. Accordingly, we are positive on TATA and Jindal Steel & Power (JSP) who are now focusing on responsible growth (see [Disciplined capital allocation key to improving payout, 16Aug21](#)).

Recommendation snapshot

Ticker	Price	Target	Rating
JSP IN	381	555	BUY
JSTL IN	683	795	HOLD
SAIL IN	111	150	HOLD
TATA IN	1,190	1,755	BUY

Price & Target in Rupees | Price as of 23 Nov 2021



Regional benchmark steel prices enter correction phase

China HRC prices have corrected sharply by 18%/16% in domestic/export markets to US\$ 740/US\$ 780 per tonne from a month ago. This coupled with higher coking coal prices lowers the China HRC gross margin at spot prices to US\$ 185/t, 20-25% below the 10-year average. China rebar prices have also fallen to an eight-month low, reflecting weakness in construction demand.

As per Mysteel, while the average HRC margin dropped by US\$ 63/t MoM to US\$ 65/t in October, the average margin on rebar has corrected even more sharply by US\$ 87/t to US\$ 38/t.

Looking forward, the correction in coking coal prices could help stabilise steel margins. We have seen initial signs with a 9% WoW correction in coking coal. Australian FOB prices have corrected to US\$ 364/t (from a peak of US\$ 400/t) and Chinese CNF prices are down to US\$ 440/t (SteelMint). However, mean reversal will depend upon the impact of Australia's wet season, rebound in Mongolia's exports and China's production levels.

Iron ore prices appear to be stabilising around the US\$ 90/t level as the premium for high grade and discount for low grade ore look to be recovering and stabilising at higher levels.

India steel margins also start to ease

Indian steel prices are showing initial signs of decline after the regional benchmark, gave up some gains over October. Both HRC and rebar prices have corrected 1-2% from the recent peaks. This has significantly wiped out the domestic price discount to landed import prices.

Relative to the Chinese benchmark, Indian steel margins benefit from the differential on iron ore and coking coal, with the latter being a more recent phenomenon. Given the rise in coking coal prices, Indian steel margins are likely to come off from peaks. The recent guidance from TATA suggests that its standalone EBITDA margin may decline by Rs 4-5k/t QoQ from Rs 30.7k/t in Q2FY22 as higher coking coal costs feed through to operations.

Demand-supply remains in balance

China: Deceleration of steel demand in China has been followed by aggressive production cuts, keeping the demand-supply balance in check. There are concerns of an increase in exports from China, but we believe sharp cuts will constrain exports.

Outside China: Production has started recovering from a seasonal slowdown in Europe but may see some impact from higher energy prices. The recent Covid wave is raising uncertainty levels in Europe, though demand in the US remains strong.

China weakness continues but exports to remain in check

China weakness continued in October with a 3% and 6% MoM reduction in production and apparent consumption respectively. The market remained in balance with exports showing a marginal reduction to 4.5mn tonnes (mt). Steel inventory of the five major finished steel products dropped to a 9.5-month low of 16.5mt by 18 November (Mysteel).

Looking at the granularity of production cuts, non-member mills have seen a higher impact despite recent reductions by CISA mills. While Chinese steel production is down 1% YoY over Jan-Oct'21, this was primarily driven by a 17% YTD cut by non-member mills as they offset the 6% YTD increase from CISA mills.

Global steel markets are worried about the possibility of an increase in steel exports, resulting in disruptions in ex-China markets. Although the Chinese industry has started testing markets with aggressive offers, we believe sharp domestic cuts will limit any material increase in exports. Production has already reduced by 320mt (annualised) in October from the peak in April and continued to retreat in November. Daily crude steel output during the first ten days of November has declined 3.6% from the late-October average (Mysteel).

With the onset of winter, China has started implementing stricter production cuts for mills with high emissions to improve air quality in cities such as Tangshan, Handan in Hebei province and others. Winter restrictions extend curtailments into Q1CY22 with at least a 30% YoY cut for ~40% of production in China over 1 Jan to 15 Mar 2022. Though an intermittent rise in exports is possible as the Chinese industry attempts to leverage higher export prices, we believe the mandated cuts will restrict such sales.

Per its October analyst meet, global steel major AMNS also does not expect a material increase in exports from China given the sharp deceleration in production.

China demand stabilisation may go into Q2CY22

The slowdown in Chinese construction demand is reflected in the recent weakness in rebar prices, which have hit an 8.5-month low. Daily trading volumes of rebar, wire rod and bar-in-coil are down 18.6% MoM in October and are far below the normal threshold of 200kt/d for the autumn peak consumption season (Mysteel).

Real estate: Near-term weakness; projects under construction to help stabilise demand through CY22

Fixed asset investment (FAI) in China's real estate market has contracted to 7.4% YoY over Jan-Oct'21 from 14.7% in H1CY21. The weakness is more prominent in new construction starts which have dropped below the five-year range. This is exacerbated by a monthly decline in house prices (by 0.3% MoM in October, the biggest monthly drop since 2015) and sharp reduction in house sales due to bearish sentiments.

Lower sales could constrain the availability of finance for developers and scale back construction activities in coming months. China's property sector has been relying on advances and deposits after the tightening of financing norms for developers.

However, with the acceleration of real estate investment till H1CY21, the total floor space under construction remains at a five-year high. To avoid any contagion effect on the economy, China needs to complete a majority of the construction that has been started. This could help stabilise demand as we go further into CY22. Chinese regulators have started to fine tune policies – initial measures include a loosening of mortgage loans for homebuyers and development loans for qualified developers.

Infrastructure: May help to partly cushion impact of decline in real estate

Infrastructure investments in China have slowed markedly since Jul'21. The slowdown has been particularly visible in highway and rail transportation, electricity, gas and power investment. At the same time, select areas such as investment in manufacturing and the collective of transport, storage and posts are improving.

To support funding for construction projects undertaken by the local government, the Ministry of Finance announced last month its aim to complete the issuance of all local bonds for special purposes within the month. In October, local government bond issuance was RMB 370bn higher YoY, reaching RMB 6.5tn over Jan-Oct'21.

Other sectors show mixed trends

- Automobiles showed a sequential uptick in October with production/sales rising 12.2%/12.8% MoM. However, the rise is from a lower base after the impact of semiconductor shortages (China Association of Automobile Manufacturers).
- Shipbuilding is holding up. Completion of vessels increased 5% YoY over Jan-Oct'21 (vs 6.2% over Jan-Sep). Demand from the sector is likely to hold up well over CY22 as new vessel orders are up 210% YoY over Jan-Oct'21. The backlog for all builders increased 38% YoY by the end of October.
- Appliances demand showed a sharp reduction with a seasonal pullback in air conditioners and flattish demand for refrigerators and freezers.

Ex-China production recovering

Ex-China production is recovering after a seasonal slowdown, particularly in the EU. Both US and Asia ex-China production are running close to the top of their seasonal ranges.

Looking forward, steel producers – particularly EAF-based producers around Europe – are exposed to the risk of high electricity prices. They account for ~40% of European production and output could be affected if they are exposed to higher contractual prices even as energy prices remain elevated. With EAF production at risk, long-product producers are likely to see a higher impact than sheet producers.

Ex-China demand running healthy

The World Steel Association (WSA) has raised its forecast for ex-China demand growth to 11.5% (from 9.3%) for CY21, whereas AMNS maintained its CY21 forecast of 12-13% YoY growth.

Eurofer (European Steel Association), in its latest Q4CY21 assessment, does expect recovery in steel-using industries and in steel demand to continue through CY21, but at a moderate rate and subject to uncertainty at least until Q1CY22 when global supply chain disruptions should ease significantly. Although the association has raised its growth forecast for apparent steel consumption to 13% (from 11.2%) in CY21, it has lowered its estimate for output of steel-using sectors to 8.5% (from 9.3%).

US apparent steel consumption for September was running at the top of its seasonal range, supported by a rising construction index and strong machinery shipments as well as appliances demand that offset the significant downturn in automobiles. Going ahead, the housing cycle is now stabilising at a higher base as seen from stabilising permits and new starts.

Iron ore market in surplus, coking coal market shows initial sign of easing

Pressure on the global seaborne iron ore market has reduced significantly with the pullback in demand from China. Australian iron ore exports finally showed signs of improvement in September whereas Brazilian exports are slowing down as Vale focuses on a 'value over volume' strategy.

For the seaborne coking coal market, a 9% price correction over last week shows signs of improvement in supply. Australian export data for October is not yet available, but BHP confirmed in its October analyst call that it has completed maintenance at its Australian coal mines though supply remains subject to the risk of wet weather starting from November.

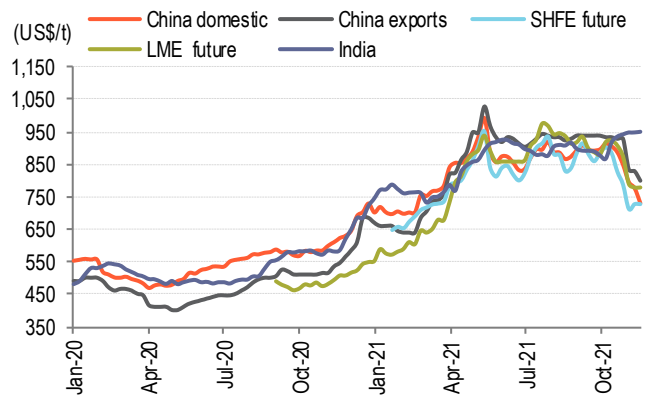
Given curtailed crude steel production, seaborne demand from China has started to soften. However, a further reduction in demand pull on seaborne market will depend on restoration of domestic production and resumption of imports from Inner Mongolia.

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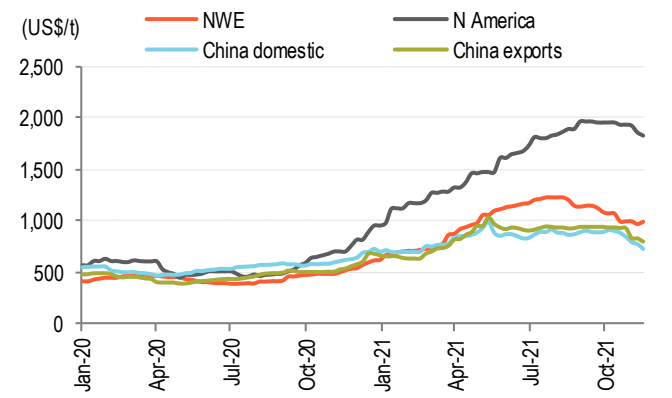
Prices

Fig 1 – HRC steel prices (China and India)



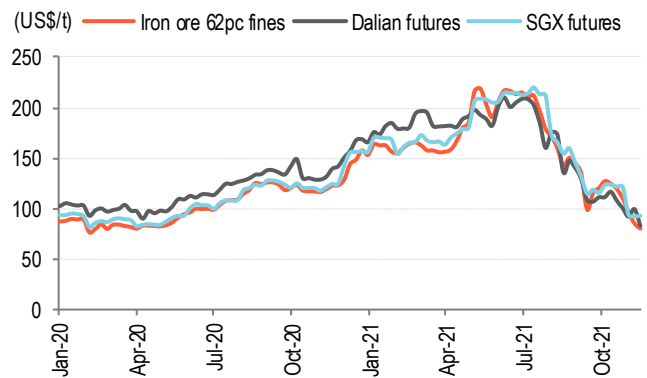
Source: Bloomberg, BOBCAPS Research

Fig 2 – Regional HRC steel prices



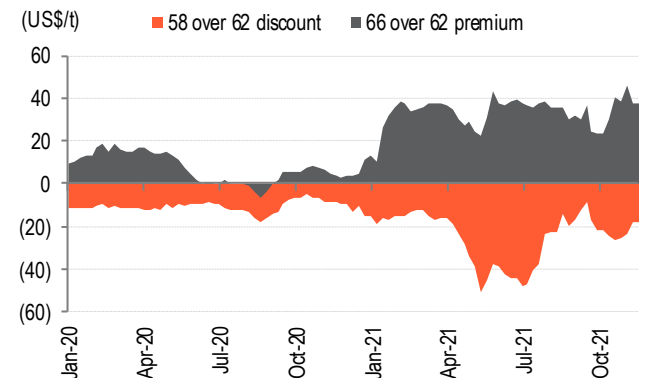
Source: Bloomberg, BOBCAPS Research

Fig 3 – Iron ore prices



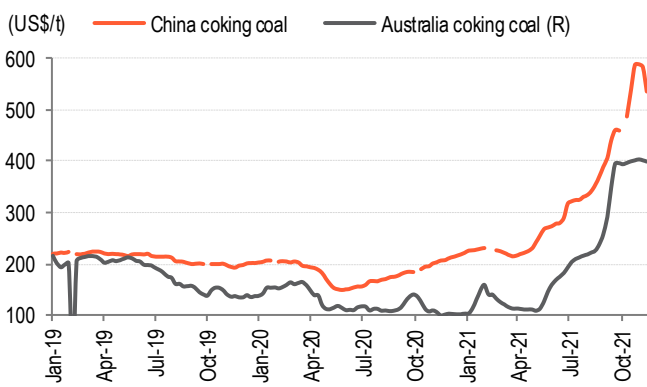
Source: Bloomberg, BOBCAPS Research

Fig 4 – Iron ore grade premia/ discount



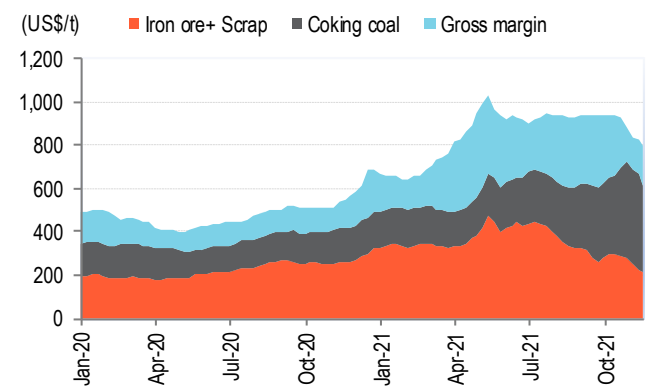
Source: Bloomberg, BOBCAPS Research

Fig 5 – Coking coal prices



Source: Bloomberg, BOBCAPS Research

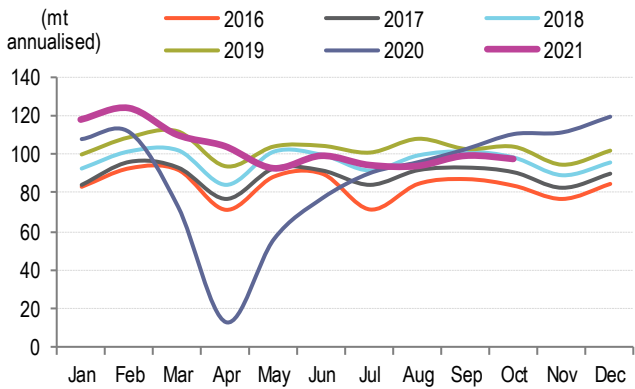
Fig 6 – China HRC gross margin proxy (on export price)



Source: Bloomberg, BOBCAPS Research

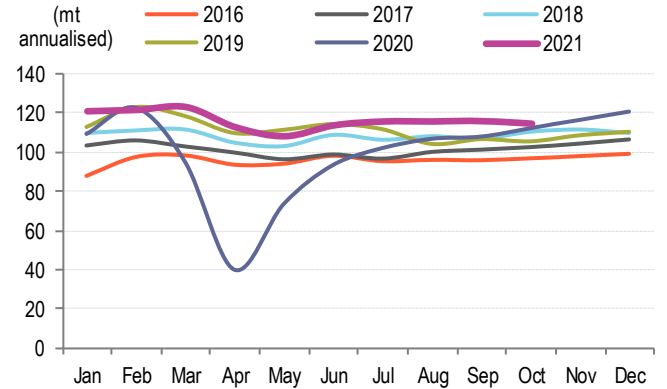
India steel demand supply and prices

Fig 7 – India steel consumption



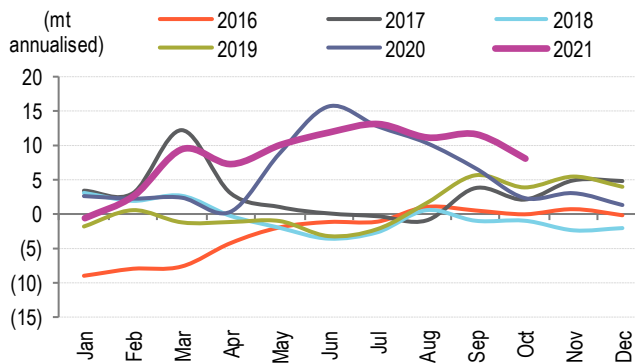
Source: CMIE, BOBCAPS Research

Fig 8 – India steel production



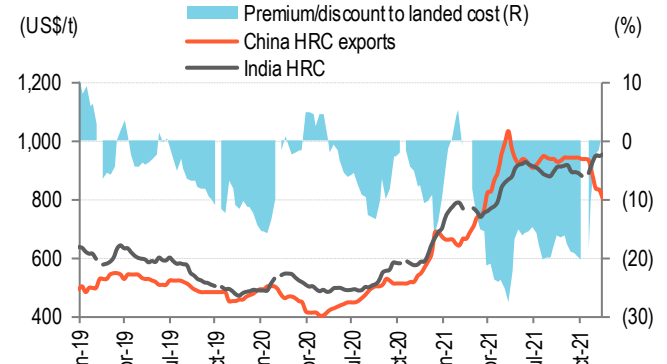
Source: CMIE, BOBCAPS Research

Fig 9 – India steel exports



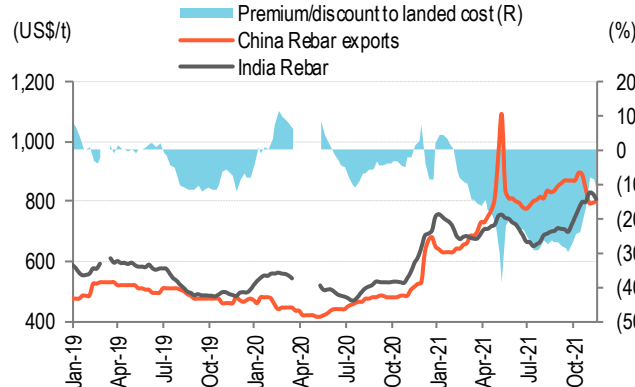
Source: CMIE, BOBCAPS Research

Fig 10 – India HRC premium/discount



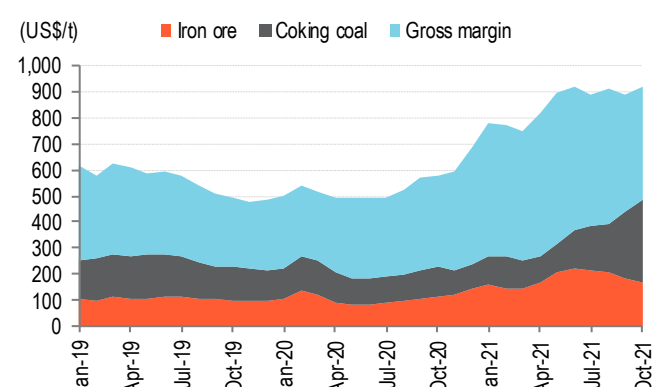
Source: Bloomberg, CMIE, BOBCAPS Research

Fig 11 – India rebar premium/ discount



Source: Bloomberg, Steelmint, BOBCAPS Research

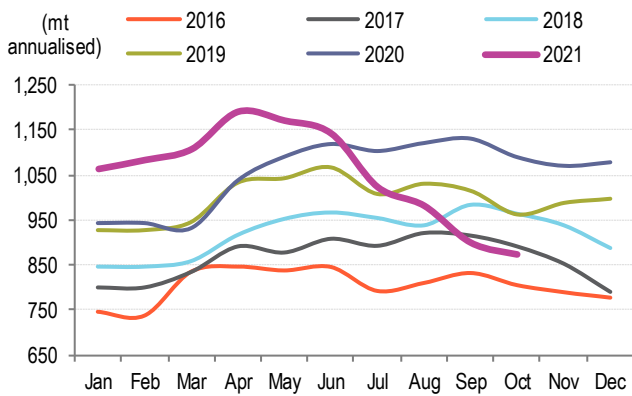
Fig 12 – India HRC gross margin proxy



Source: Bloomberg, CMIE, Steelmint, BOBCAPS Research

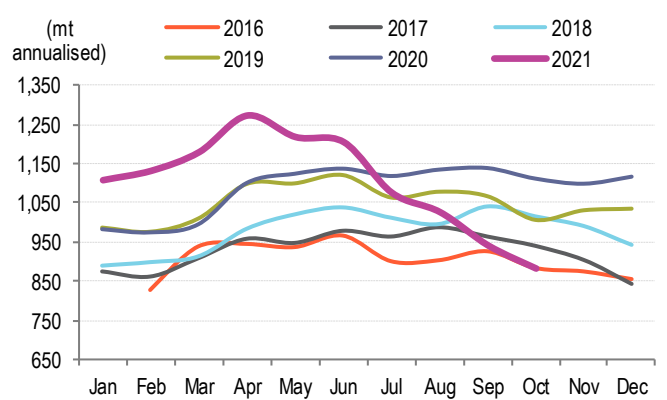
China steel production and consumption

Fig 13 – China steel production



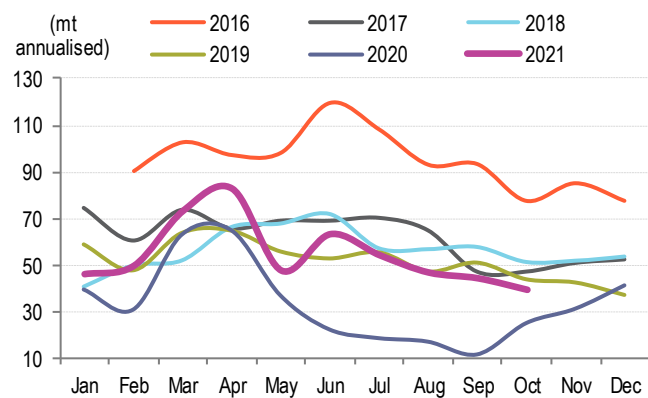
Source: Bloomberg, China National Bureau of Statistics, BOBCAPS Research

Fig 14 – China steel apparent consumption



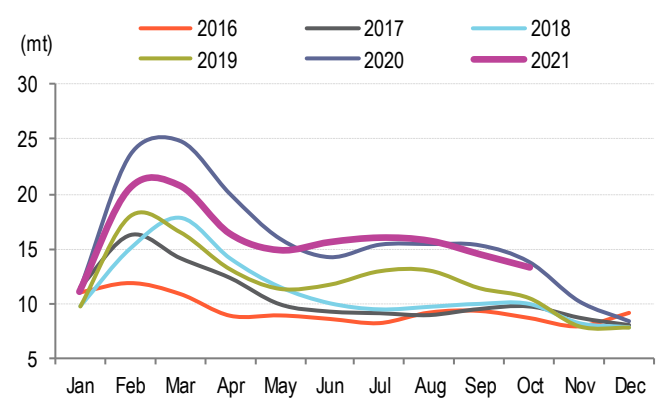
Source: Bloomberg, China Customs, China National Bureau of Statistics, BOBCAPS Research

Fig 15 – China steel net exports



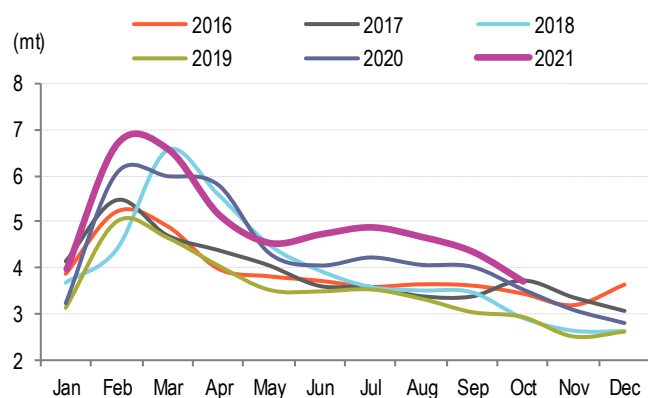
Source: Bloomberg, China Customs, BOBCAPS Research

Fig 16 – China steel inventory for market place



Source: Antaike, Bloomberg, BOBCAPS Research

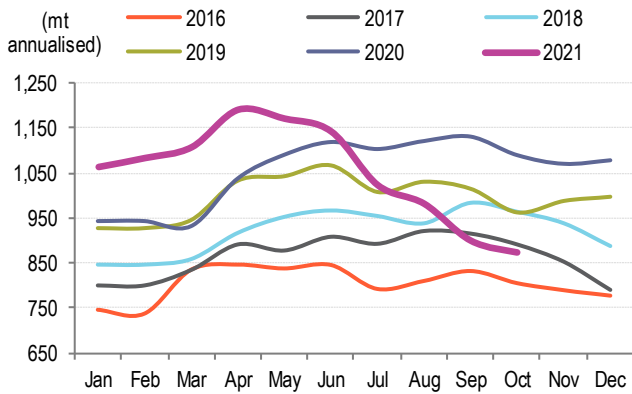
Fig 17 – China steel inventory of traders



Source: Bloomberg, Steelhome, BOBCAPS Research

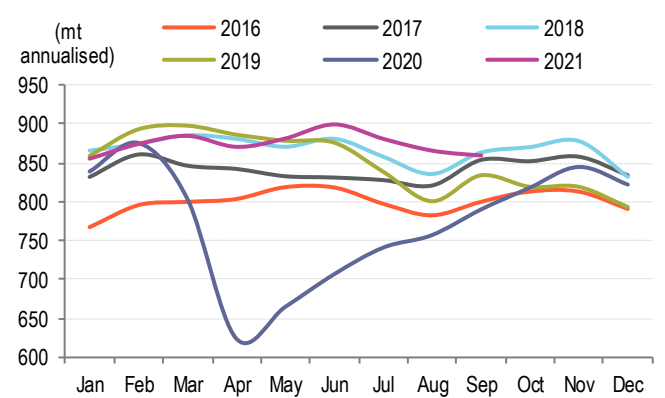
World steel production

Fig 18 – China production



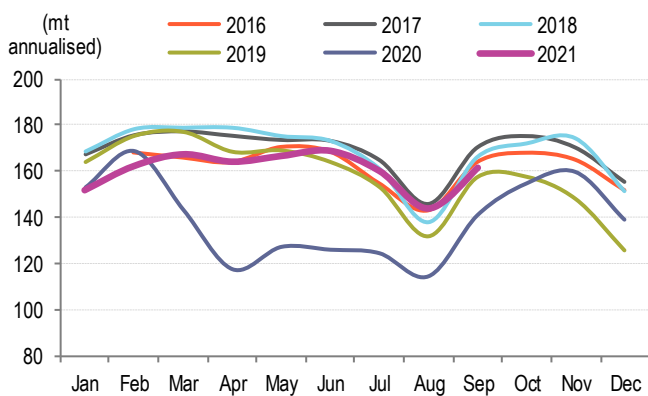
Source: Bloomberg, China National Bureau of Statistics, BOBCAPS Research

Fig 19 – Ex-China production



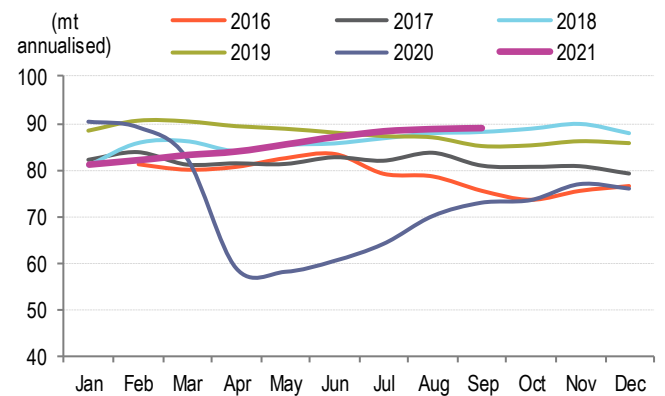
Source: Bloomberg, World Steel Association, BOBCAPS Research

Fig 20 – EU production



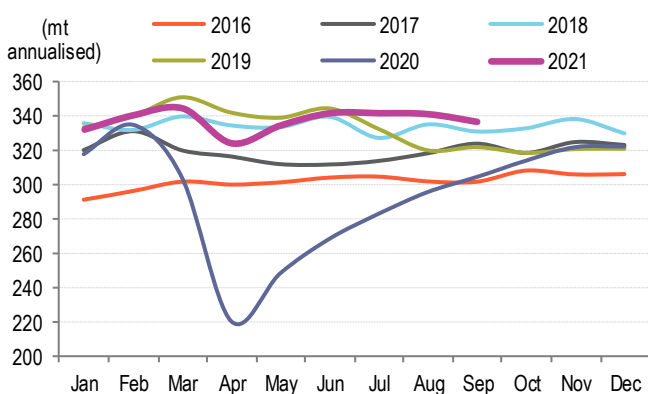
Source: Bloomberg, World Steel Association, BOBCAPS Research

Fig 21 – US production



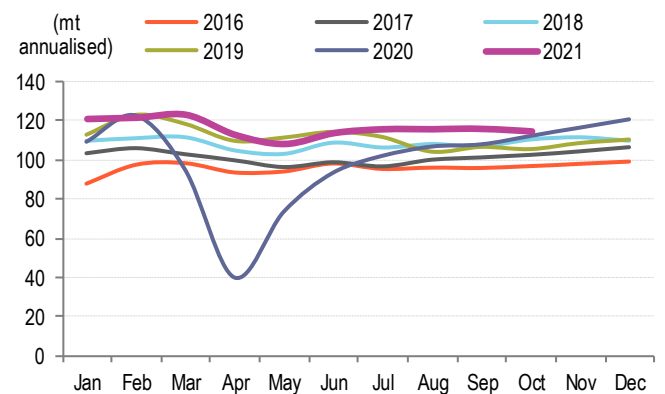
Source: Bloomberg, World Steel Association, BOBCAPS Research

Fig 22 – Asia ex China production



Source: Bloomberg, World Steel Association, BOBCAPS Research

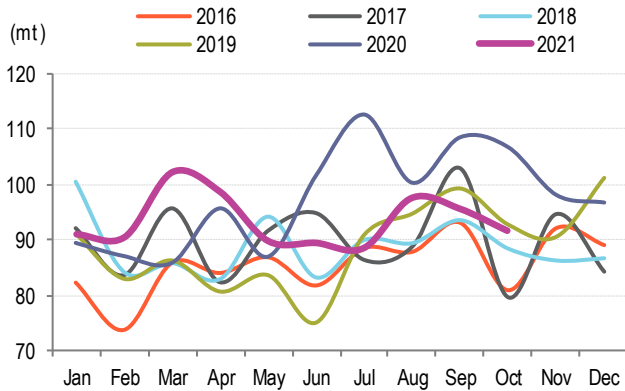
Fig 23 – India production



Source: CMIE, BOBCAPS Research

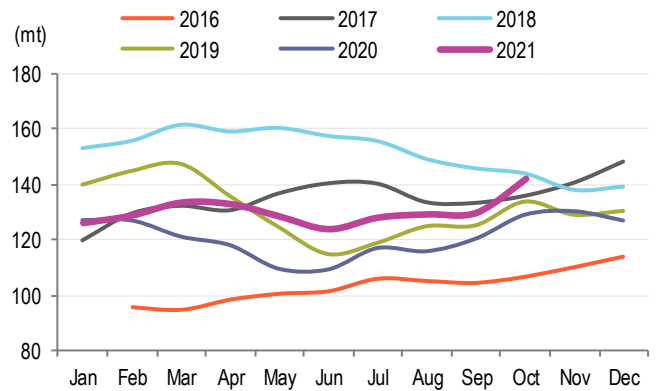
Iron ore import/ export

Fig 24 – China iron ore imports



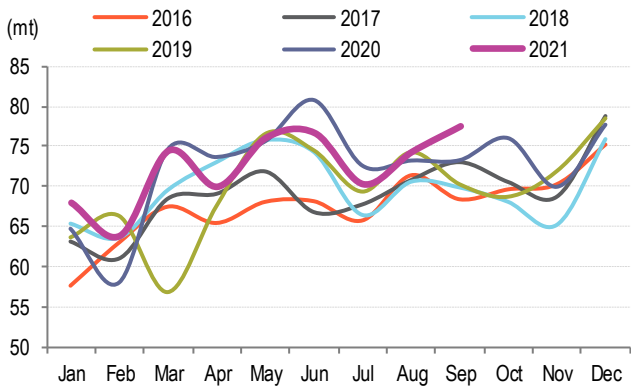
Source: Bloomberg, China Customs, BOBCAPS Research

Fig 25 – China iron ore port inventory



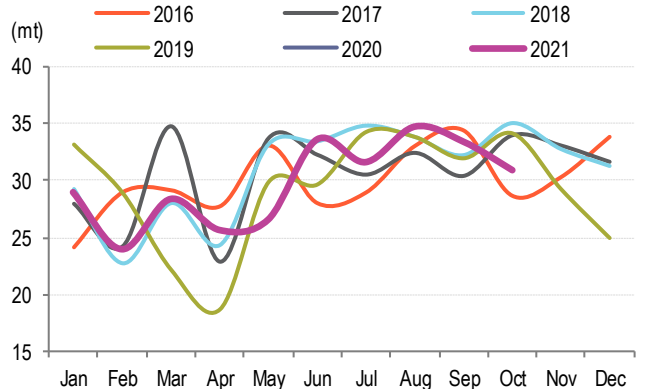
Source: Bloomberg, Steelhome, BOBCAPS Research

Fig 26 – Australia iron ore exports (monthly)



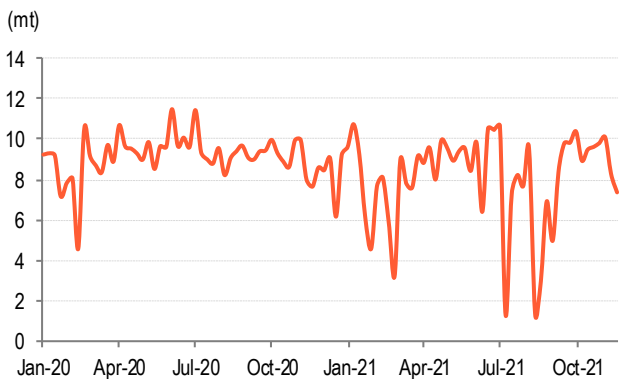
Source: Bloomberg, Australian Bureau of Statistics, BOBCAPS Research

Fig 27 – Brazil iron ore exports (monthly)



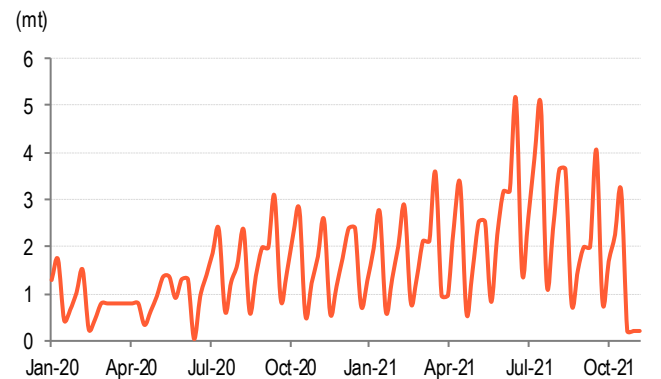
Source: Bloomberg, Brazil Ministry of Commerce, BOBCAPS Research

Fig 28 – Australia Port Headland iron ore exports (weekly)



Source: Bloomberg, Global Ports, BOBCAPS Research

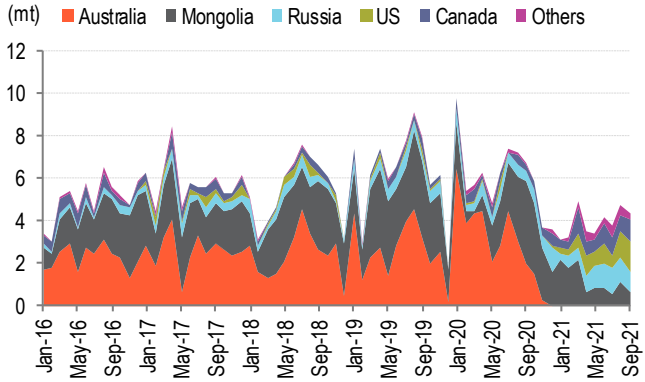
Fig 29 – Brazil iron ore exports (weekly)



Source: Bloomberg, Brazil Ministry of Commerce, BOBCAPS Research

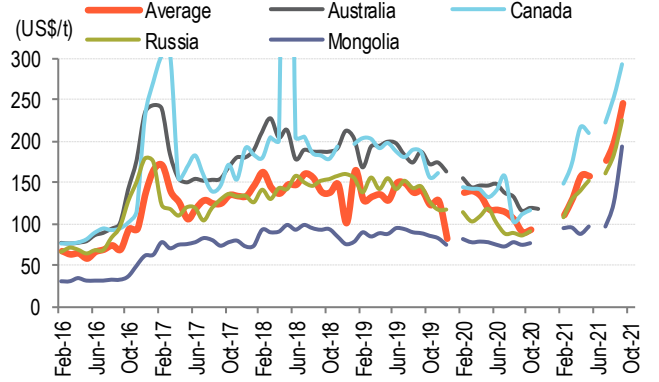
Coking coal

Fig 30 – China coking coal imports



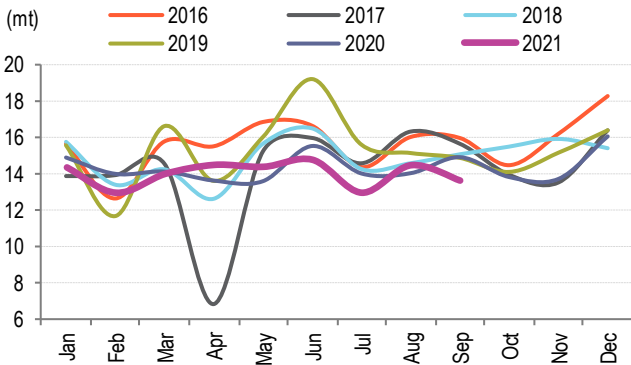
Source: Bloomberg, China Customs, BOBCAPS Research

Fig 31 – China coking coal import price



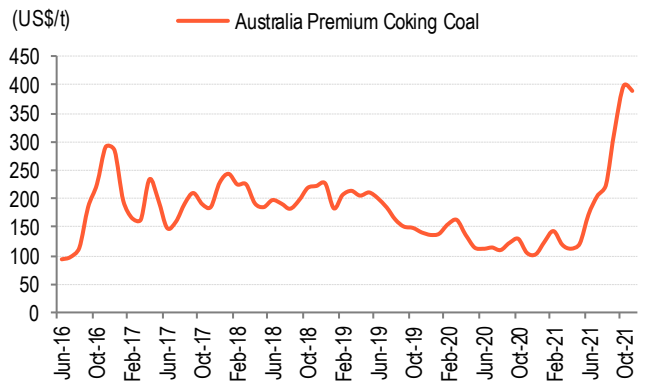
Source: Bloomberg, China Customs, BOBCAPS Research

Fig 32 – Australia coking coal exports



Source: Australian Bureau of Statistics, Bloomberg, BOBCAPS Research

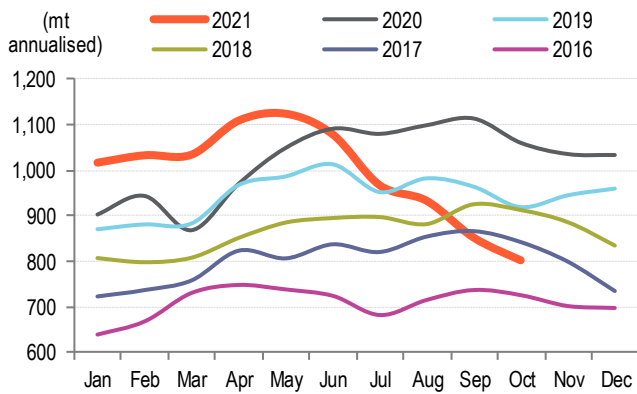
Fig 33 – Australia coking coal FOB price



Source: SteelMint, BOBCAPS Research

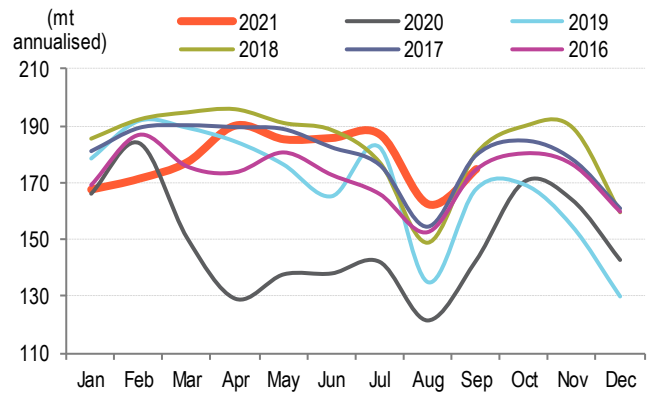
Apparent steel demand

Fig 34 – China



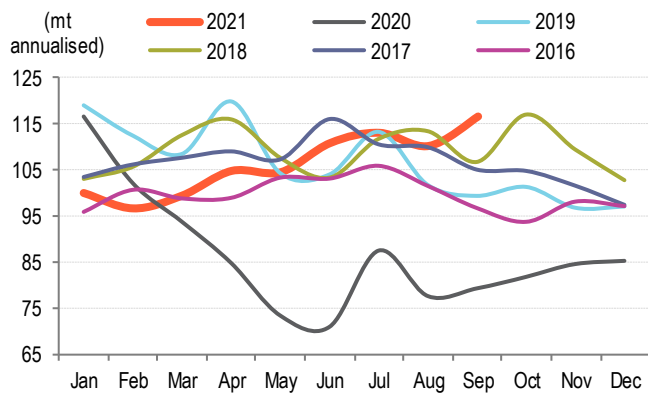
Source: Bloomberg, China Customs, National Bureau of Statistics, BOBCAPS Research

Fig 35 – Europe



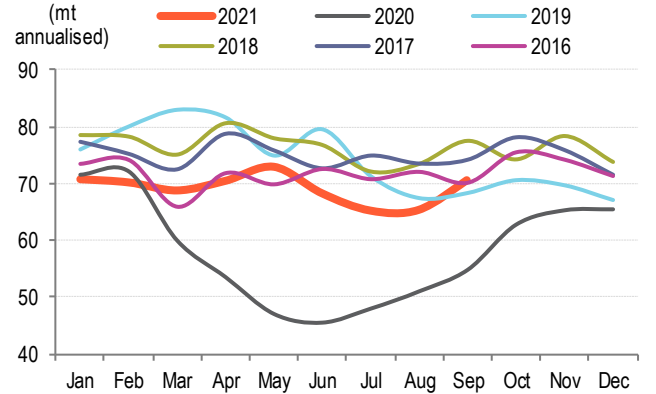
Source: Bloomberg, Eurofer, World Steel Association, BOBCAPS Research

Fig 36 – US



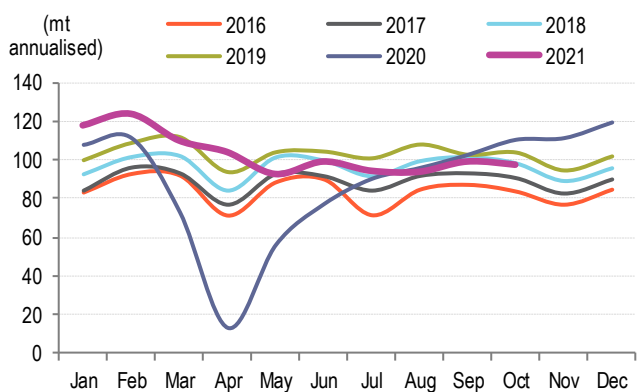
Source: Bloomberg, US Census Bureau, World Steel Association, BOBCAPS Research

Fig 37 – Japan



Source: Bloomberg, Ministry of Finance Japan, World Steel Association, BOBCAPS Research

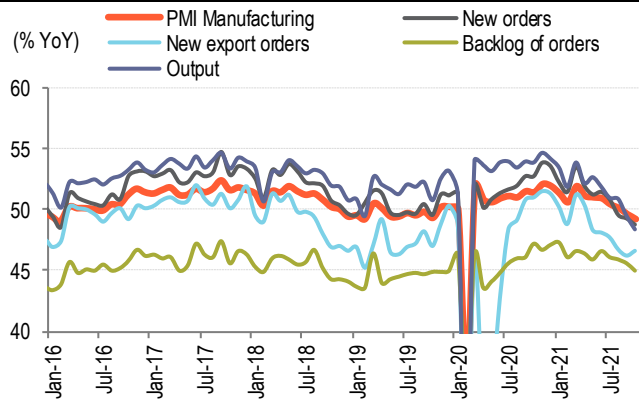
Fig 38 – India



Source: CMIE, BOBCAPS Research

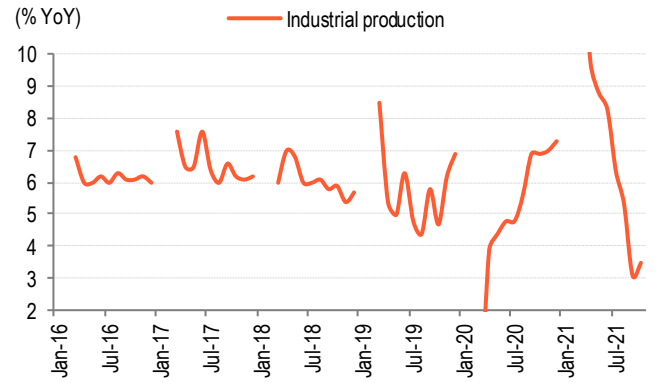
China demand indicators

Fig 39 – China manufacturing PMI



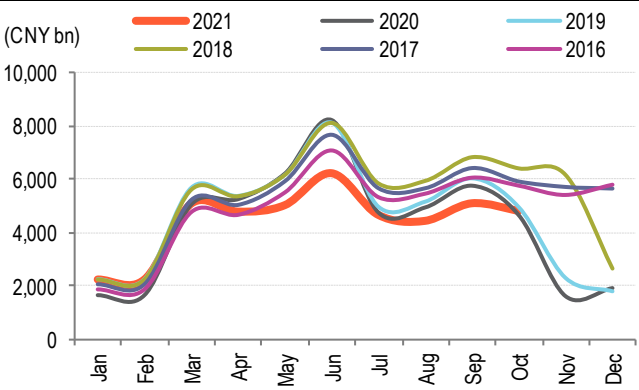
Source: Bloomberg, National Bureau of Statistics, BOBCAPS Research

Fig 40 – China Industrial Production YTD growth



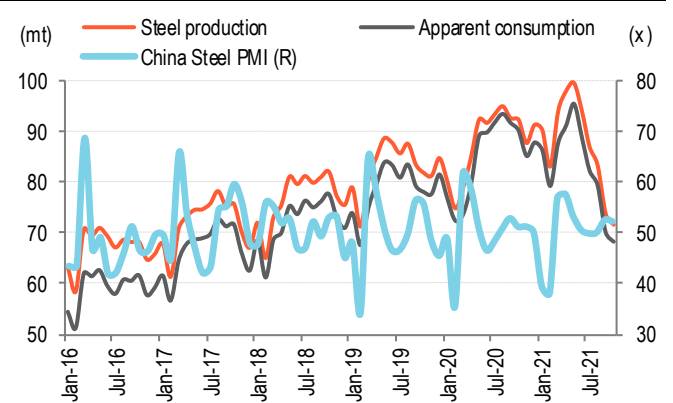
Source: Bloomberg, National Bureau of Statistics, BOBCAPS Research

Fig 41 – China FAI ex rural households



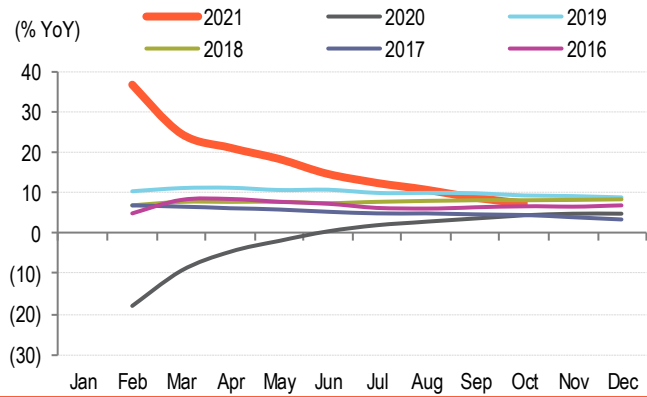
Source: Bloomberg, National Bureau of Statistics, BOBCAPS Research | FAI – Fixed Asset Investment

Fig 42 – China steel PMI



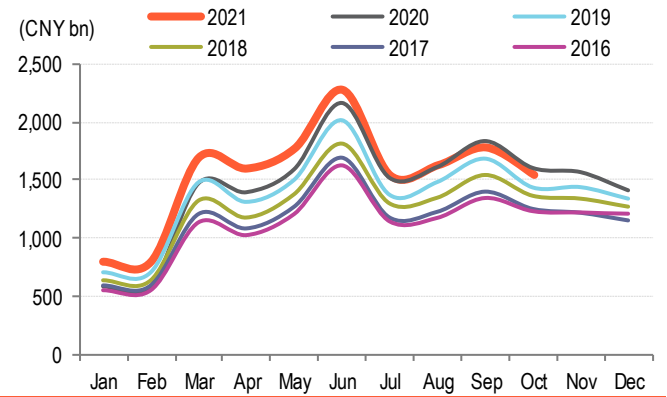
Source: Bloomberg, Steelhome, BOBCAPS Research

Fig 43 – China FAI real estate FAI, YTD growth =



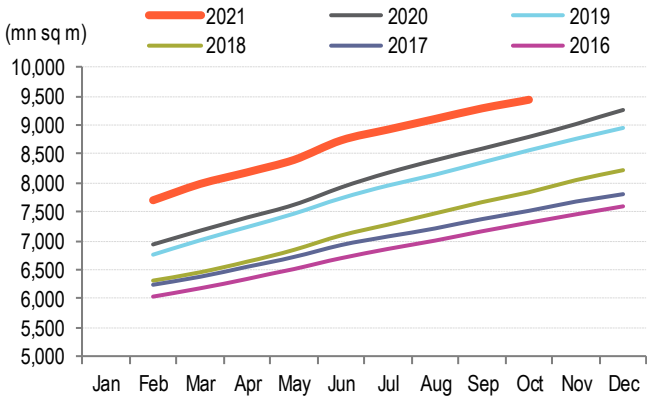
Source: Bloomberg, National Bureau of Statistics, BOBCAPS Research

Fig 44 – China real estate FAI



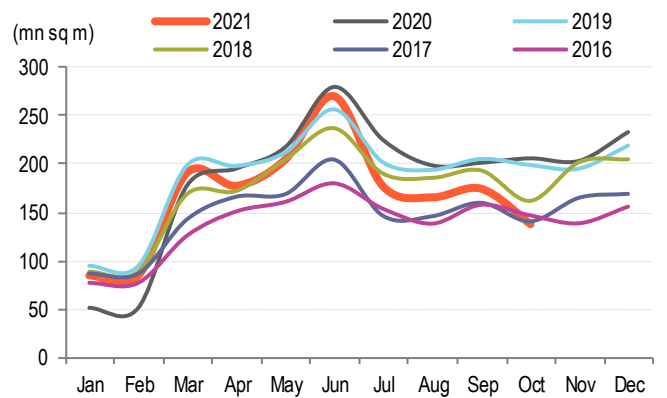
Source: Bloomberg, National Bureau of Statistics, BOBCAPS Research

Fig 45 – Real estate floor space under construction



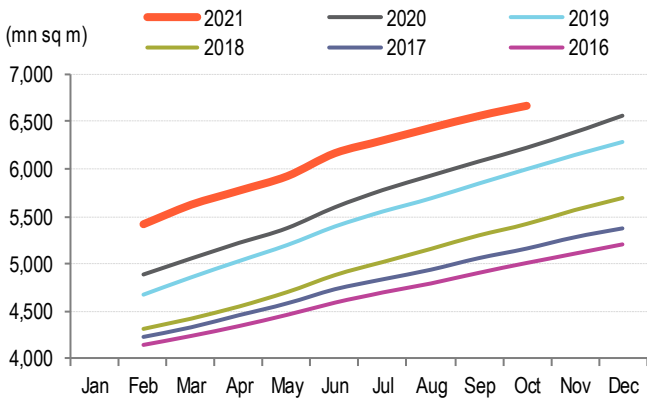
Source: Bloomberg, National Bureau of Statistics, BOBCAPS Research

Fig 46 – Real estate floor space newly started



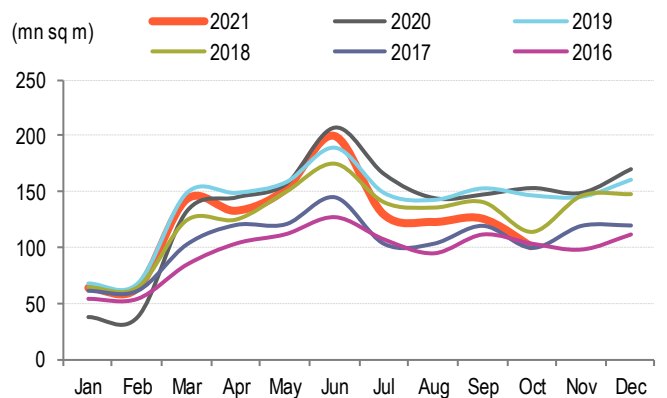
Source: Bloomberg, National Bureau of Statistics, BOBCAPS Research

Fig 47 – Residential floor space under construction



Source: Bloomberg, National Bureau of Statistics, BOBCAPS Research

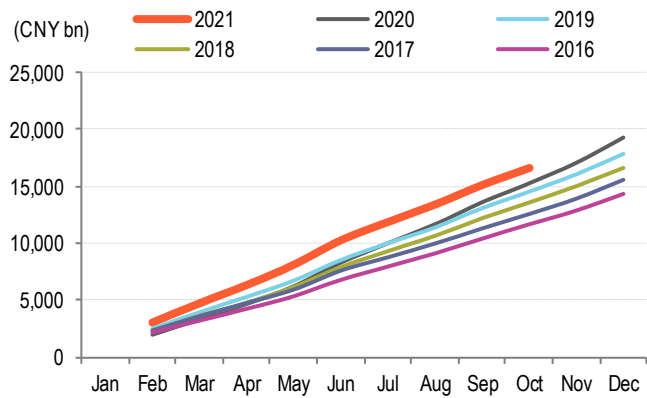
Fig 48 – Residential floor space newly started



Source: Bloomberg, National Bureau of Statistics, BOBCAPS Research

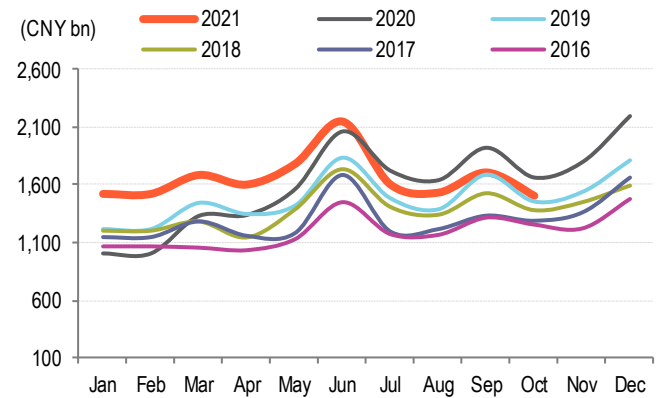
China property sector indicators

Fig 49 – Real estate – total funds cumulative



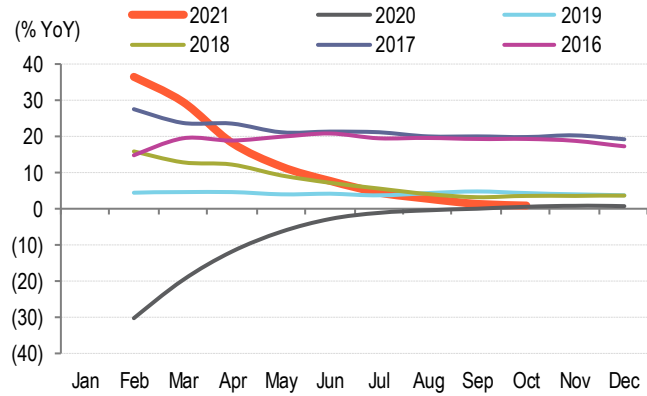
Source: Bloomberg, National Bureau of Statistics, BOBCAPS Research

Fig 50 – Real estate – total funds monthly



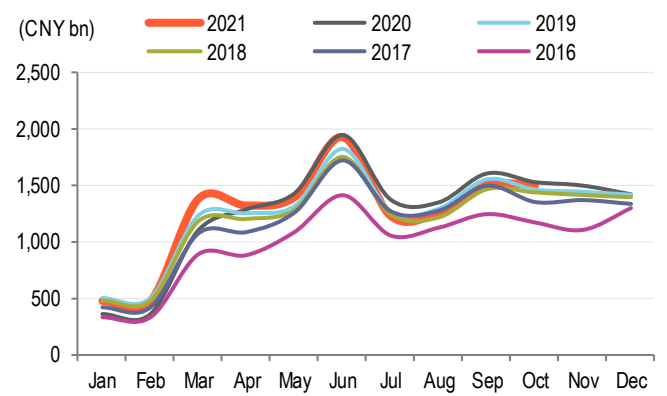
Source: Bloomberg, National Bureau of Statistics, BOBCAPS Research

Fig 51 – Infrastructure FAI excluding electric power, heat power, gas and water, YTD growth



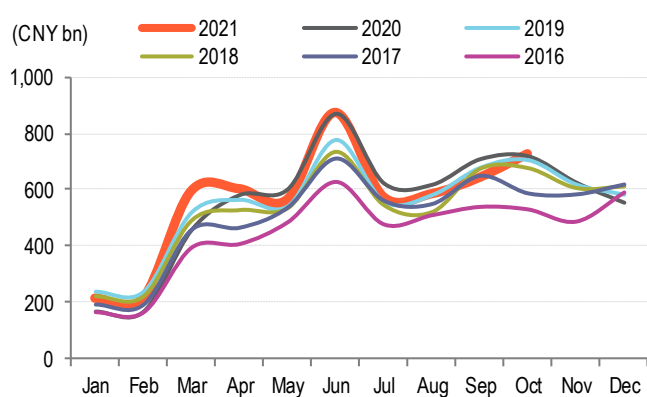
Source: Bloomberg, National Bureau of Statistics, BOBCAPS Research

Fig 52 – Infrastructure FAI excluding electric power, heat power, gas and water



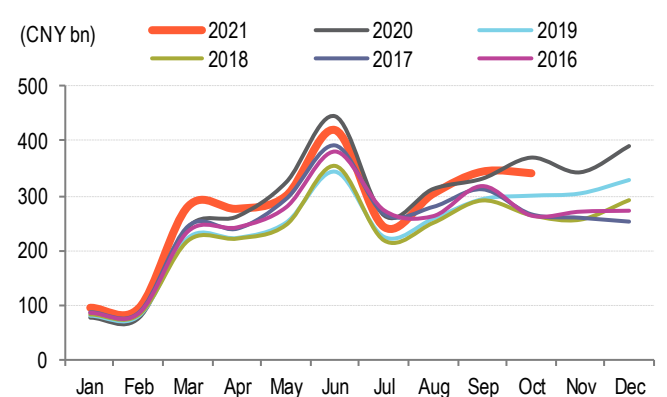
Source: Bloomberg, National Bureau of Statistics, BOBCAPS Research

Fig 53 – Transport, Storage, Posts FAI



Source: Bloomberg, National Bureau of Statistics, BOBCAPS Research

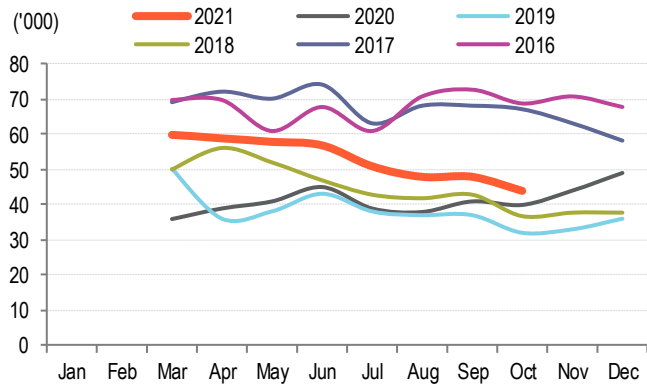
Fig 54 – Power, Gas and Water FAI



Source: Bloomberg, National Bureau of Statistics, BOBCAPS Research

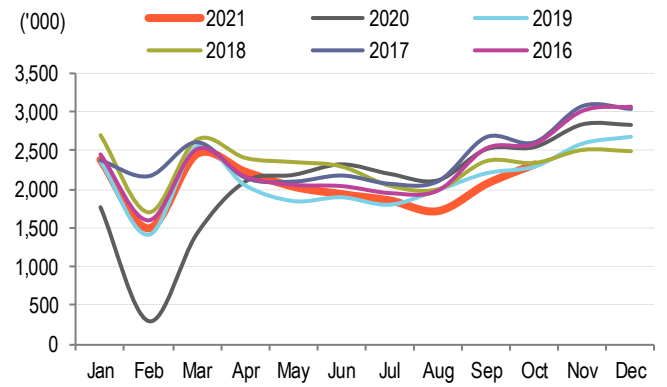
China downstream demand indicators

Fig 55 – Machinery: metal cutting machine production



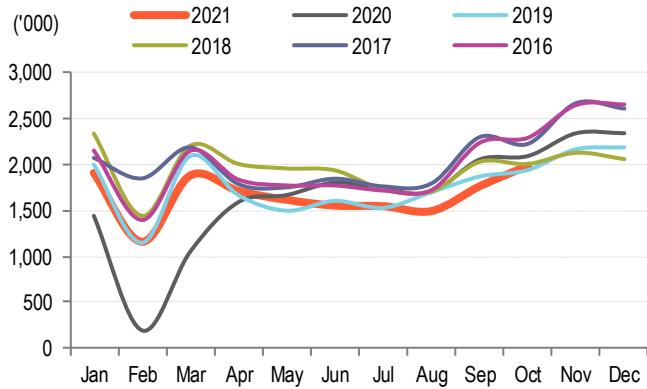
Source: Bloomberg, National Bureau of Statistics, BOBCAPS Research

Fig 56 – Automobiles: vehicle production



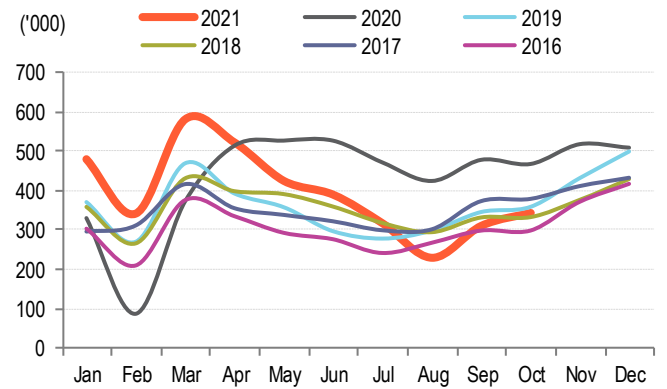
Source: Bloomberg, China Automotive Information Net, BOBCAPS Research

Fig 57 – Automobiles: Passenger vehicles production



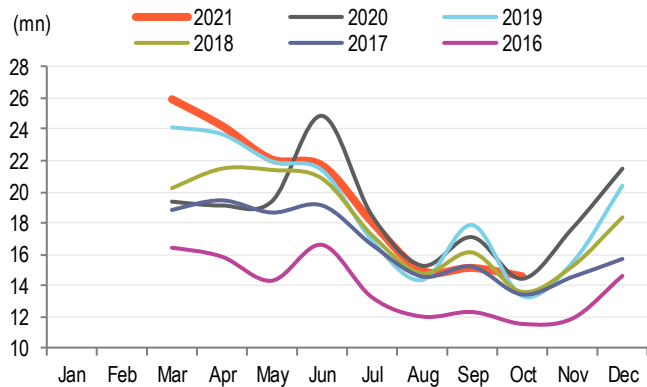
Source: Bloomberg, China Automotive Information Net, BOBCAPS Research

Fig 58 – Automobiles: Commercial vehicles production



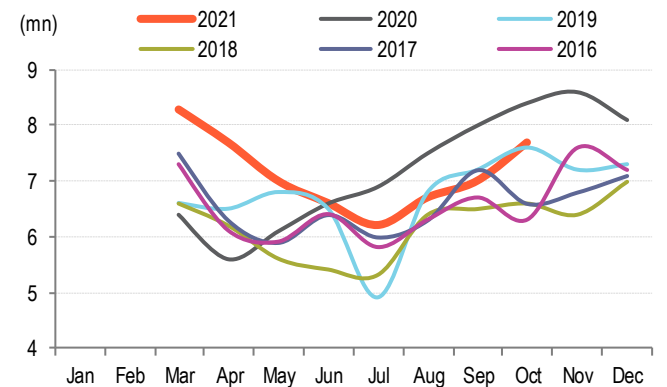
Source: Bloomberg, China Automotive Information Net, BOBCAPS Research

Fig 59 – Appliances: Air-conditioner production



Source: Bloomberg, National Bureau of Statistics, BOBCAPS Research

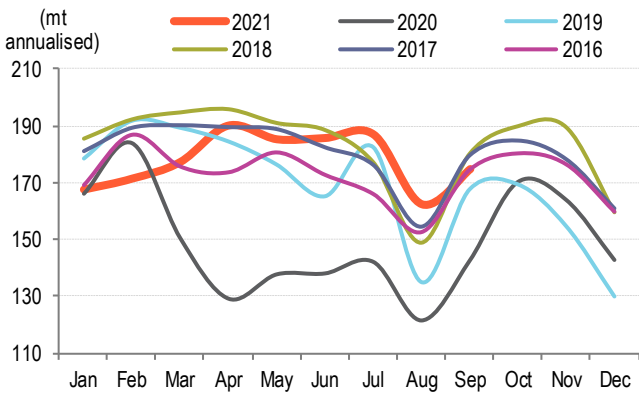
Fig 60 – Appliances: Washing machine production



Source: Bloomberg, National Bureau of Statistics, BOBCAPS Research

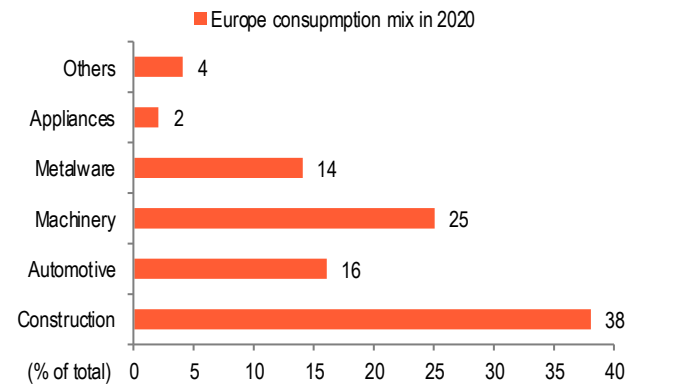
Europe: steel demand indicators

Fig 61 – Europe apparent demand



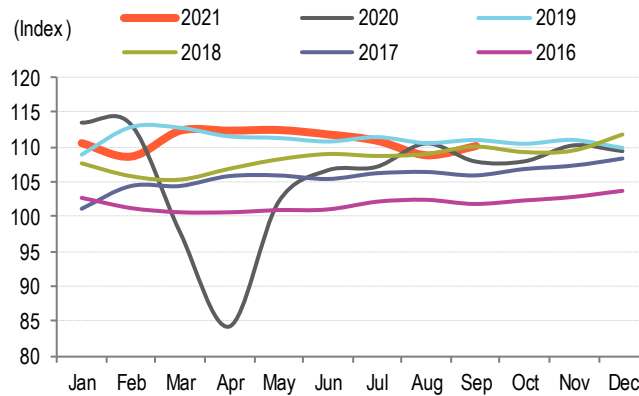
Source: Bloomberg, Eurofer, World Steel Association, BOBCAPS Research

Fig 62 – Europe demand break-up



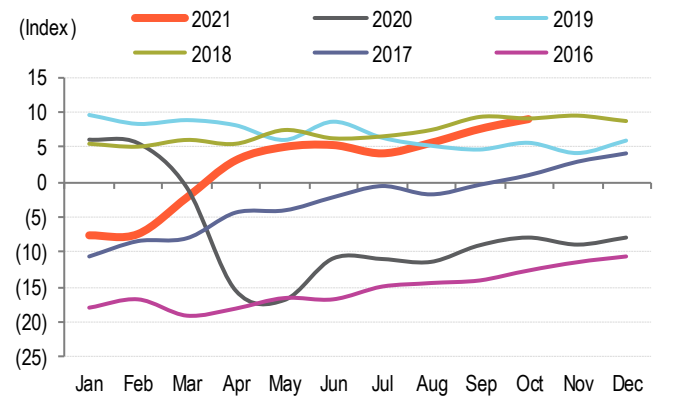
Source: Eurofer, BOBCAPS Research

Fig 63 – Europe construction index seasonally adjusted



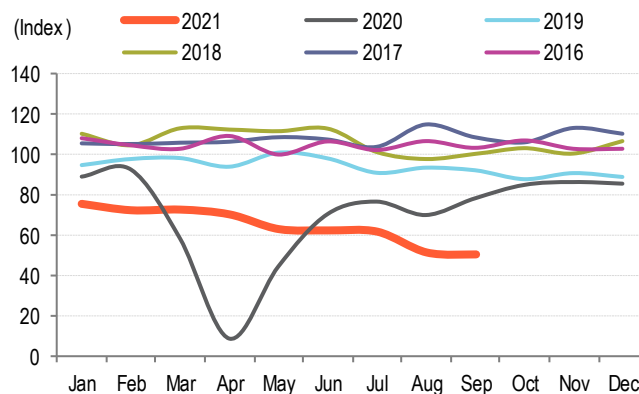
Source: Bloomberg, Eurostat, BOBCAPS Research ! SA – Seasonally adjusted

Fig 64 – Eurozone construction confidence indicator SA



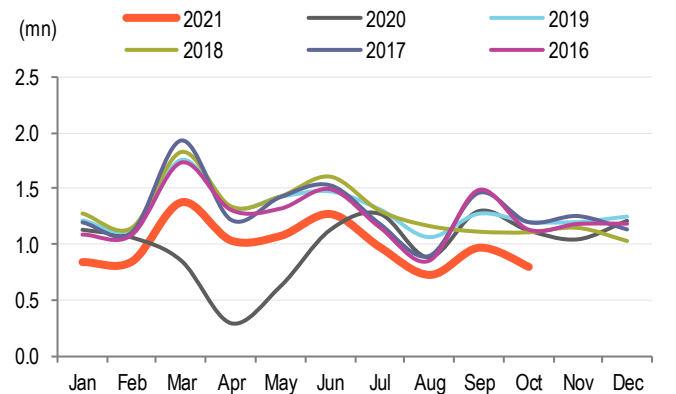
Source: Bloomberg, European Commission, BOBCAPS Research ! SA – Seasonally adjusted

Fig 65 – EU motor vehicle production index



Source: Bloomberg, Eurostat, BOBCAPS Research

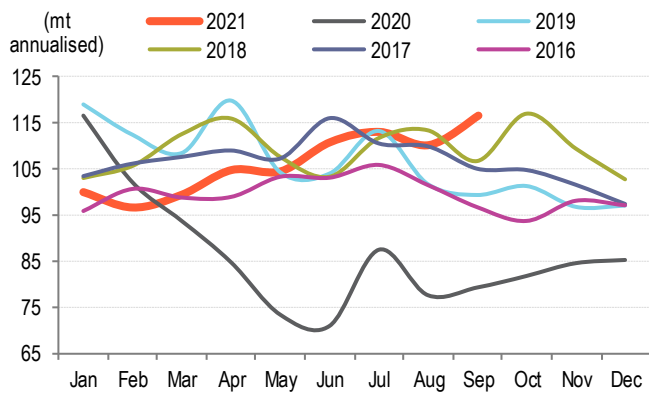
Fig 66 – Europe vehicles registration



Source: ACEA, Bloomberg, BOBCAPS Research

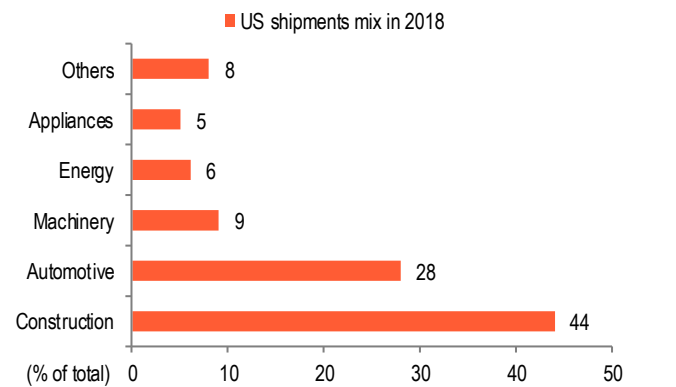
US steel demand indicators

Fig 67 – US apparent steel demand



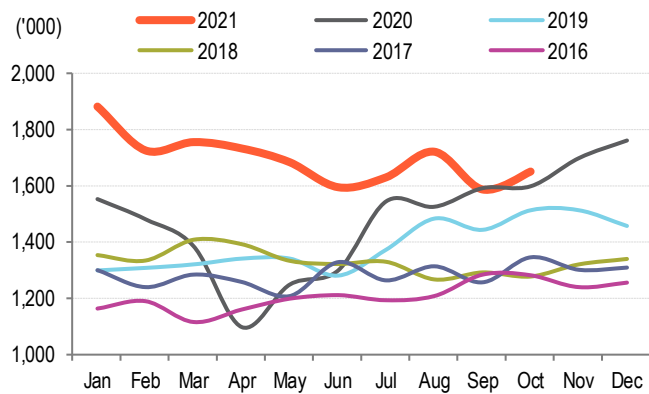
Source: Bloomberg, US Census Bureau, World Steel Association, BOBCAPS Research

Fig 68 – US steel shipments break-up (2018)



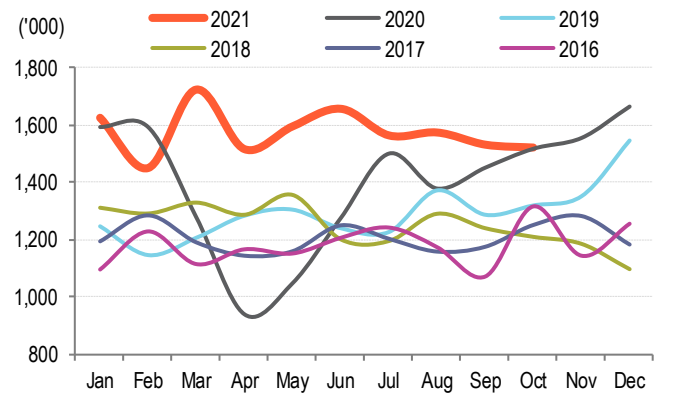
Source: AISI, BOBCAPS Research

Fig 69 – US housing permits



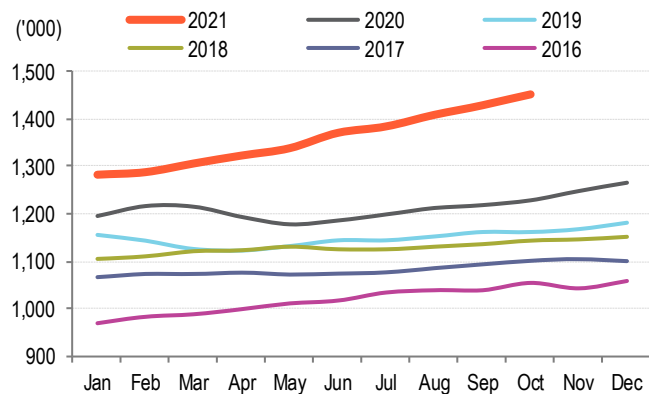
Source: Bloomberg, US Census Bureau, BOBCAPS Research

Fig 70 – US housing starts



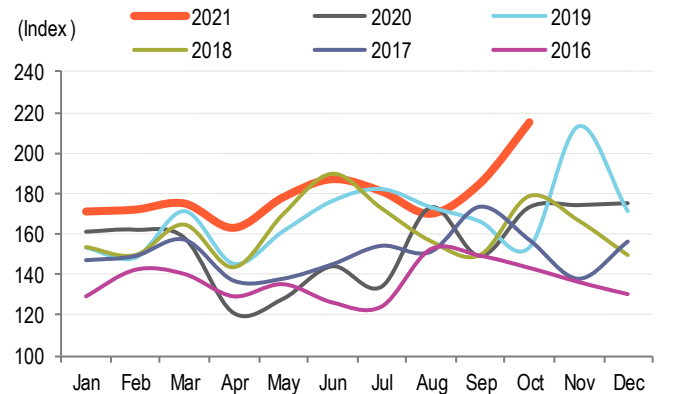
Source: Bloomberg, US Census Bureau, BOBCAPS Research

Fig 71 – US new homes under construction



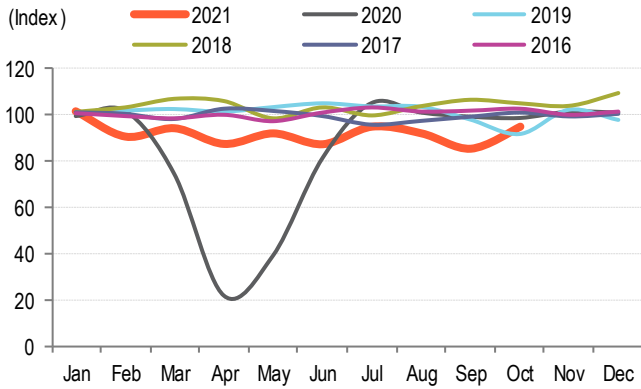
Source: Bloomberg, US Census Bureau, BOBCAPS Research

Fig 72 – US FW Dodge Construction Index



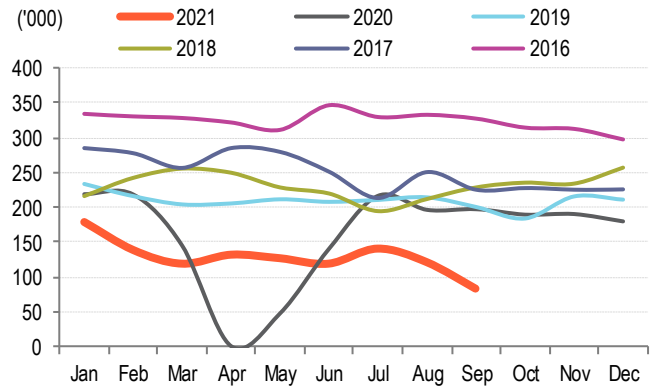
Source: Bloomberg, FW Dodge, BOBCAPS Research

Fig 73 – US motor vehicle and parts production manufacturing SA index



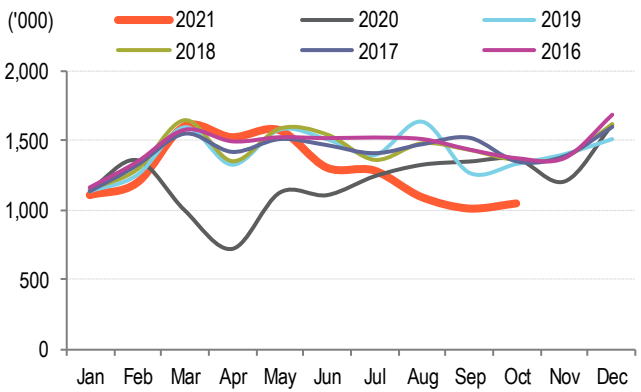
Source: Bloomberg, US Federal Reserve, BOBCAPS Research | SA – Seasonally adjusted

Fig 74 – US domestic auto production



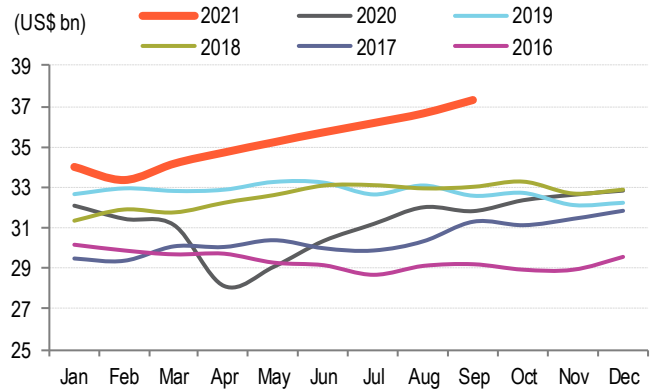
Source: Bloomberg, Bureau of Economics, BOBCAPS Research

Fig 75 – US truck and car vehicle sales



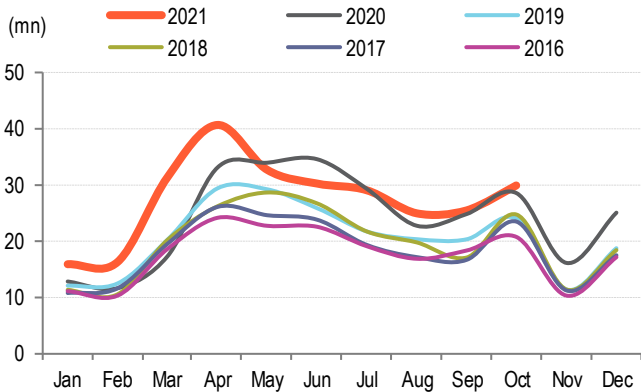
Source: Bloomberg, Bureau of Economics, BOBCAPS Research

Fig 76 – US machinery shipments



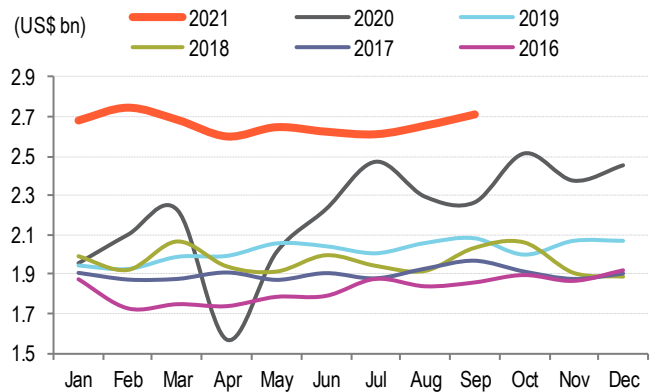
Source: Bloomberg, US Census Bureau, BOBCAPS Research

Fig 77 – US farm wheel tractor retail sales



Source: Association of Equipment Manufacturers, Bloomberg, BOBCAPS Research

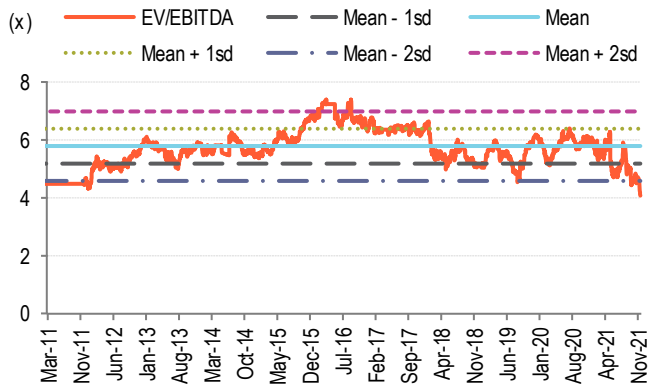
Fig 78 – US appliances new orders



Source: Bloomberg, US Census Bureau, BOBCAPS Research

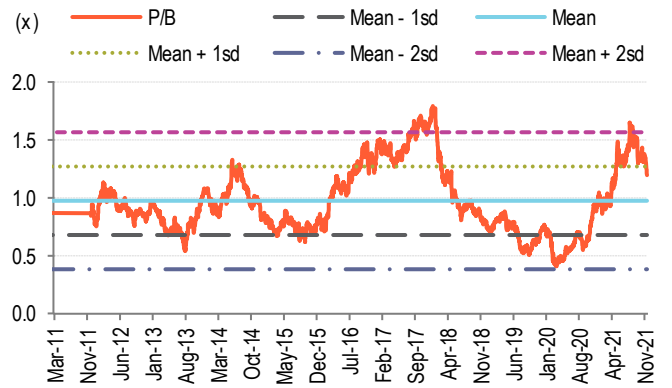
India steel sector valuation charts

Fig 79 – Tata Steel EV/EBITDA 2Y forward



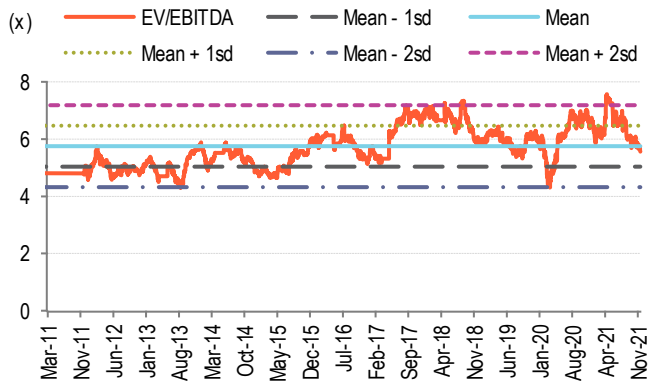
Source: Bloomberg, BOBCAPS Research

Fig 80 – Tata Steel P/B 1Y forward



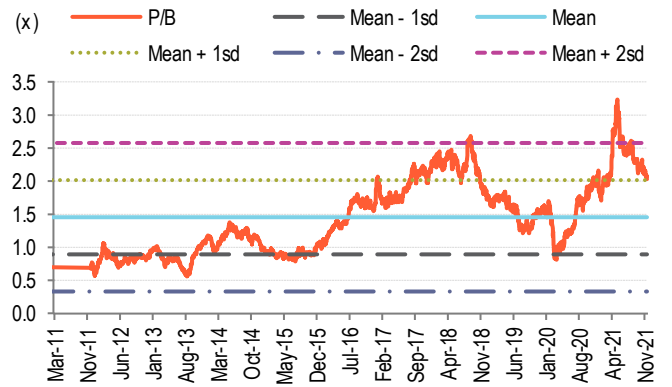
Source: Bloomberg, BOBCAPS Research

Fig 81 – JSW Steel EV/EBITDA 2Y forward



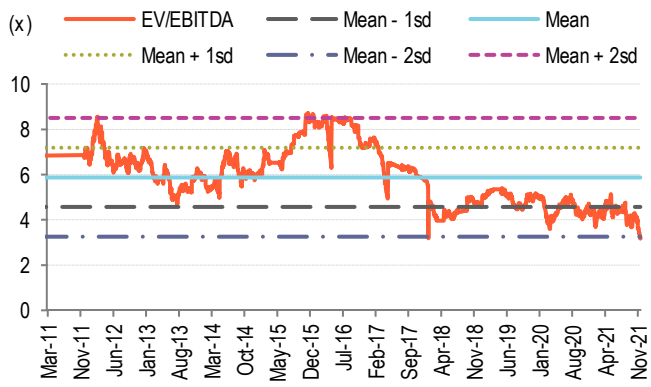
Source: Bloomberg, BOBCAPS Research

Fig 82 – JSW Steel P/B 1Y forward



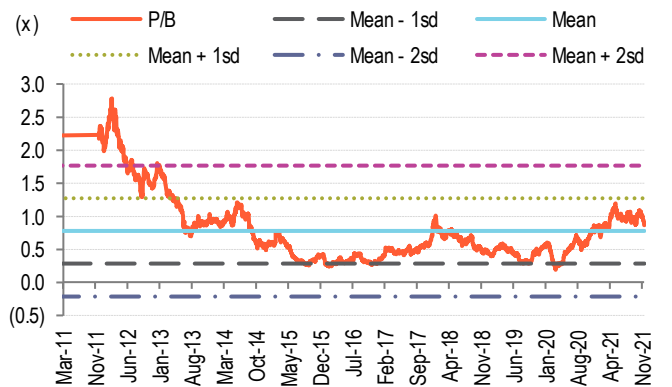
Source: Bloomberg, BOBCAPS Research

Fig 83 – JSPL EV/EBITDA 2Y forward



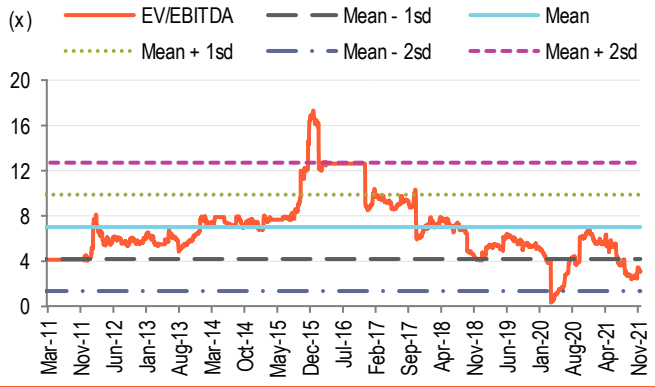
Source: Bloomberg, BOBCAPS Research

Fig 84 – JSPL P/B 1Y forward



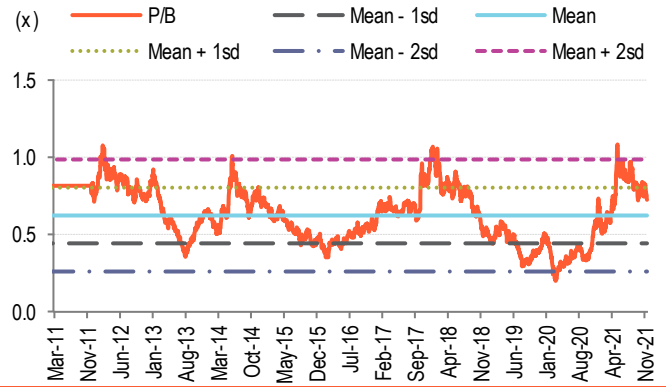
Source: Bloomberg, BOBCAPS Research

Fig 85 – SAIL EV/EBITDA 2Y forward



Source: Bloomberg, BOBCAPS Research

Fig 86 – SAIL P/B 1Y forward



Source: Bloomberg, BOBCAPS Research

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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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