China's low-value steelmakers beat high-end peers

- Steelworld Research Team

Powered by China's infrastructure push, Chinese construction steel producers are seeing their best profits in years, lording it over their high-value counterparts in a setback for Beijing's years-long drive urging steelmakers to move up the value chain. As its manufacturing engine sputters, the world's second largest economy is increasingly relying on infrastructure spending to boost growth, spurring demand for construction steel products and lifting producer profit margins to near record levels.

Combined with recent cuts to low-quality steel capacity amid a war on pollution, this infrastructure drive looks set to brighten the outlook for construction grade steelmakers just as their more sophisticated peers wrestle with sluggish demand from manufacturers and automakers. Because of capacity cuts and expected stronger infrastructure spending by China, there's a strong upside for long products consumption which can boost rebar makers' profits in the years ahead," said Richard Lu, analyst at CRU consultancy in Beijing.

The profit margin on construction steel product rebar, also known as long steel, has surged more than 800 percent this year to around 1,100 yuan ($162) per tonne in early June, according to data tracked by brokerage CLSA. Improving infrastructure is high on Chinese President Xi Jinping's agenda as he promotes his ambitious Belt and Road initiative - building road and rail connections with Central Asia and beyond. Meantime, manufacturing has struggled, with China's car sales falling for a second straight month in May for the first time since 2015, limiting demand for high-value flat products like CRC. The reversal of fortune between Chinese producers of cheap, low-grade construction steel and makers of high-value steel was also triggered by Beijing's crackdown on industrial pollution. As it battles smog, China has vowed to eliminate induction furnaces - a highly polluting type of plant that produces mostly rebar - by the end of June. Analysts estimate induction furnaces produced about 50 million tonnes of rebar last year - about a quarter of China's total rebar output.

So far this year, average margins for rebar were 572 yuan per tonne compared with 91 yuan in all of 2016, CLSA data showed. The unexpected resurgence among producers of lower grade, cheaper steel is a setback for China's efforts to modernise its massive steel sector, mainly by pushing the big, sophisticated steelmakers to swallow smaller rivals and shut inefficient ones. Last year, China's most technologically advanced steelmaker Baosteel acquired rival Wuhan Iron and Steel, creating the world's second largest steelmaker behind ArcelorMittal. Some Chinese mills that produce both long and flat steel products are making more of the former because of the robust margins, said Daniel Meng, a Hong Kong-based analyst at CLSA. "It is quite a general phenomenon," said Meng. "You should see such switching across many mills rather than just a small number of mills. But some mills that make only flat steel products could not shut their plants. Although flat producers realize the margin is narrowing, they have no choice but to continue producing since it would cost more money to stop the equipment and turn it on again when profit goes better," said a manager of a unit of state-owned Shandong Iron and Steel Group.