

## 10% STEEL OUTPUT CUTS IN H2 IN CHINA –

RATIONALES, IMPACT, CONTINGENCY -  
AND ANOTHER SUPPLY CHAIN CHALLENGE

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### Steel Production Up 8% First 7 Months but Output to be Cut 10% for H2 2021

The National Bureau of Statistic in China reports that the country made 649.3 million tons of steel in first seven months of 2021, up 8% from 2020. However, the government has ordered steel mills to ensure that the annual crude steel output in 2021 should not exceed the output as in 2020. In other words, approximately 10% of total output needs to be cut in H2 to restrain emissions and reach de-carbonization goals, which is part of President Xi Jinping commitment per his speech at the [UN Summit September 2020](#).



## CCA Newsletter Sept 27, 2021

The CCA Newsletter is summary of articles about the Asia Business environment. This newsletter's topic is the supply chain challenges. Please follow-us on [Linkedin](#) for more.

### About China Centric Associates

Since 2003, China Centric has assisted 250+ companies and 30+ Private Equity firms to develop and execute customized regional business strategies in China and Asia. We provide Consulting and Project Management, Outsourced Supply Chain Management and Hosted Facility and Administration.

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### Your input is valuable to us

China Centric Associates always welcome your contribution of the [questions and feedback](#) to the subject of this newsletter. You are also welcomed to raise [specific topics](#) that you are interested. Our team members will make response to your request in quickest manner.



“Since late June 2021, Beijing has dispatched inspection teams to local governments and mills to check that cuts in steel capacity and output are being implemented, shutting down outdated blast furnaces and limiting production at more heavily polluting plants.” - [www.mining.com](http://www.mining.com)

If China successfully maintains the 2021 annual output at the 2020 level, it will be likely that there will be a shortage of 20-30 million tons available in the domestic market in H2 2021, according to some market sources. Both the iron ore price and quantity contracted have significantly drop recently: \$148.99/ metric tons on Aug 17 for 62% iron-ore fine delivered to China vs \$219.77 for the equivalent on July 16. With the cut, the situation becomes volatile.

### **Export Rebates Cuts and Tariffs Removed for Scrap Steel Imports**

Alongside with the Steel Production Cap plan, the State Government also changed its export taxes policy to “reduce incentives to produce steel for international markets”. The government cancelled export tax rebates on some steel products in May and raised export tariffs on crude form of iron in July.

Simultaneously, the scrap steel import tariff was removed in April to encourage steel mills to increase the content of scrap steel in their production to reduce the reliance on Iron Ore and emissions in the hot smelting process.

### **Perfect Timing or Perfect Storm?**

The objective of the crude steel production cap is to reduce carbon emission by focusing companies with poor environmental performance, high energy consumption and outdated technology and equipment.

Some analysts believe this is the right time to implement the production cut plan in China because domestic demand is expected to slow down due to the effects of hot and rainfall weather across the country in the last few months, Covid-19 cases, and the slowing of the real estate market. In addition, cutting steel output from November

to February has been a normal practice to reduce “Winter Smog” since 2017. It is believed that tighter controls implemented this year is to prepare for the Winter Olympic which will be held at Beijing in February 2022.

However, some observers with pessimistic views are afraid that the production cut will have severe impacts to steel mills industry because global steel demand is fueled by the “economic recovery” programs worldwide and most of the steel mills overseas are nearly in full capacity. Chinese steel producers are facing lower margin impacts from oversea competitors lowering raw material price and export tariffs limiting their exporting volume.

Improving environmental performance, reducing energy consumption, and upgrading technology and equipment equals to considerable CAPEX reinvestment. This means the price of steel along with its supply chain will increase. This would potentially increase the government’s effort of price stabilization.



### **Potential Impacts Across the Supply Chain**

CCA sees that the price pressure and supply shortage will ripple along the Supply Chain Network and impact the stakeholders in the downstream:

- Output and potential margin reduction will force steel mills to focus on the best revenue and profit generating product programs; lower added value or niched assortment supplies are at threat.
- Consumer goods containing steel such as home appliances, machines and tooling, utensils, stamping and fittings, could be impacted by

supply shortage or prolonged delivery lead time. In extreme situations, they may have to switch to other specifications with consequences on cost and delivery reliability.

- Some segments may try to stack-up their raw material inventories and compete for limited supplies and traders may be tempted to actively participate in the trade for margin gaining which could further worsen the shortage.
- Construction and automobiles are the two biggest industries of steel consumption, the shortage will make recovery for these industries more challenging.
- Steel billets are an alternative supply to liquid steel smelting from iron ore. There are reports indicating that both tonnages imported from near-by countries and unit prices increased in last few months since the steel output cap launched. The import cost is further impacted by the freight increases worldwide. These cost increases will be passed along through the supply chain network to the final product producers.
- To fulfill the emission cut goals and better control, China wants its top five steelmakers to account for 40% of the country's total steel output by 2025. The industry consolidation process has expedited in the last few months. 7 major M&A's were announced in July-August, making the total capacity of top 5 China producers increase from 26% to 30%. It will be very likely to meet or exceed the 40% target over the next few years. However, this would also mean buyers (especially smaller ones) will have less bargaining power in the trade.

### CCA Recommendations

Judging and forecasting the impacts of the steel output cap in 2021 is rather complicated and difficult to reach a firm conclusion because different parties will benefit or suffer from the campaign. However, to those who have considerable amount of steel and iron in their lines:

- Review product programs to determine if there is likely to have critical impacts on steel output cut,

specifically, understand the content assortment and if there are low margin/niche crude steels involved.

- Most of the final product makers might not get their crude steel supply directly from the steel mills but in semi-product form through value added process in between (e.g., getting parts from a stamping plant). Stakeholders in the downstream should have good communication with their suppliers to make sure that the impacts are adequately addressed.
- Until the government fully implements policies on the steel prices and supply stabilization, short-term fluctuation should be expected. Stakeholders should keep an eye on price and supply cycle changes to avoid last minute disturbances.
- Review and update the process and technology to reduce the dependence of the steel supply is always recommended but this seems to be a bit long term against current short and mid-term supply impacts.
- Stakeholders should be prepared for a steel output cap (using 2020 output as guideline) through 2025 because Ministry of Industry and Information Technology (MIIT) will formally submit the proposal to State Council in Q3 about the plan and implementation of achieving the target of carbon emission peak in 2025 and carbon neutralization by 2030.

As the capacity cap has only been launched for a few months, CCA projects that more impacts and new challenges will surface in the upcoming quarters as more parties adapt the new regulation.

*(Note: If you provide us the HS Code of the steel product or material that you have interest or concern, we can provide the information such as export tariff, tax rebate information free of charge. Please provide us the HS Code and your contact details at [hello@china-centric.com](mailto:hello@china-centric.com).)*