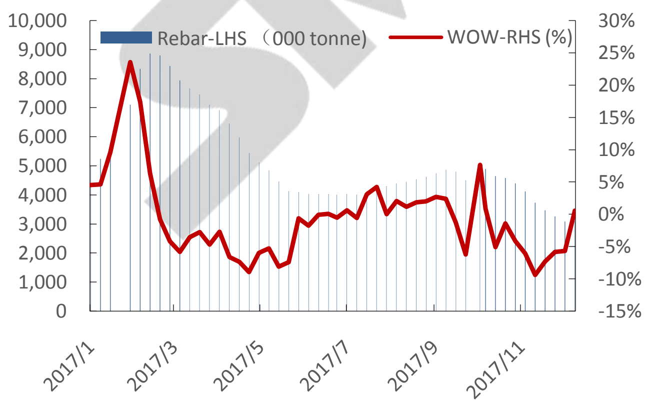
Where Will Steel Prices Go under the Long-and-Short Game?

Both the supply and demand have declined due to the winter heating season policy since 4Q. Rebar prices jumped as demand was better than expected, in spite of supply falling lessthan expected. However, since December, demand declined substantially due to thewinter brea0k, and tight supply was alleviated once the port cargo backlog caused by the shipment of steel products from North China to the South solved, pressuring the high-level rebar prices in the short term. Besides, our short-term bearish view is also supported by the pause of the decline of rebar social inventory, which has been falling for eight consecutive weeks. SMM expect that after the short-term price pullback, rebar prices will rebound again due to the winter storage/spring restocking and the ongoing production limits. SMM forecasts rebar price will be in the V-shapes trend with the range of Rmb4,500-5,000/ton in the short term.

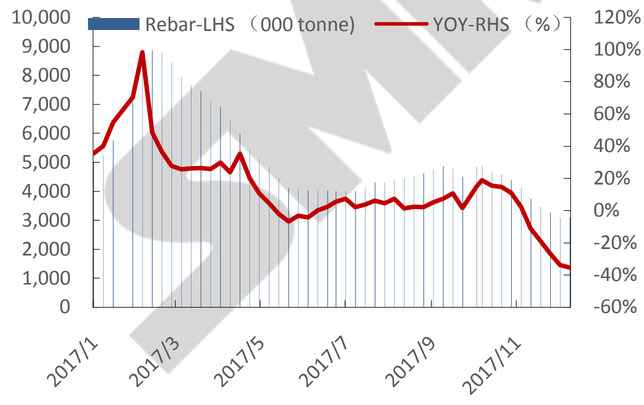
SMM believes that the steel demand from real estate and infrastructure will weaken in 2018 from 2017, as the regulatory control of real estate will be further strengthened, and infrastructure will be subject to overall budget constraints and PPP bond issuance limitation. However, the demand from auto and home appliance sectors will remain stable. SMM expects steel prices to open high then trend lower next year and to show divergent trends of stronger flat steel products while weaker long products. Besides, we expect that the environmental protection policies will continue to be implemented. In order to ensure the stable supply of industrial products throughout the year, it is highly likely production will be conducted ahead to avoid the heating season disruptions. The rebar social inventory increased more rapidly in non-production-limit month this year, proving our views. SMM forecasts that the demand will not be weak in the weak-demand-season and not strong in the strong-demand-season going forward.

Chart 1: Rebar Social Inventory (000 tonne)



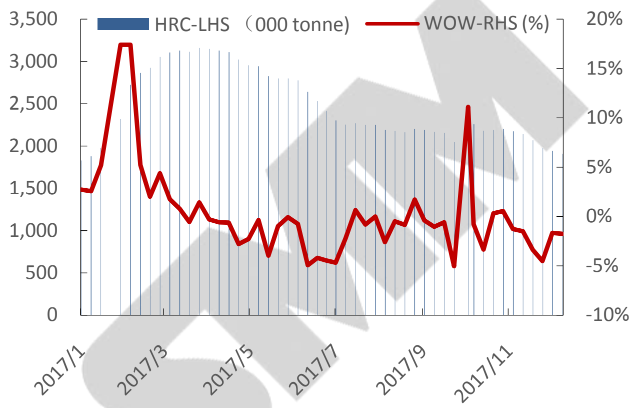
Source : SMM

Chart 2: Rebar Social Inventory & YOY (000 tonne)



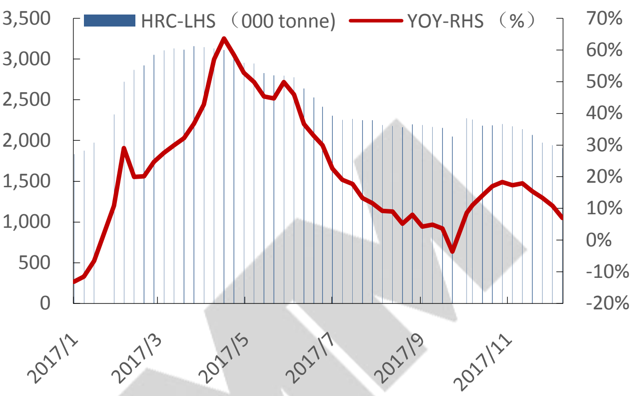
Source : SMM

Chart 3: HRC Social Inventory (000 tonne)



Source ：SMM

Chart 4: HRC Social Inventory & YOY (000 tonne)

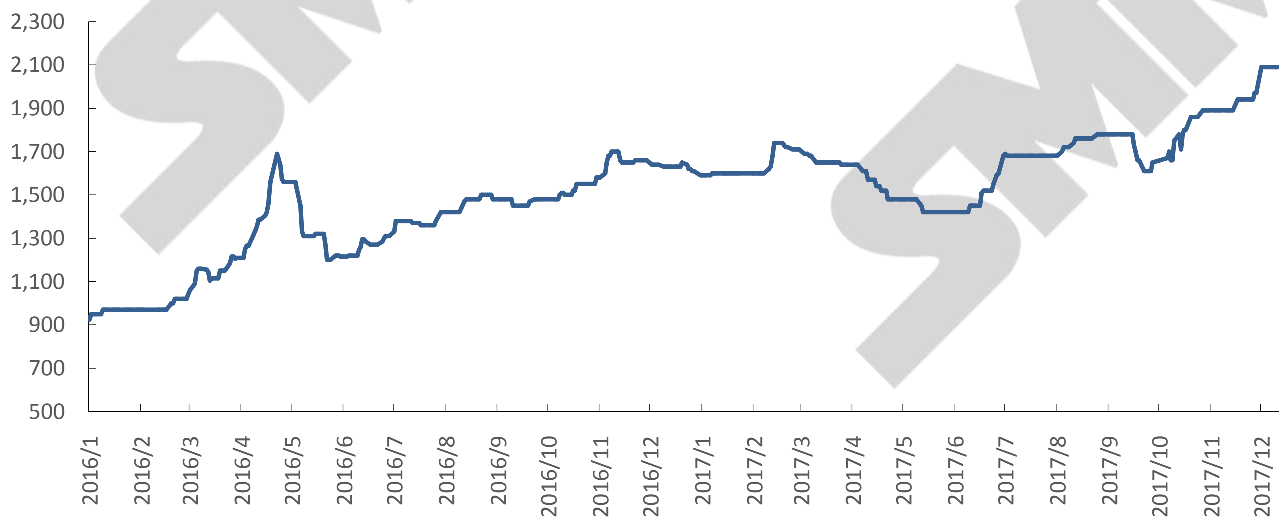


Source ：SMM

Scrap Ratio Increases, Iron Ore Remains Oversupplied

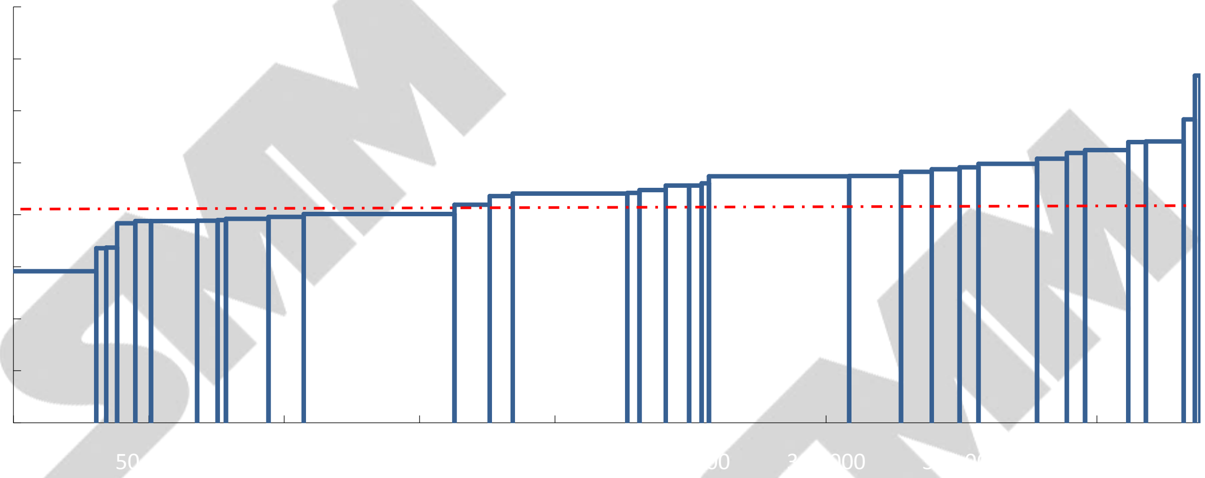
Mills have been actively lifting the scrap ratio for higher crude steel output, as gross profits of producing per ton of steel increase. The restart of electric furnaces is expected, driving up scrap steel prices. The big four iron ore miners will maintain their shipments to China next year due to their low costs, though oversupplied. SMM forecasts iron ore prices will be at US$60-70/ton next year. The average cost of mining for domestic miners are higher, at US$70-75/ton, due to low ore grades. Domestic miners are likely to incur more losses next year.

Chart 5: Zhangjiagang Scrap Steel Price（6-8mm Rmb/ton）



Source ：SMM

Chart 6: China's domestic mine unit cost (Rmb/ton)



Source：redline represents annum iron ore average price in 2017,SMM

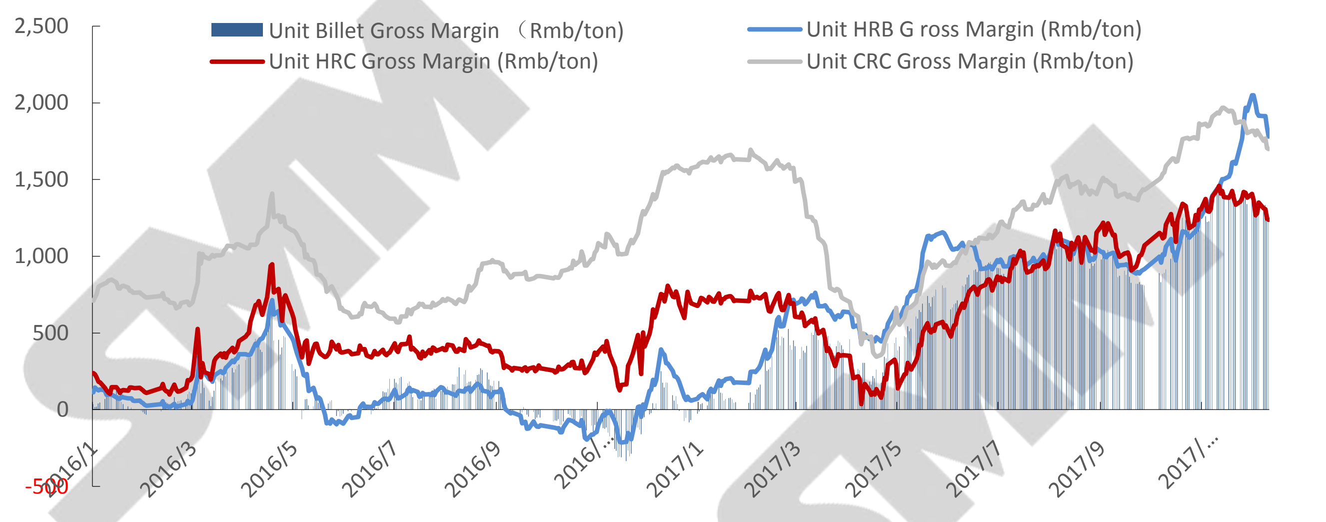
SMM has comprehensive **China Cost Database** for noferrous and ferrous metals, by conducting regular field trips and interviews with all Chinese metal producers, from large-scaled to small-scaled, from SOEs to private-owned. We collect their detailed cost breakdown for individual plants/mines and for the whole production processw, and update the database regularly as well as keep close track of any updates/changes.

We also have Cost Database for Steel, Iron Ore, Aluminuu, Copper, Copper Mine, Nickel, Nickel-Pig-Iron (NPI), Tin, Manganese, Lead and Lead Ore, etc.

High Gross Profitability of Steel May not Continue

According to SMM estimates, the gross profit of spot rebar, HRC, CRC, and billet in Shanghai market was Rmb1,780, 1,238, 1,698 and 1,278 per ton respectively. The higher profit of rebar was mainly due to the shutdown of the intermediate frequency furnace better than expected demand from infrastructure and real estate projects. Overall, however, gross profits of steel products are all at the historical high levels currently. SMM expects the current high-profitability may not continue as we forecast weaker demand in 2018. SMM expects the higher profitability of long products than flat products will no longer exist, and is likely to return to the previous norm, i.e. flat products enjoy higher profitability than long products.

Chart 7: Steel gross profit per unit Rmb/ton, by Dec 14, 2017)



Source ：Based on Shanghai market spot price to calculate unit steel gross margin ，SMM

SHFE Rebar Futures Soaring Since Nov 2017

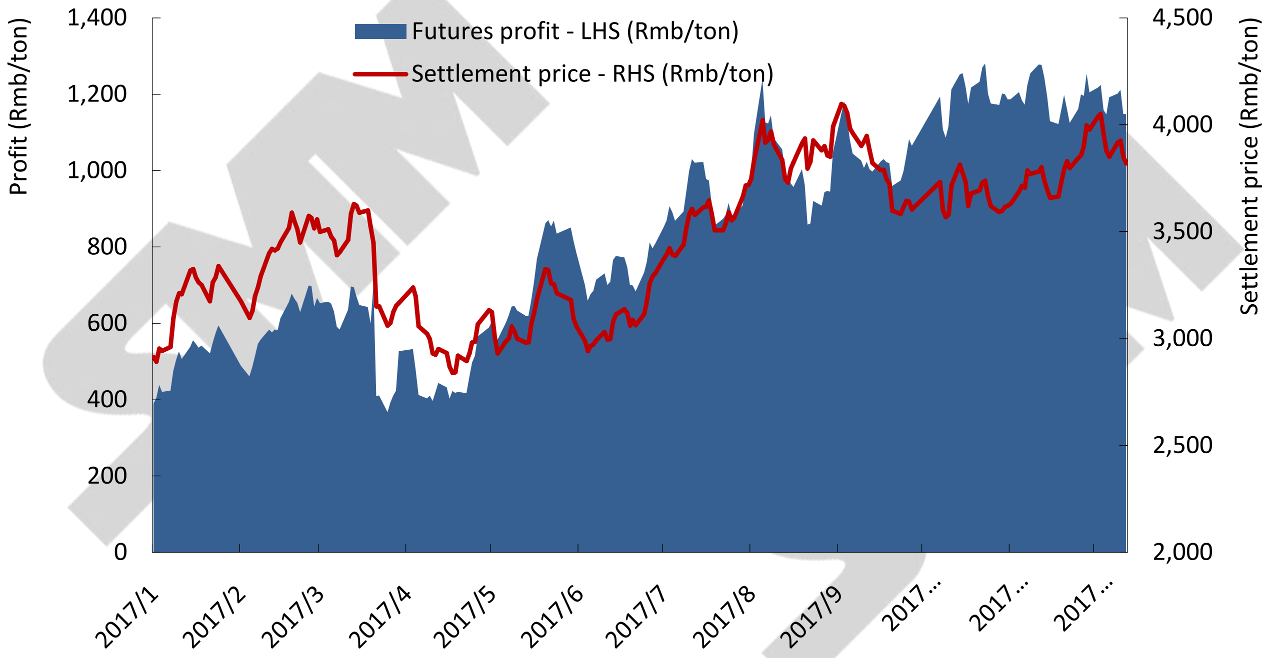
SHFE steel rebar futures contract has been soaring since Nov 2017, driving up profits. The corresponding profit has been updating the year high since Nov and now experiencing a fluctuation at the high level.

Before Oct 2017, the correlation between rebar futures profit and rebar futures price is 0.8153, a relatively high correlation. However, it has declined to 0.3752 recently due to the weak performance of SHFE RB1805, which we do not expect to last long. The profit will therefore return to a lower level.

Suggestion strategy:

Portfolio	Spread Type	Ratio
RB1805-I1805-J1805	Inter-commodity	20:32:09
Strategy Suggestion	Taking short position	

Chart 8: Rebar Futures Profit (Rmb)



Source：SHFE，SMM