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CHINA PUTS ONE FOOT IN FRONT OF THE OTHER

CHINA CONTINUES TO LEAVE MARKETS GUESSING IN TERMS OF ITS ECONOMIC POLICY AS IT CONTINUES TO TAKE SECTORS ONE AT A TIME AND REFUSES TO LAUNCH A MASS NATION-WIDE STIMULUS. A DELAYED PARTY PLENUM, ENDLESS PROCLAMATIONS AND A LACK OF DETAILED POLICY MEAN THE MARKET IS CONTINUING TO BE PUSHED AROUND FREQUENTLY BY SENTIMENT. THERE ARE SOME TAKE-AWAYS WITH IMPLICATIONS FOR THE COMING YEAR HOWEVER AND THIS MONTH WE START TRYING TO PIN THOSE DOWN.



China puts one foot in front of the other

SAMPLE

China continues to leave markets guessing in terms of its economic policy as it continues to take sectors one at a time and refuses to launch a mass nationwide stimulus. A delayed party plenum, endless proclamations and a lack of detailed policy mean the market is continuing to be pushed around frequently by sentiment. There are some take-aways with implications for the coming year and this month we start trying to pin those down.

There have also been some revisions to policies and more details revealed. These include the winter production restrictions and export rebate policies which will have an impact both on the supply-demand balance in the coming months and China's relationship with the outside world.

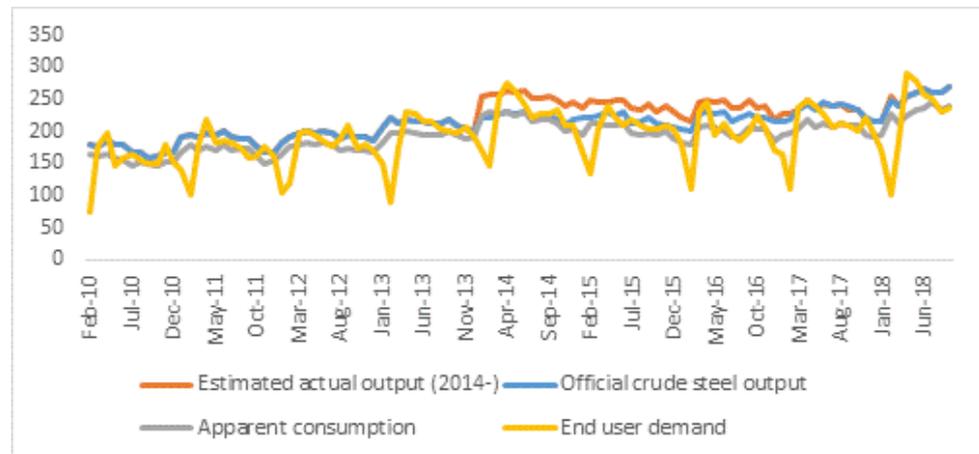
The question now is, when will more policies be revealed and will they shift expectations?

Table 1: Supply and Demand (million tonnes)

	2017	2018 ytd	Y-o-y	2018 outlook	Y-o-y
Official crude steel output	831.7	699.4	6.10%	848.7	2.04%
Apparent consumption	737.4	621.3	5.99%	762.9	3.46%
End user demand	745.5	611.1	4.23%	761.3	2.12%

Source: Kallanish

Figure 1: Daily steel production and demand 2010-2017 (tonnes)



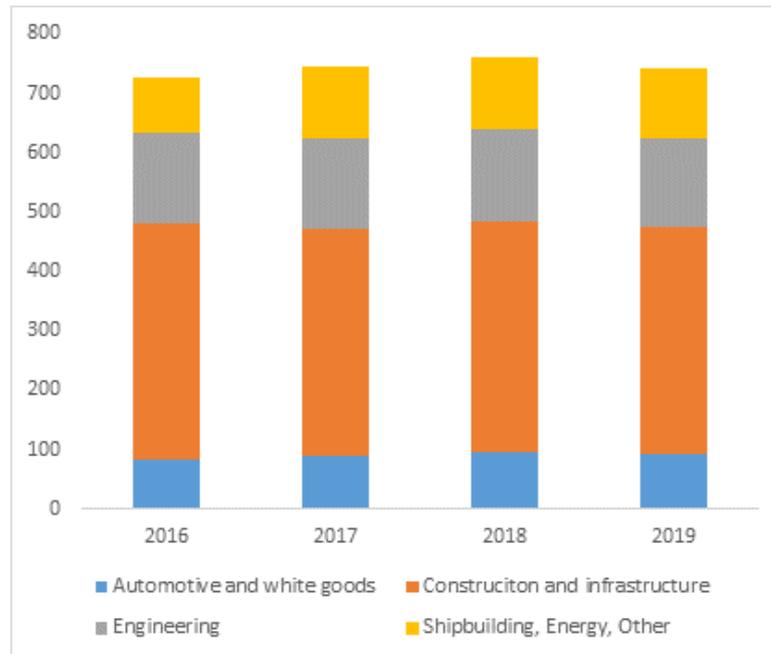
Source: NBS, Kallanish



China puts one foot in front of the other

Step by step China's policy towards slowing growth is mirroring the approach taken early in the term of president Xi Jinping, before supply-side reform really took effect. Instead of launching any large-scale stimulus, Beijing is looking for areas of weakness and taking more specific measures to support growth there. If successful, China should be able to engineer a modest slowdown in economic growth in 2019, while steel demand could see another moderate increase. If Beijing fails however, then steel demand will

Figure 2. Steel consuming sectors at structural peaks



Source: Kallanish

resume its structural decline, possibly accelerated by wider economic problems.

The underlying problem in the Chinese steel market is the structural peak of Chinese steel demand. Demand has been driven by sectors that have little additional opportunity for growth and many will begin to contract over the coming years. The engineering steel sector will remain key going forward as the sector moves increasingly towards high-end products but this will also imply falling volumes. Investment in machinery will be steadily more concentrated in high-tech sectors and not in heavy industry. The trend is likely to be accentuated in the near term by the link to corporate profits, which especially for heavy industries are coming off a peak year in 2017 because of supply-side reform. The automotive sector meanwhile is also seeing vehicle production topping out and has recently seen a sharp y-o-y contraction in demand. White goods and their manufacturing sectors have seen continued growth but are also moving into less steel intensive products and are seeing negative impact from the trade war with the US. The crucial construction and infrastructure sectors meanwhile have seen investment and construction rates

Table 2. Demand generation increasingly depends on the state

	2016	2017	2018
Government	31.10%	31.80%	32.60%
Consumer	11.90%	12.10%	12.10%
Corporate	57.00%	56.10%	55.30%

Source: Kallanish

increase on the back of policy support and it remains uncertain to what extent further growth can be



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