

## China Power Crunch (PART 2 OF 3):

### More Coal More Electricity, Short Term Fix?

The China Power Crunch in September not only worried manufacturing sectors but also households. (To learn more about the Power Crunch check out our last [newsletter](#).) The government launched various actions to ease the impacts of the power shortage. In a State Council press conference on October 13, it was disclosed that the daily generation reached 20.7 GWh on October 11 and month-to-day generation was 228.5 GWh, a 10.8% increase year-on-year. It seems that the electricity shortage has been resolved temporarily, but will it last?

#### Important Measures Launched

- **More Coals from Mines** – Coal mines were encouraged to increase their production and reopen mines that were closed due to safety shortfalls and other reasons; and new mine permit issuance process was also speed up. After all these efforts, the National Development and Reform Commission (NDRC) announced that the average daily coal production increased by 1.1 million tons compared to September end. Since mid-October, the daily production has been above 11.5 million tons. Since the NDRC press release on November 1, the coal inventory reserves at power plants reached 110 million tons, which is equivalent to 20 days of consumption.
- **Lowering Coal Price** - The trend of the coal price surging did not immediately revert back when the government announced the increased coal supply policy. Instead, the price reached a record high in the first two weeks of October. It wasn't until drastic policies were launched to crack down on future contracts in commodity markets that the price per ton dropped to nearly half of the record high price.

## CCA Newsletter Nov 15, 2021

The CCA Newsletter is summary of articles about the Asia Business environment. This issue “Coal Consumption: To be or Not to be” is Part 2 of 3 of a series about China Power Crunch. Please follow-us on [Linkedin](#) for more.

### About China Centric Associates

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Source: NY Times

- **Enforcing More Long-Term Contracts with Lower Price** – Power Plants normally get their coal supplies through two channels: 1) Long-Term Supply Contract with mines and 2) Spot Markets. Long-Term Supply Contracts are usually much lower than Spot Markets. Due to the huge price gap of these two supply modes, most miners tend to keep their portion for Long Term Contracts as low as possible to maintain profit. The NDRC indicated in the early 2021 that 75% of production should be contracted but it seems this policy was not followed initially. After the Power Crunch, the NDRC reinforced this policy so that power plants could procure coal at a more stable price level.
- **Raising the Electricity Price Cap** – One of the known reasons of the Power Crunch was that power companies were demotivated to produce more electricity output because of the sky-high coal prices. More power generation meant higher net loss. Before the Power Crunch, the electricity transaction price was capped with a floating range between 10% and 15% from the benchmark price. At the end of September, the State Council decided that the floating range of market-based electricity transactions would be adjusted to a range of 20% both ways. That way power companies could have more room to breathe and not use the low electricity unit price as an excuse to produce less.

## Supply Chain After Shock Symptom for Survival

With the important measures mentioned previously, it seems that the chaos and panics from the Power Crunch have been stabilized. However, the aftereffects are still controversial. The following impacts are observed by CCA:

- **Fears of Power Cuts Again** – Most manufacturers believe that there is still a chance there will be power cuts in the upcoming winter - either planned rationing as they used to have or another surprising blackout. This puts manufacturers in a dilemma of whether or not they should invest in stand-by generation system or not. Most manufacturers are facing lower profit margin because of the various impacts in the last 18 months. Nobody can predict if there will be another power shortage, but manufacturers cannot afford to invest in a white elephant investment because their bottom lines are already impacted by global inflation. However, if they really encounter power cuts in the winter and are forced to stop production, they might fall into a disaster situation.
- **Diesel Supply Becomes Tight** – Even though some manufacturers are willing to invest in stand-by gensets (either as CapEx or just renting for a period of time), the supply queue is long, and they may have to wait longer than expected before they are installed and ready to use. It is further worsened as gensets need fuel, usually diesel. At the end of October, news published diesel supply shortage. Long distance trucks needed to queue for a day at petrol stations to fill their tanks and could only fill 100 liters maximum. The government responded quickly and claimed that this was just an isolated incident and launched a plan to release national strategic diesel and petrol reserves to calm the market for a few days later.

- **Preparing of Surprises** – All stakeholders in the supply chain could face a challenging situation in the upcoming winter. Manufacturers not only have to fear if their own productions will face power shutdown but also what their partners across the supply chain may face. There are many “what-if” questions that need to be asked for the decision makers and planners for production and supply planning. Just-in-time or zero inventories may be too aggressive during this current situation but keeping too much stock in warehouses could also be risky if the product outflow is jeopardized. Nobody has a one fits all answer, but a close communication with upstream and downstream supply chain is fundamental.

### **Coal Production & Consumption Policy – Will Carbon Emissions Plans Still Continue?**

Before the Power Crunch, more than 5,500 mines (mostly less efficient, unsafe working environments or highly polluting) were closed in the last 5 years. This was half of the mines within China. During this period, sizable mines invested to increase production to improve efficiency and safety conditions and reduce pollution.

According to analysts, coal consumption demand increased more than 9% in the first 8 months of 2021 compared to the year before, but coal production increased just 4%. The 5% gap represents 100 million tons. In addition, China imported coal decreased by 30 million tons during the same period. The combined effect fueled the rising coal price and Power Crunch. Therefore, the government rapidly reopened the closed mines and increased the output to stabilize the unrest market.

However, this 10% capacity boost in a short time creates concerns if China is still on the course of its Carbon Emissions Plans - emissions peak in 2030 and carbon neutrality in 2060. The China State Council's responded to this by publishing a new plan five days before Cop26

Glasgow. The document reassured that China would accelerate efforts to build a new and more flexible power system that allows new energy sources to be steadily increased.

In the document, it outlined that: in addition to new solar and wind farms, new hydroelectric dams will be built and new-generation nuclear technology, including small-scale offshore reactors, will be used.

China will also take action to ensure that energy-intensive industrial sectors such as steel, non-ferrous metals and building materials improve their energy efficiency and recycling rates and make full use of new technologies to bring their own emissions to a peak.

China's state planner said at least 30% of production capacity in those energy-intensive sectors would meet tighter energy efficiency standards by 2025.

Additionally, primary oil refining capacity in China will be capped at 1 billion tons per annum by 2025. Better planning of natural gas and biofuel usage is also mentioned in the document.

According to the document, the Emissions Peak and Carbon Neutrality targets are still as planned.



