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Losses mount in China's overcrowded steel sector

Gabriel Wildau in Shanghai


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China's biggest 101 steel companies, which helped fuel the country's industrial revolution and housing frenzy, lost a combined Rmb72bn ($11bn) in the first 10 months of 2015, or more than double the profits garnered last year.

The reversal in fortunes highlights the unwinding of rapacious demand for basic materials — in just two years the country produced more cement than the US did in the entire 20th century — as economic growth slows.

The resulting brake on demand is sending tremors across the globe, from resource-rich Brazil and Australia through to UK steelmakers.

Beijing's efforts to force domestic consolidation have largely failed, leaving a swathe of industries churning out steel, cement and glass at a loss and feeding deflation. It is also piling up fresh debts: Sinosteel, China's largest state-owned steel trader, defaulted on a bond repayment due in October.

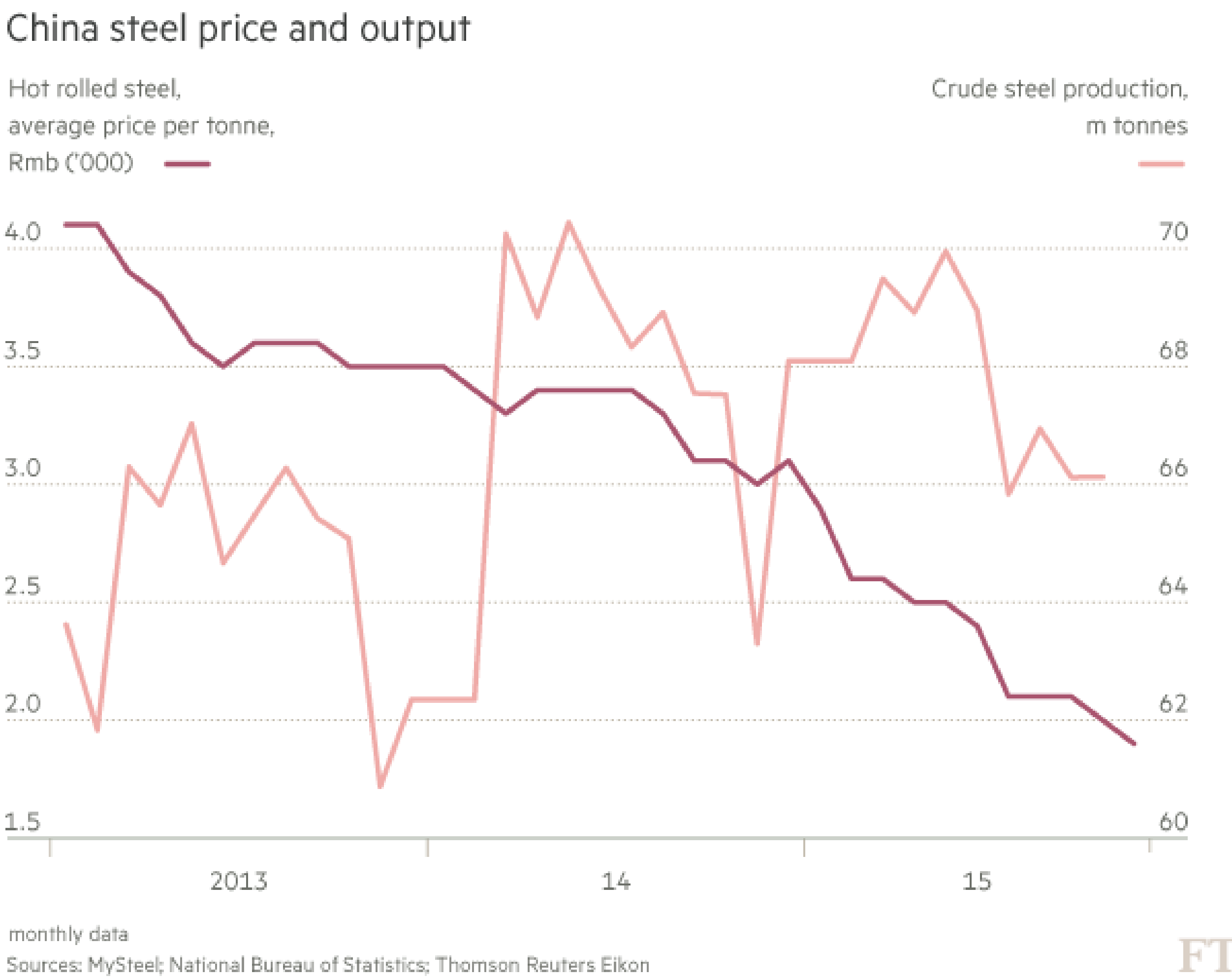
China's property sector, the biggest source of steel demand, is still struggling. Chinese home prices and sales volumes recently began rising following more than a year of declines, but construction activity continues to fall as developers wait for the market to digest the overhang of unsold homes.

"The need for social stability (is) the biggest stepping stone for a quick solution to the capacity overhang. Employment associated with steel mills is large enough that staff layoffs could spark social unrest," HSBC analysts led by Chris Chen wrote in a note on Friday.

"We also expect a prolonged stalemate between government-supported loss-making (state-owned) mills and the relatively profitable private mills — which, however, lack favourable support."

China has shuttered 50m tonnes of steel manufacturing capacity this year, just 4 per cent of its total 1.14bn tonnes of capacity, according to HSBC. The bank calculates China would need to cut an additional 120m to 160m tonnes of capacity next year for the industry-wide utilisation rate to reach a "relatively healthy" level of 80 per cent.

Of the 101 largest steel companies, 48 suffered net losses in the first 10 months of the year. For the full group, combined losses totalled Rmb39bn, according to unreleased China Iron and Steel Association figures obtained by Economic Information Daily, a newspaper owned by the official Xinhua news agency. Excluding earnings from non-core business, combined losses were Rmb72bn.



Steel market conditions are deteriorating. Core-business losses in October alone were Rmb15bn, 28 per cent larger than in September, according to the paper. China's official purchasing managers' index for the steel sector fell to 37 in November, down 5.2 points from October. A reading of below 50 signals contraction.

After growing at an average rate of 15 per cent between 2000 and 2013, CISA forecasts that

Chinese steel production has already peaked and will fall 3 per cent next year. However, iron ore producers such as BHP Billiton, Rio Tinto and Vale, who ploughed billions of dollars into expanding production over the past decade, are still clinging to more optimistic forecasts for Chinese production.

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