

China Commodity Update: Stainless Steel

Demand Dropping Despite Stimulus Pressure

We conducted a survey of ten stainless steel distributors in China. Steel is a leading indicator of housing and construction as half of all steel is consumed by these two sectors. The survey was completed just as the Chinese equity market fell. Our survey concludes that demand is declining and producers are beginning a consolidation process. The Greek crisis has added to pressure on excess stockpiles. The housing market is not growing as quickly as the consumption data would suggest. The State Council is encouraging local investment despite efforts to curtail debt.

- **State Council Pressure.** Beijing is reportedly preparing a Rmb10 trillion stimulus and is sending senior employees to push for local construction. We don't know if the number is accurate but suggests widespread stimulus expectations.
- **Low Utilization Rates.** Almost 50% of our respondents say their capacity utilization is quite low – just 25% to 50%. A majority expect to cut capacity by 10% this year.
- **Declining Prices.** Prices have fallen on average around 5% this year. But costs are dropping faster --- 10% to 20%.
- **Low Nickel Stocks.** Stocks of Nickel Pig Iron Ore – a key ingredient for steel that was affected by the 2014 Indonesian strikes – are down to just one month, according to 60% of our respondents.
- **Demand Dropping.** Demand has fallen by 1% to 3%, according to the majority of our respondents. But they are hopeful demand will pick up 1% to 3% for the rest of the year.
- **Gloomy Outlook for Exports.** Traders expect exports to plummet by 10% to 25% in the second half of 2015 and decline further in 2016.

We include a summary chart of the answer from the majority of the respondents.

The full data is available. Please contact us for additional information. We also include summaries of the interviews we conducted with the distributors.

Question	Majority Response	% of Respondents
What is your capacity utilization today?	25% - 50%	40%
How much do you expect your capacity to grow by in 1 year?	down 10%	40%
What has Stainless Steel Pricing done ytd	down 5%	60%
What have Stainless Steel costs done ytd	down 10-20%	60%
What is current stockpiles of NPI ore (ie laterite ore) in China based on 2014 NPI production?	1 month	60%
What is your stainless steel demand forecast for China in 2015?	+1-3%	40%
What has stainless steel demand been trending ytd?	down 1-3%	40%
What do you expect stainless exports to be in 2H15?	down 10-25% vs 1H15	50%
What do you expect stainless exports to be in 2016?	down 10-25% vs 2014	50%

Interview Summaries

- Strong Global Pipe Demand.** “We expect import of stainless steel pipes in will exceed 1 billion tonnes by the end of 2015, boosted by the current upgrade of manufacturing industry in China. Another driver is the continuous declining price of iron ore in the global market, which creates the opportunity for low-cost construction. Although the overall supply of stainless steel is in surplus in 2015, we’ve seen a slight increase in pipe prices in the past few months due to the release of favorable policies. Meanwhile, profits of most pipe producers have improved.
- Pipe Production Recovery.** There’s an obvious signal of a recovery of production. While the average daily output accelerates, demand for iron ore increases. Resupply orders have become stronger. Liquidity for the whole market is getting better. This could be read from the decrease of iron ore inventory at the ports, which dropped to the new low recently. Supported by both the rising downstream demand and shock rise of iron ore price, most

small & medium-size mines that halted production before quickly returned to production. As a result, domestic iron ore output increased sharply. Nevertheless, import also rebound. “The combined growth of domestic output and import of iron ore is much faster than the declining port inventory, which is believed to bring more pressure on already oversupply of nickel ore market. This’s negative the continuing price rebound of stainless steel pipes.”

- **Greek Crisis is Affecting Demand.** The Greek crisis has had a huge impact on global commodity market, including nickel ore in China. Coming to July, even the nickel ore price has dropped to the levels of six year ago. Pressure on large stockpiles remains high. “We believe the price will continue to decline due to: 1) lower-than-expected downstream demand in July and August; 2) tighter environmental protection and anti-dumping.
- **Declining Demand.** Partly due to the unusual weather, stainless steel market is cool this summer for 1) recent weak shock on raw materials; 2) low demand from downstream; 3) weak cost support; 4) slow consumption of previous inventory; 4) pessimistic attitude of most manufacturers. At the beginning of this month, most manufacturers are conservative about adjusting the price limited by the fund pressure. Also, there’s no intention of stocking inventory at this moment. First, transportation is blocked by the heavy rain in Southern China, which led to few order inquiries. Secondly, most stainless products are being sold with large discounts due to the slack season.
- **More Negotiations.** In general, the imbalance between supply and demand intensified in the second quarter. Quoted prices have been lowered several times in exchange for sales. However, the downstream end users remain cautious. There’s been no large-scale bottom fishing as the price was dropping to a new low. It’s obvious the market has lost confidence in the after-market.
- **Restructuring Likely,** In line with declining nickel ore prices, a few types of stainless steel also created a new low for prices. This may accelerate restructuring and consolidation of the steel mills, particularly the small and medium size mills.
- **Summer Slowdown.** Until the end of second quarter, the slump in the China stainless steel market hadn’t changed. Damaged market confidence is hard to repair as distributors aggressively dumped inventories to downstream end-users by surrendering part of their profits. Even so, end-users weren’t convinced to increase orders. “We expect a weak but relatively stable trend of

stainless prices in July. The major reason is that the rising hot and humid weather will force most outdoor construction to slow down, which directly affects downstream orders. In fact, large and falling sales of gas turbines in June have already proved this.” According to the data from CICEIA, gas turbine sales in June decreased 8% QoQ and 5% YoY. In addition, inventory pressure remains high. For example, stainless steel inventory in Wuxi increased 9% QoQ to roughly 160,000 tonnes. Although, inventory in Foshan decreased 8% MoM to roughly 128,000 tonnes, it’s still 18% higher than the beginning of 2015.

- **State Council Pressure.** “We believe demand will improve in 2H15 driven by the over Rmb 10 trillion investment planned by NDRC. Moreover, we’ve heard that the State Council has sent out groups of people to supervise and push the progress of in-construction projects. Year-on-Year growth of stainless demand is expected to reach 3% including inventory consumption.
- **Output to Rise This Year.** In general, June and July are the two slack seasons for stainless steel. Sales could drop 30% to 40% MoM. Before the end of traditional slack season, ASPs are likely to drop below Rmb11,000 to 12,000 per tonne. We expect the average for the whole year to be lower than Rmb14,000. The imbalance between demand and supply is likely to continue into next year. In 2014, stainless production was 21 million tonnes. “We estimate output for 2015 to increase 5% to 10%, namely, 21 to 23 million tonnes.
- **Steady Nickel Ore Prices.** “We are not as pessimistic about nickel ore as our peers. First, we’ve learned that inventory at the ports has gradually declined in the past few months, especially high-grade laterite-nickel ore, which is likely to be consumed in the following two months. Thus, we expect nickel ore prices to rebound in the third quarter as import from Indonesia cannot meet the domestic gap. However, the golden days for demand in 2014 will never come back.”
- **Declining Nickel Inventories.** “There’s a general misunderstanding of China’s ongoing consumption of nickel ore inventory. We think the process is almost done. Next steps are either inventory-rebuilding or internal transfer of domestic inventory.” According to news, the domestic nickel pig iron inventories have dropped from 70,000 to 80,000 tonnes at the beginning of 2014 to 20,000 tonnes. Similarly, pure nickel inventory has decreased from 25,000 tonnes to 18,000 tonnes. On the other hand, imports are increasing.

“Although oversupply of nickel ore still exists for 2015, we think the excess of 20,000 tonnes has limited impact on price.”

