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Will China's export rebate cut make a difference?

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ANALYSIS

Will China's export rebate cut make a difference?

16 January 2015 - Alistair Ramsay - Research Manager - Metal Bulletin Research

Metal Bulletin Research (MBR) examines the likely effects of China's cancellation of sales tax rebates on certain types of hot rolled "alloy" steel products from January 1.

While MBR expects export volumes of rebar, rod and hot rolled narrow strip from China to decline in the short term, volumes of hot rolled plate and the plethora of non-affected exports will actually rise by a similar amount, raising the question of whether export volumes will be materially affected overall.

As the situation stands at the moment, we are leaving our forecast of export volumes for 2015 unchanged.

There are some who expect Chinese exports to reach 100 million tonnes this year, based on rumours in Chinese suppliers' circles. This would mean an overall increase of at least 10 million tonnes over last year.

This is not our base-case view. After all, not a single Chinese export price has yet risen as a result of the lost rebate.

For a low-value product such as rebar, at $400 per tonne fob, the net value received by the exporter when the 13% rebate existed was $386 per tonne fob, above the value of the domestic sales price when excluding sales taxes.

Now that the supplier has to give 17% rather than 4% to the tax man, the implied value for the exporter will be slashed to just $342 per tonne fob.

As costs have gone up due to a mild revival in iron ore prices, and profitability has been eroded as a result, there is simply no incentive to export, until such time as China's rivals decide to raise sales prices and are successful in doing so.

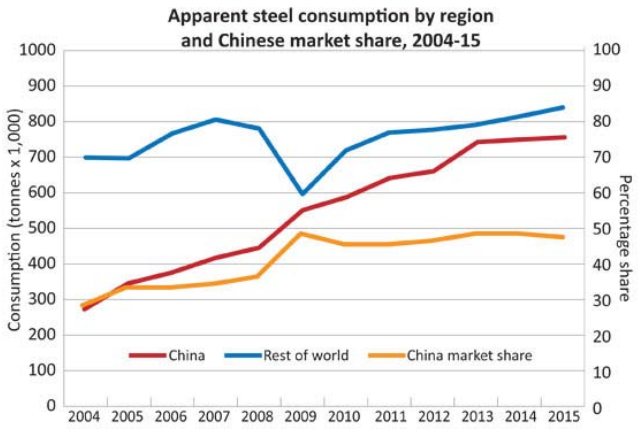
There can be no doubt that exporters of flat rolled material will be hopeful that ArcelorMittal's intention to raise strip-mill products prices by a minimum of €30 ($36) per tonne in Europe will be accepted.

The only advantage that Chinese steel producers had in 2014 was their international consumers because, domestically, steel demand for mill production actually retreated. However, this was mainly related to destocking of excess supplies inherited in 2013 rather than underlying demand, which actually rose.

Import volumes may have continued to rise, along with underlying demand for higher-value steels, but local shipments were, proportionately speaking, a lot less popular.

Given the subdued growth outlook for demand heralded by the World Steel Assn in October 2014, and more recently by the China Iron & Steel Assn (Cisa) for this year, the decision by the Chinese authorities to obstruct exports was controversial – particularly if export demand will actually rise further.

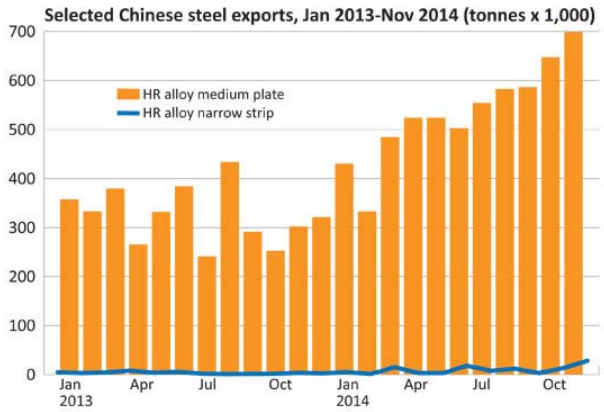
Indeed, demand from outside China is expected to rise faster than the country's domestic demand again this year, with leading forecasters still unwilling to predict that Chinese demand will ever form the majority of the world's consumption (see chart)



Trying to discern the reasons for the decision effectively to reduce the sales tax rebate to 0% on boron-containing hot rolled (HR) bars, rods, medium plates and narrow strips – from as much as 13% – is fraught with difficulty.

It is nonetheless interesting that not all products have been affected, and rebates have not been removed from products such as cold rolled coil (CRC) and hot dipped galvanized coil (HDG), for which export volumes have surged.

For the flat rolled products affected, the removal of HR narrow strip, whether produced from square billet or cast slab, seems rather pointless. Only small volumes are being sold, so the removal of these rebates will have little effect on overall trade (see chart).



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The medium plate number – which in China is typically defined by the gauge of the coil it was cut from, commonly 3-20mm thick – is clearly far more significant but it would appear that there are already ways that exporters can avoid the consequences of rebate reductions.

If the rebate is really only to be removed from hot-strip mill material that is subsequently cut to a determined length (cut-length), then what is to stop the exporters from simply selling the material in coil form, as this will continue to receive a 9% rebate?

If we examine the price differences for plate in coil and cut-length plate around the world, we only see significant differences at the higher, stainless-quality end of the market.

In reality, exporters are still paying just 4% sales tax, having replaced the small amount of boron with an equally small amount (0.27% and above) of chromium.

Given the low price of ferrochrome in China, the chromium addition in the melt adds less than $10 per tonne to the operating cost.

The loss of the 13% rebate on prices close to $450 per tonne fob, by contrast, will cost Chinese exporters $48 per tonne, making the switch to chromium a better option.

It is also better than selling material as coil, which is currently (but not always) priced at a discount to cut plate and has only a 9% rebate compared with 13%.

At MBR, we believe that the authorities intend to block the loopholes more on the long products side of the finished steel portfolio.

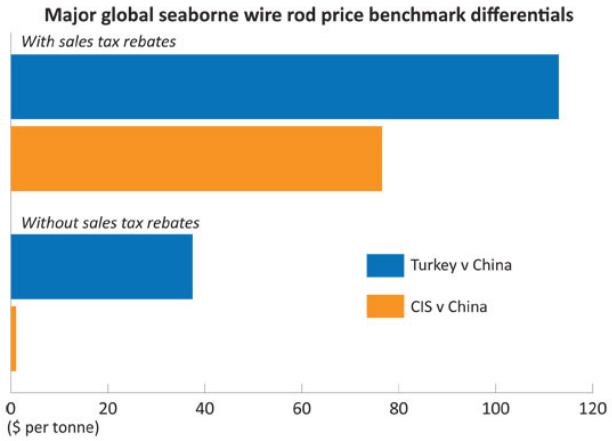
Wire rod is already being affected by international duties in the USA and Indonesia, for example, and the rebate for boron-containing wire rod was already low, at just 9%.

The Chinese have also removed the rebate for good measure and, in addition, have reintroduced an export tax on the carbon steel (boron-free) equivalent product.

Boron-containing bars, meanwhile – the majority of which we believe are basic reinforcing bars rather than other merchant bars or light sections – are being exported at fast rate (see below).

Profit margins for rebar in China are currently slightly better than for HR coil simply because of lower production costs. On average, however, MBR believes that the profit margin is only $15 per tonne – less than 100 yuan. Clearly, a $43 per tonne additional cost for rebar, or $30 per tonne for wire rod, implied by the higher tax charged, would make exporting unprofitable unless the Chinese can raise prices on an fob basis.

The so-called 50:50 transfers, where the buyer agrees to a 4.5% rise in the price, are clearly not available. Even if they were, it would still be hard for Chinese producers to break even. Moreover, the domestic price would remain more attractive to suppliers.



The chart above reveals that, on an international pricing basis, all is not lost for Chinese rebar and rod exporters.

If we assume that they will pass the full tax burden on to their customers, they will still be more competitive today, on an fob basis, than their major rivals.

Chinese mills may be able to raise export prices to make exporting of bar and rod attractive again, but this will require support from their rivals who, given the recent improvement in margins, may not be inclined to follow their lead.

Meet the Editor

Alistair Ramsay

Alistair rejoined MBR in 2012 as our Research Manager, focusing on the weekly, monthly, and quarterly forecasting services. This followed eight years at CRU where he edited various carbon and special steel subscription reports and several bespoke services. He first joined MBR in 2002 as a Research Analyst, developing a broad knowledge of steel raw materials and finished steel markets. His main area of expertise is in stainless steel flat products. .

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