

## Analyst Express

### China Steel Sector – Possible turnaround on more sever-than-expected output cutback

- ❖ Event: As electricity supply came under restriction in certain provinces since the beginning of Sep 10 in answer to government calls for energy conservation and emission reduction, some steel mills have halted operation. From 4 Sep 10, most of the steel plants in the Wu'an area of Hebei Province suspended production. On 6 Sep 10, some steel producers in Tangshan, Hebei, received notice from the local government that power supply to them would be down by 30% from 7 Sep 10 onwards. As a result, steel prices surged in most local markets in north China, with an aggregate hike of Rmb200-400/tonne. Distributors in Tianjin and Tangshan are limiting or stopping steel trade.
- ❖ Unprecedented policy strength, especially in Hebei. As of now, steel plants nationwide (with the exception of those in Liaoning, Shandong, Hunan, Hubei, Anhui and Jiangxi provinces) have received government circulars that electricity supply to them will come under restriction. The impact is substantially, especially for Hebei Province, where steel output has dived 46% as a result.
- ❖ Short- and long-term effects to the industry. In the short run, given government pledge to reduce energy consumption and cut pollutant emission by 20% in the 2006-10E period, there is tremendous pressure to accomplish relevant tasks. Saving energy and reducing emission has become a top priority for local officials as it is linked to their administrative performances. Going forward, we believe that curbing power supply will continue to be a major means for the attainment of relevant goals. The Central Government has set the target of eliminating ~5% (30m tonnes) of China's steel capacity within 2010E. But judging from the current situation (Hebei Province alone saw 40m-50m tonnes of its steel capacity being suspended now), we estimate the nation's total steel capacity could be slashed by some 80m tonnes this year. Short-term impact is significant. From a long-term perspective, although China began phasing out obsolete capacity as early as 2004, the overall effect has been marginal. Given the target of eliminating 70m steel capacity in 2011E, we expect limiting power supply will be applied in the future as well.
- ❖ Forecast steel supply to decline 10-15% and steel price to rise 20%-plus. All considered, we expect sector supply-demand to improve constantly for steel companies going forward. The upward trend of steel prices is likely to be sustained over a long period.
- ❖ Long steel producers to benefit more than plate producers; State-owned large corporations will be less affected.
- ❖ The domestic steel sector may turnaround soon, with corporate earnings rising sharply. Although demand from the real estate sector and welfare housing construction remains unclear, the strength of phasing out backward capacity has surpassed market expectations by far. We believe (i) the steel supply-demand dynamics will change for the better, (ii) sector earnings have bottomed and (iii) an overall rebound is imminent.
- ❖ Potential risks: Demand for steel will be dampened in the event of (i) drastic decline of FAI growth due to the energy-saving and emission-cutting efforts or (ii) significant economic slowdown.

### Principal Market Indices

Index	Close	Change %		
		1-d	5-d	YTD
CSI 300	2975.09	1.88	2.1	-17
S&P/CITIC300	2517.37	1.66	2.0	-16
S&P/CITIC 50	2076.75	2.28	1.8	-23
Shanghai Composite	2696.25	1.54	1.6	-18
Hang Seng Index	21355.77	1.83	3.0	-2
H-share index	11960.57	1.64	3.7	-7
Red Chip	4158.46	1.79	4.1	2
Nikkei 225	9301.32	2.05	1.7	-12
Dow Jones	10447.93	NA	2.9	0
S&P 500	1104.51	NA	3.8	-1
Nasdaq	2233.75	NA	3.7	-2
DAX	6155.04	0.33	4.1	3
CAC	3684.73	0.34	5.7	-6
FTSE 100	5439.19	0.20	4.6	0
BDI	2881.00	0.17	6.2	-4

### Major mercantile futures

Futures	Close (USD)	Change %		
		1-d	5-d	YTD
NYME Oil	74.60	NA	-0.8	-7
NYME Gold	1249.80	NA	1.1	14
LME Copper	7695.50	0.79	3.3	5
LME Aluminum	2168.25	2.08	6.2	-2
LME Zinc	2196.00	2.09	4.8	-14
Spot silver	19.84	-0.21	4.4	18
Corn futures	464.50	NA	6.5	7
Soybean futures	1035.00	NA	0.9	-2
Wheat futures	741.25	NA	6.7	31
Cotton futures	89.45	NA	3.9	16
Rough rice futures	11.72	NA	2.1	-24
Sugar futures	20.60	NA	3.2	-11

### Major foreign exchanges

FX	Close	Change %		
		1-D	5-D	YTD
USD index	82.08	0.08	-1.3	5
USD-RMB	6.79	-0.23	-0.2	-1
USD-JPY	84.19	-0.30	-0.6	-10
EUR-USD	1.29	-0.05	1.6	-10
GBP-USD	1.54	-0.13	-0.4	-5

### Major stock index futures in China

Futures	Chg%	Basis	Position	Chn in position
IF1005	2.31	17.11	26264	2677
IF1006	2.30	29.11	2962	329
IF1009	2.32	60.11	3252	169
IF1012	2.25	90.91	801	-16

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## Investment rating system

Performance of stock or sector relative to MSCI-China over next 6 months after research publications

	Rating	Remark
Stock rating	Buy	Relative performance over MSCI-China Index >20%
	Overweight	Relative performance over MSCI-China Index 5% ~ 20%
	Hold	Relative performance over MSCI-China Index -10% ~ 5%
	Sell	Relative performance over MSCI-China Index > -10%
	NR	Not rated
Sector rating	Outperform	Relative performance over MSCI-China Index >10%
	Neutral	Relative performance over MSCI-China Index -10% ~10%
	Underperform	Relative performance over MSCI-China Index > -10%

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