Chinese Steel Squeezed by Importers and Iron Ore Suppliers

February 01,2008

by CSC staff

For years China has bee the world’s biggest steel producer and exporter. However, China’s steel industry is also known for its high costs and low efficiency, and is now squeezed by importers and the rising price of iron ore supplies.

China is controlling its steel exports to cope with anti-dumping investigations and threats from the European Union, Canada and the United States. Some analysts believe that China’s steel exports may decline this year, as there is a growing need for this, and now China is facing an inflation threat from iron ore monopolists.

China’s negotiations with iron ore monopolists to be tough

China is the largest steel consumer. During the first three quarters of 2007, China’s steel imports totalled 12.978 million tons, and its steel output of 2007 is estimated to be 520 million tons. A large production capacity leads to the production of cheap and low-end steel whilst consuming a great deal of resources and importing a great deal of iron ore.

Recently, Baoshan Iron and Steel Co. (Baosteel), China's largest steel company, signed a ten year iron ore supply contract with BHP Billiton, based in Australia, and the total supply will be 94 million tons. Baosteel individually consumed 47 million tons of iron ore last year. Insiders say that this long-term contract for a huge amount of supply indicates China's growing need for iron ore in the future.

Currently Baosteel, on behalf of China's steel industry, is negotiating with the world's largest iron ore companies, namely BHP Billiton and Rio Tinto based in Australia and CVRD based in Brazil, over supply contracts in 2008. As the world's largest iron ore consumer, China can only accept the quotation passively. So it is not surprising at all when panic arose among Chinese steel producers at the rumour of BHP Billiton's plans to buy into Rio Tinto several months ago.

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The global iron ore price went up respectively 71.5%, 19% and 9.5% over the past three years. Many overseas institutes have predicted that in 2008 the price for iron ore will continue to surge, and the increment was thought to be respectively 50% and 40% according to Macquarie Bank and Merrill Lynch.

China is said to only accept a rise of within 30%. According to statistics from the China Iron and Steel Association (CISA), China imported 380 million tons of iron ore in 2007, an increase of 17% over the previous year. The average C.I.F. price of the year hit a historical high at $125 per ton and in December the price peaked at $190 per ton. Luo Bingshen, vice chairman of CISA, severely criticised the current price as distorted and said that China's steel industry would never accept it.

Luo predicts that the growth in the need for iron ore in China will drop to 12%. This year's incremental volume of iron ore imports is thought to be 40 million tons, while last year it was 47 million.

The recent slump in ocean freight added to China's bargaining counter, however, it is expected nationwide that steel prices will increase this year. Many Chinese steel plants have been forced to shut up or restrict their production as result of the power failures and shortage of raw materials cased by the recent blizzards. Some steel plants cannot get enough raw materials and steel prices have begun to grow.

Coping with anti-dumping rules by restricting exports

A wide gap still exists between China and developed countries in the variety, quality and products structure of steel. Steel exports reached 49.522 million tons, the average F.O.B. price being $686.74 per ton and the average C.I.F. price $1206.03 per ton.

The Alliance for American Manufacturing (AAM) recently issued an investigation report declaring that a large amount of energy subsidies from the government has made China the world's biggest steel producer and exporter. According to this report, subsidies given to China's steel industry in 2007 totalled up to RMB 15.7 billion, rising by 3800% since 2000.

By comparing the international and domestic prices for coal, coke, natural gas and power, the report drew the conclusion that China's steel industry gained a $27.11 billon subsidy from 2000 to 2007, and China's local governments provided a large part of this subsidy, since steel plants can offer employment opportunities and increase revenue. In China, every province has its own steel plants. Due to this reason, China's steel industry is becoming increasingly split, while in other countries merging steel industries are a major trend.

Xu Xiangchun, Information Chief of LGMI Steel Information Research Centre, believes that China is now undergoing a transformation from a planned economy to a market economy. The price for energy, such as natural gas and power, is controlled by the government, and this control is not specially for steel, but instead for the whole of society.

In spite of this, China has come to realize that the development of its steel industry is not sustainable. The National Development and Reform Commission (NDRC) ordered, in the last week of 2007, a second round of elimination of backward production capacity in eighteen provinces and in Baosteel, China's biggest steel company. It is required that by 2010, 49.31 million tons of backward iron-making capacity and 36.1 million tons of steel-making capacity across 573 companies will be shut down and eliminated

Meanwhile, the Ministry of Finance announced its intention to raise export tariffs of some steel products. The tariff rate for building steel such as steel bars and wire rods will rise from 10% to 15%; the tariff for primary products like steel billets and steel ingots will be increased from 15% to 25%; and welded tubes will be levied a 15% tariff whereas in the past these were exempt. On hearing this message, steel companies successively transported their steel products to bonded areas in Shanghai and Tianjin at the end of last year, in the hope of exporting them before the policy was implemented so as to avoid risks of increased costs. Steel products in bonded areas are treated as those that have been exported.

Xu Xiangchun thinks that the readjusted policy fully demonstrates the trend to restrict the export of products with low added value, and is a further improvement to the earlier policy.

Since April 2007, the Ministry of Finance has made great efforts to restrain steel exports by cutting down the export rebate of some products and increasing the export tariff. Although steel exports in October and November decreased over the previous year, the total volume still exceeded the limit of the government.

Some experts believe that after the adjustment, the average export tariff for China's steel products will have reached over 9%, and the export of steel products, especially those with higher tariffs, will be extremely hard in 2008 unless there is a big price difference between the domestic and international markets. Therefore, steel exports in 2008 are expected to drop significantly.

Wu Xichun, a consultant at CISA, estimates a decrease of about 20 million tons in China's steel exports in 2008. In detail, long products are to drop by over 8 million tons, flat products by 4 million tons and steel tubing by 400 million tons. Steel billet export is also supposed to subside.

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