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CHINESE MILLS FIGHT FOR VAT GAINS

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Mill profits meanwhile are under attack from surging iron ore prices.

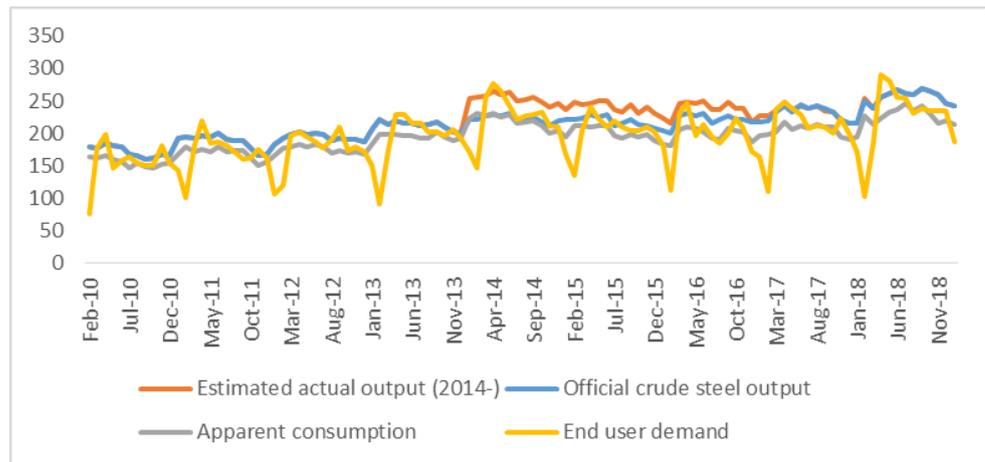
The question now is, can Chinese mills defend their margins?

Table 1. Supply and Demand (million tonnes)

	2018	2019 ytd	Y-o-y	2019 outlook	Y-o-y
Official crude steel output	928.3	149.58	9.20%	947.0	1.30%
Apparent consumption	825.5	133.4	8.59%	844	1.60%
End user demand	827.6	76.91	-4.39%	845	1.00%

Source: Kallanish

Figure 1. Daily steel production and demand 2010-2018 (tonnes)



Source: NBS, Kallanish

China's VAT cut: for producers or consumers?

On 1 April China put into effect its new lower VAT rates. VAT for manufacturers has been cut from 16% to 13%, while for logistics and construction it has been cut from 10% to 9%. The move is part of a range of measures designed to support the economy this year. As growth rates slow, corporate profits and employment come under pressure and consumers lose confidence, Beijing is moving to cut payroll taxes, reduce consumer costs and maintain economic activity. In sectors that have been hit the most by weak consumer confidence, prices were already being cut on 1 April. Apple's iPhones, Gucci and Louis Vuitton handbags and Volkswagen's cars have all seen a 3% drop in prices. Steelmakers however have not cut prices. Eastern China's Shagang, Yonggang and Zenith have all kept their prices for the first ten days of April flat from the last eleven days of March.



China's VAT cut: for producers or consumers?

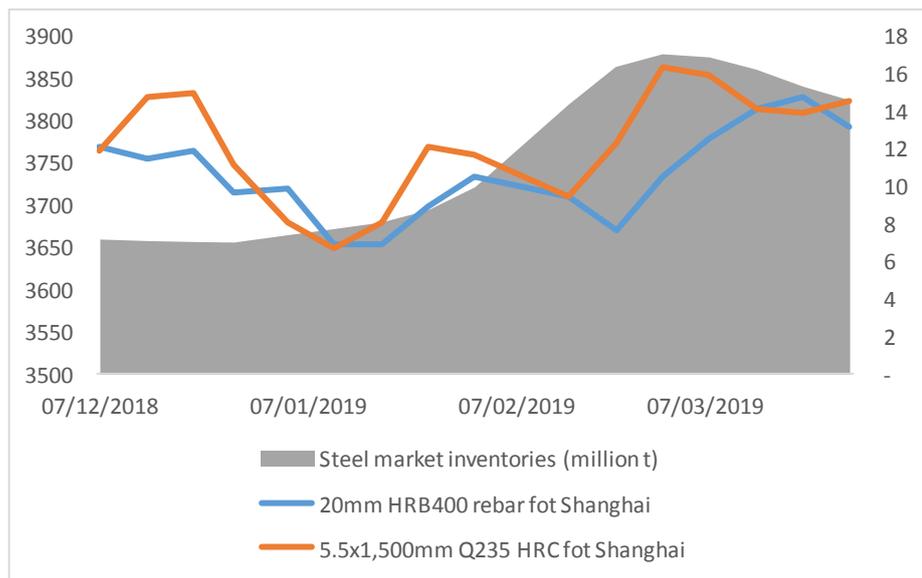
Table 2. China's long steel producers holds prices (CNY/t)

	Rebar HRB400 16-25mm	High speed wire rod 6.5mm	Rebar HRB400 8-10mm
Shagang offer	4,050	4,140	4,230
Shagang change	0	0	0
Zenith offer	4,050	4,230	4,230
Zenith change	0	0	0
Yonggang offer	4,050	4,240	4,240
Yonggang change	0	0	0

Source: Kallanish

In other circumstances, this could be explained as giving up the increases of a rising market. But rebar prices in Shanghai at the end of March were down CNY 35/tonne week-on-week at CNY 3,790-3,800/t. The limited confidence these mills had in the strength of the market was also shown by their planned shipment levels. In the reporting period, Zenith announced it would cut -20% of rebar supply, and Yonggang plans to reduce -30% of rebar supply and -15% of wire rod and rebar in coil supply compared with the previous eleven days. In the domestic market, mills can see that prices could be supported by falling steel market inventories. Even though the recovery in construction steel demand this year has been modest and has not pushed prices rapidly higher, it had been enough to maintain the usual upward seasonal trend in prices and inventories.

Figure 2. Inventory cycle normal but prices restrained



Source: Kallanish, MySteel

Export markets may be another matter however. Here, prices for both flat and long products have been falling since mid-March. Chinese suppliers are also having to compete with aggressive offers from other markets such as India for hot rolled coil and Malaysia for wire rod. Even Brazilian HRC has been sold into Southeast Asia in recent weeks. Here, VAT cuts are more likely in effect to be passed on to customers. Mills have only made limited volumes available for export recently as they have focussed on the domestic market. Many mills are now offering June shipments. As export allocations pick up however, exporters



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